

Lumber Liquidators Holdings, Inc.
Form 10-Q
July 26, 2011
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2011

or

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission File Number: 001-33767

Lumber Liquidators Holdings, Inc.

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of
incorporation or organization)

27-1310817
(I.R.S. Employer
Identification No.)

3000 John Deere Road

Toano, Virginia
(Address of Principal Executive Offices)

23168
(Zip Code)

(757) 259-4280
(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of July 22, 2011, there were 27,759,099 shares of the registrant's common stock, par value of \$0.001 per share, outstanding.

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LUMBER LIQUIDATORS HOLDINGS, INC.

Quarterly Report on Form 10-Q

For the quarter ended June 30, 2011

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Table of Contents**PART I****FINANCIAL INFORMATION****Item 1. Financial Statements.****Lumber Liquidators Holdings, Inc.****Condensed Consolidated Balance Sheets**

(in thousands, except share data)

	June 30, 2011 <i>(unaudited)</i>	December 31, 2010
Assets		
Current Assets:		
Cash and Cash Equivalents	\$ 33,356	\$ 34,830
Merchandise Inventories	182,279	155,131
Prepaid Expenses	5,262	4,837
Other Current Assets	8,845	8,007
Total Current Assets	229,742	202,805
Property and Equipment, net	39,788	35,314
Other Assets	4,277	4,171
Total Assets	\$ 273,807	\$ 242,290
Liabilities and Stockholders Equity		
Current Liabilities:		
Accounts Payable	\$ 40,973	\$ 33,744
Customer Deposits and Store Credits	19,506	12,039
Accrued Compensation	1,499	2,460
Sales and Income Tax Liabilities	3,175	2,859
Other Current Liabilities	6,715	5,585
Total Current Liabilities	71,868	56,687
Deferred Rent	3,156	2,746
Deferred Tax Liability	1,914	2,352
Stockholders Equity:		
Common Stock (\$0.001 par value; 35,000,000 authorized; 27,754,984 and 27,472,680 outstanding, respectively)	28	27
Additional Capital	105,855	100,531
Retained Earnings	91,009	79,947
Accumulated Other Comprehensive Loss	(23)	
Total Stockholders Equity	196,869	180,505
Total Liabilities and Stockholders Equity	\$ 273,807	\$ 242,290

See accompanying notes to condensed consolidated financial statements

Table of Contents**Lumber Liquidators Holdings, Inc.****Condensed Consolidated Statements of Income**

(in thousands, except share data and per share amounts)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Net Sales	\$ 175,460	\$ 168,674	\$ 335,140	\$ 319,869
Cost of Sales	115,736	110,134	217,623	207,825
Gross Profit	59,724	58,540	117,517	112,044
Selling, General and Administrative Expenses	51,051	43,863	99,504	86,076
Operating Income	8,673	14,677	18,013	25,968
Interest and Other Income, net	(67)	(135)	(155)	(228)
Income Before Income Taxes	8,740	14,812	18,168	26,196
Provision for Income Taxes	3,453	5,719	7,104	10,135
Net Income	\$ 5,287	\$ 9,093	\$ 11,064	\$ 16,061
Net Income per Common Share Basic	\$ 0.19	\$ 0.33	\$ 0.40	\$ 0.59
Net Income per Common Share Diluted	\$ 0.19	\$ 0.32	\$ 0.39	\$ 0.57
Weighted Average Common Shares Outstanding:				
Basic	27,687,617	27,385,644	27,630,250	27,334,753
Diluted	28,430,209	28,292,014	28,404,455	28,236,422

See accompanying notes to condensed consolidated financial statements

Table of Contents**Lumber Liquidators Holdings, Inc.****Condensed Consolidated Statements of Cash Flows****(in thousands)****(unaudited)**

	Six Months Ended June 30,	
	2011	2010
Cash Flows from Operating Activities:		
Net Income	\$ 11,064	\$ 16,061
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation and Amortization	3,992	2,580
Stock-Based Compensation Expense	1,935	1,532
Changes in Operating Assets and Liabilities:		
Merchandise Inventories	(27,185)	(9,804)
Accounts Payable	7,084	365
Customer Deposits and Store Credits	7,470	4,052
Prepaid Expenses and Other Current Assets	(1,642)	(1,803)
Other Assets and Liabilities	735	(390)
Net Cash Provided by Operating Activities	3,453	12,593
Cash Flows from Investing Activities:		
Purchases of Property and Equipment	(8,297)	(8,394)
Net Cash Used in Investing Activities	(8,297)	(8,394)
Cash Flows from Financing Activities:		
Proceeds from the Exercise of Stock Options	2,116	1,321
Excess Tax Benefits on Stock Option Exercises	1,414	1,107
Common Stock Purchased Pursuant to Equity Compensation Plans	(140)	(133)
Net Cash Provided by Financing Activities	3,390	2,295
Effect of Exchange Rates on Cash and Cash Equivalents	(20)	
Net (Decrease) Increase in Cash and Cash Equivalents	(1,474)	6,494
Cash and Cash Equivalents, Beginning of Period	34,830	35,675
Cash and Cash Equivalents, End of Period	\$ 33,356	\$ 42,169

See accompanying notes to condensed consolidated financial statements

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Lumber Liquidators Holdings, Inc.

Notes to Condensed Consolidated Financial Statements

(amounts in thousands, except share data and per share amounts)

(unaudited)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

Lumber Liquidators Holdings, Inc. (the Company), a Delaware corporation, is a multi-channel specialty retailer of hardwood flooring, and hardwood flooring enhancements and accessories, operating as a single business segment. The Company offers an extensive assortment of exotic and domestic hardwood species, engineered hardwoods and laminates direct to the consumer. The Company also features the renewable flooring products, bamboo and cork, and provides a wide selection of flooring enhancements and accessories, including moldings, noise-reducing underlay and adhesives. These products are primarily sold under the Company's private label brands, including the premium Bellawood brand floors. The Company sells primarily to homeowners or to contractors on behalf of homeowners through a network of 250 store locations in primary or secondary metropolitan areas. At June 30, 2011, the Company operated 246 stores in 46 states and four stores in the greater Toronto area in Canada. In addition to the store locations, the Company's products may be ordered, and customer questions/concerns addressed, through both the call center in Toano, Virginia, and the website, www.lumberliquidators.com. The Company finishes the majority of the Bellawood products on its finishing line in Toano, Virginia, which, along with the call center, corporate offices, and the Toano distribution center, represent the Corporate Headquarters.

Organization and Basis of Financial Statement Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q for interim financial reporting pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). While these statements reflect all normal recurring adjustments which are, in the opinion of management, necessary for a fair presentation of the results of the interim period, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. Therefore, the interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes included in the Company's annual report filed on Form 10-K for the year ended December 31, 2010.

The consolidated financial statements of the Company include the accounts of its wholly owned subsidiaries, including Lumber Liquidators, Inc. (LLI). All significant intercompany transactions have been eliminated in consolidation.

Results of operations for the three and six months ended June 30, 2011 are not necessarily indicative of the results to be expected for the full year.

Fair Value of Financial Instruments

The carrying amounts of financial instruments such as cash and cash equivalents, notes receivable, accounts payable and other liabilities approximate fair value because of the short-term nature of these items. Of these financial instruments, the cash equivalents are classified as Level 1 as defined in the Financial Accounting Standards Board ASC 820 fair value hierarchy. The Company had cash equivalents of \$12,060 at June 30, 2011 and \$17,050 at December 31, 2010.

Comprehensive Income

The following table sets forth the computation of comprehensive income:

Three Months Ended June 30, Six Months Ended June 30,

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	2011	2010	2011	2010
Net Income	\$ 5,287	\$ 9,093	\$ 11,064	\$ 16,061
Foreign Currency Translation Adjustments	(22)		(23)	
Comprehensive Income	\$ 5,265	\$ 9,093	\$ 11,041	\$ 16,061

Table of Contents**NOTE 2. NET INCOME PER COMMON SHARE**

The following table sets forth the computation of basic and diluted net income per common share:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Net Income	\$ 5,287	\$ 9,093	\$ 11,064	\$ 16,061
Weighted Average Common Shares Outstanding Basic	27,687,617	27,385,644	27,630,250	27,334,753
Effect of Dilutive Securities:				
Common Stock Equivalents	742,592	906,370	774,205	901,669
Weighted Average Common Shares Outstanding Diluted	28,430,209	28,292,014	28,404,455	28,236,422
Net Income per Common Share Basic	\$ 0.19	\$ 0.33	\$ 0.40	\$ 0.59
Net Income per Common Share Diluted	\$ 0.19	\$ 0.32	\$ 0.39	\$ 0.57

The following have been excluded from the computation of Weighted Average Common Shares Outstanding Diluted because the effect would be anti-dilutive:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Stock Options	777,770	249,437	777,770	249,437
Restricted Stock Awards	8,496		8,496	

NOTE 3. RELATED PARTY TRANSACTIONS

As of June 30, 2011, the Company leased the Corporate Headquarters and 27 of its store locations from ANO, LLC, a company that is wholly owned by the Company's founder and current chairman of the Board. The Company also leased one store location from Wood on Wood Road, Inc. and one store location from BMT Holdings, LLC. Wood on Wood Road, Inc. is wholly owned by the founder, and 50% of the membership interest of BMT Holdings, LLC is owned by the founder. Rental expense related to these companies for the three and six months ended June 30, 2011 was \$686 and \$1,362, respectively. Rental expense related to these companies for the three and six months ended June 30, 2010 was \$674 and \$1,318, respectively.

NOTE 4. COMMITMENTS AND CONTINGENCIES

The Company is, from time to time, subject to claims and disputes arising in the normal course of business. In the opinion of management, while the outcome of any such claims and disputes cannot be predicted with certainty, the ultimate liability of the Company in connection with these matters is not expected to have a material adverse effect on the Company's results of operations, financial position or cash flows.

On September 3, 2009, a former store manager and an assistant store manager (together, the Plaintiffs) filed a putative class action suit against LLI in the Superior Court of California in and for the County of Alameda. The Plaintiffs allege that with regard to certain groups of current and former employees in LLI's California stores, LLI violated California law by failing to calculate and pay overtime wages properly, provide meal breaks, compensate for unused vacation time, reimburse for certain expenses and maintain required employment records. The Plaintiffs also claim that LLI did not calculate and pay overtime wages properly for certain of LLI's non-exempt employees, both in and out of California, in violation of federal law. In their suit, the Plaintiffs seek compensatory damages, certain statutory penalties, costs, attorney's fees and injunctive relief. LLI removed the case to the United States District Court for the Northern District of California. In an order dated March 2, 2011, the court denied without prejudice the Plaintiffs' motion for conditional class certification of non-exempt employees throughout the country. LLI intends

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to continue to defend the claims in this suit vigorously. While there is a reasonable possibility that a material loss may be incurred, the Company cannot estimate the loss or range of loss, if any, to the Company at this time.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Cautionary Note Regarding Forward-Looking Statements

This report includes statements of our expectations, intentions, plans and beliefs that constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 and are intended to come within the safe harbor protection provided by those sections. These statements, which involve risks and uncertainties, relate to matters such as sales growth, comparable store net sales, impact of cannibalization, price changes, earnings performance, stock-based compensation expense, margins, return on invested capital, strategic direction, the demand for our products, and store openings. We have used words such as may, will, should, expects, intends, plans, anticipates, believes, thinks, estimates, seeks, predicts, could, projects, potential and other similar terms and references to assumptions, in this report to identify forward-looking statements. These forward-looking statements are made based on expectations and beliefs concerning future events affecting us and are subject to uncertainties, risks and factors relating to our operations and business environments, all of which are difficult to predict and many of which are beyond our control, that could cause our actual results to differ materially from those matters expressed or implied by these forward-looking statements. These risks and other factors include those listed in this report and in our other reports filed with the SEC, including the Item 1A, Risk Factors, section of the Form 10-K for the year ended December 31, 2010.

When considering these forward-looking statements, you should keep in mind the cautionary statements in this report and the documents incorporated by reference. New risks and uncertainties arise from time to time, and we cannot predict those events or how they may affect us. There may also be other factors that we cannot anticipate or that are not described in this report that could cause results to differ materially from our expectations. Forward-looking statements speak only as of the date they are made and we assume no obligation to update them after the date of this report as a result of new information, future events or subsequent developments, except as required by the federal securities laws.

This management discussion should be read in conjunction with the financial statements and notes included in Part I, Item 1. Condensed Consolidated Financial Statements of this quarterly report and the audited financial statements and notes and management discussion included in our annual report filed on Form 10-K for the year ended December 31, 2010.

Overview and Trends

Lumber Liquidators is the largest specialty retailer of hardwood flooring in the United States, based on industry sources and our experience. We believe we have achieved a reputation for offering great value, superior service and a broad selection of high-quality hardwood flooring products. We offer an extensive selection of premium hardwood flooring products under multiple proprietary brands at everyday low prices designed to appeal to a diverse customer base. We believe that our vertically integrated business model enables us to offer a broad assortment of high-quality products to our customers at a lower cost than our competitors. As of June 30, 2011, we sold our products through 246 Lumber Liquidators stores in 46 states, four stores in Canada, a call center, websites and catalogs.

Net Sales and Customer Demand. Net sales for the second quarter of 2011 increased 4.0% over the second quarter of 2010, and for the six months ended June 30, 2011, net sales increased 4.8% over the six months ended June 30, 2010. We believe our second quarter net sales were weak as value-conscious consumers became more price sensitive and cautious in their discretionary spending.

At our comparable stores¹, our net sales decreased 7.9% and 6.2% comparing both the three and six months ended June 30, 2011 to the prior year periods, respectively, primarily as a result of reductions in the number of customers invoiced. Our average sale² decreased slightly in the second quarter comparison, but increased in comparing the first six months of 2011 and 2010. We believe the number of customers invoiced has weakened in 2011 primarily as a result of greater consumer caution with regard to large ticket, discretionary purchases and the impact of opening new locations in existing markets. Within our average sale, the average retail price per unit sold has increased in comparing both the three and six month periods, indicating the average volume per sale, primarily measured in square feet, decreased. We believe our increase in average retail price per unit sold resulted from both continuing efforts to interest customers in premium products within our proprietary brands, and increased net sales of selected hardwoods in certain promotional periods, including our April Big Sale and the launch of our new Bellwood warranty.

¹ We generally consider a store comparable on the first day of the thirteenth full calendar month after opening.

² Average sale is defined as the average invoiced sale per customer, measured on a monthly basis and excluding transactions of less than \$250 (which are generally sample orders, or add-ons or fill-ins to previous orders) and of more than \$30,000 (which are usually contractor orders).

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Changes to comparable prior year results were as follows:

	For the three months ended		For the six months ended	
	2011	June 30, 2010	2011	June 30, 2010
Comparable Stores:				
Net sales	(7.9%)	5.5%	(6.2%)	6.7%
Customers invoiced ¹	(7.5%)	7.0%	(8.6%)	13.1%
Average sale ²	(0.4%)	(1.4%)	2.6%	(5.7%)
Average retail price per unit sold ³	8.7%	(3.0%)	7.6%	(6.9%)

¹ Approximated by applying our average sale to total net sales at comparable stores.

² Average sale is calculated on a total company basis.

³ Average retail price per unit sold is calculated on a total company basis and excludes certain service revenue, which consists primarily of freight charges for in-home delivery.

Store Base Growth. New store locations continue to drive our net sales growth, with our non-comparable stores contributing \$20.7 million and \$36.1 million in net sales for the three and six month periods ended June 30, 2011. In comparing 2011 to 2010, we have a greater number of non-comparable stores. In addition, the number of stores opened each quarter over the last two years has not been consistent, and as a result, the average maturity of a non-comparable store in the first six months of 2011 as measured in months of operation was approximately 20% less than in the first six months of 2010. At our non-comparable locations, monthly net sales are expected to increase with maturity, resulting in a progressively more favorable impact on operating margin.

In the first six months of 2011, we opened 27 new store locations, including 23 in the United States and our first four stores in Canada. Domestically, we opened 14 locations in existing markets. In Canada, the four new locations were in the greater Toronto area. In the first six months of 2010, we opened 17 new store locations, with seven in existing markets.

In the second half of 2011, we now expect to open between 13 and 17 new store locations, for a total of 40 to 44 new store locations in 2011. For the full year 2010, we opened 37 new stores, including 14 in new markets. We have opened 82 of our 250 store locations in the 24 months after June 30, 2009, and our recent store opening activity is as follows:

	2011	2010
Number of stores at January 1	223	186
New U.S. stores opened during the first quarter	13	11
New Canadian stores opened during the first quarter	3	
Number of stores at March 31	239	197
New U.S. stores opened during the second quarter	10	6
New Canadian stores opened during the second quarter	1	
Number of stores at June 30	250	203

Sourcing Initiatives. In 2011, we began a process which will continually challenge the structure of our sourcing relationships with our vendor-mill partners. We believe this multi-phased, multi-year process will ultimately strengthen our relationships with the best international and domestic partners, and eliminate weaker sources. Three primary phases are being, or are expected to be, implemented through 2012. We believe these sourcing initiatives will play a key role in maintaining the best combination of quality and value in our product assortment and will result in lower net product costs. The phases are as follows:

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In the first phase, vendor-mill partners participate in specific promotions designed to create incremental customer traffic, share in the cost of certain continuing marketing programs, costs of product samples and new store locations, and offer discounts based on purchase volume. In the first six months of 2011, we believe these initiatives benefited operating margin through both expanded and more effective promotions, a net lower cost of certain products sold and a net reduction in certain selling, general and administrative (SG&A) expenses.

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During the second phase, current and potential vendor-mill partners participate in competitive line reviews of specific merchandise categories. During these line reviews, management and vendor-mill partners evaluate breadth of assortment, quality, logistics and product cost, as well as those considerations defined in the first phase. During the second quarter of 2011, we completed the initial line review of the laminate merchandise category, generally broadening and diversifying our supply base while reducing the cost of the product, which will benefit our cost of laminates in the second half of 2011.

In the third phase, we seek to better control product cost through our own international sourcing operations and potentially utilizing our balance sheet to control raw material costs through scale not available to our vendor-mill partners, if such opportunities align with our strategic long-term goals.

Results of Operations**Net Sales**

	For the three months ended		For the six months ended	
	June 30, 2011	2010	June 30, 2011	2010
	(dollars in thousands)			
Net sales	\$ 175,460	\$ 168,674	\$ 335,140	\$ 319,869
Percentage increase	4.0%	17.9%	4.8%	19.8%
Comparable store net sales increase (decrease)	(7.9%)	5.5%	(6.2%)	6.7%

Net sales for the second quarter of 2011 increased \$6.8 million over the second quarter of 2010 as a result of a \$20.1 million increase in non-comparable store net sales partially offset by a \$13.3 million decrease in comparable store net sales. Net sales for the six months ended June 30, 2011 increased \$15.3 million over the same prior year period as a result of an increase of \$35.2 million in non-comparable store net sales partially offset by a \$19.9 million decrease in comparable store net sales. In addition to the items discussed in Overview and Trends, our net sales have been impacted by the following factors:

Net sales benefited from more consistent in-stock positions of certain key product lines, such as laminates, moldings and accessories. These product lines are included within our never out of stock program through which we have strengthened our in-stock commitment to our top selling products by region across all product lines. Our sales mix of moldings and accessories increased to 14.4% and 14.1% of total net sales in the three and six months ended June 30, 2011, respectively, from 13.9% and 13.6% in the three and six months ended June 30, 2010, respectively. Additionally, our sales mix of laminates increased to 23.2% and 23.8% of total net sales in the three and six months ended June 30, 2011, respectively, from 20.8% and 20.7% in the three and six months ended June 30, 2010, respectively.

We believe net sales in the first half of 2011, primarily in the first quarter, were adversely impacted by our reduced productivity subsequent to the August 2010 implementation of the first, and most significant, phase of our integrated information technology solution. Specifically, inconsistent servicing of new demand prior to a customer placing an order interrupted the normal sales cycle, resulting in either delayed or lost sales. We believe this adverse impact is contained to the first half of 2011.

Comparable store net sales benefited from the continued maturation of stores in operation for 13 to 36 months at June 30, 2011, where net sales increased 1.2% for the quarter, and 4.5% for the six month period. Net sales at these comparable stores generally increase faster than at our stores in operation for more than 36 months, which decreased 10.9% in the second quarter and 9.6% in the first six months of 2011. We believe our stores in operation for more than 36 months are more likely to be adversely impacted by the opening of non-comparable stores in an existing market. Excluding the net sales of markets which include a non-comparable store and at least one comparable store older than 36 months, net sales at these more mature stores decreased 6.9% in the second quarter of 2011 and 6.4% in the first six months of 2011.

Table of Contents**Gross Profit and Gross Margin**

	For the three months ended		For the six months ended	
	June 30, 2011	June 30, 2010	June 30, 2011	June 30, 2010
	(dollars in thousands)			
Net Sales	\$ 175,460	\$ 168,674	\$ 335,140	\$ 319,869
Cost of Sales	115,736	110,134	217,623	207,825
Gross Profit	\$ 59,724	\$ 58,540	\$ 117,517	\$ 112,044
Gross Margin	34.0%	34.7%	35.1%	35.0%

Gross profit increased \$1.2 million and \$5.5 million, or 2.0% and 4.9%, for the three and six month periods ended June 30, 2011, respectively, from the comparable prior year periods. The change in gross margin in comparing the three and six months ended June 30, 2011, to those ended June 30, 2010, was primarily due to the following factors:

Our second quarter gross margin has historically been weaker than the first quarter due to our April Big Sale, our broadest chain-wide sale, featuring liquidation deals, odd-lots, and promotional pricing on certain products within our everyday assortment. The 2011 event concluded in May due to the shift in the Easter holiday, slightly more than a week later than the conclusion of the 2010 event. In 2011, both our net sales and open orders during the event increased over the prior year.

Our second quarter net sales in the weeks prior and subsequent to our April Big Sale were weaker in 2011 than in 2010. As a result, a greater proportion of our 2011 second quarter net sales, particularly those in April and May, were a result of the April Big Sale, and therefore, at more promotional prices. We believe this adversely impacted our second quarter gross margin by approximately 40 basis points.

Our sourcing initiatives benefited gross margin approximately 50 basis points and 60 basis points during the three and six months ended June 30, 2011, respectively.

Sales mix shifts expanded gross margin by approximately 50 basis points and 65 basis points in the three and six months ended June 30, 2011, respectively. Gross margin continued to benefit from increased sales of moldings and accessories. In addition, gross margin benefited from increased sales of certain premium products within our laminate and bamboo lines, due to both our commitment to in-stock positions and vendor-supported promotions. Gross margin also benefited from a decrease in the sales mix of certain hardwood products that carry a lower than average gross margin.

Higher net transportation costs reduced gross margin by approximately 60 basis points and 70 basis points for the three and six months ended June 30, 2011, respectively. This adverse impact was primarily due to higher inbound transportation costs capitalized into our unit cost and an increase in the average cost per mile driven resulting from higher fuel costs. Partially offsetting these higher costs was a significant increase in direct shipments received by our stores, either through our China consolidation center or direct from the mill to the store. In the second quarter of 2011, 27.3% of our unit purchases were received directly at the store, up from 13.0% in the second quarter of 2010.

Increased investment in our quality control procedures, particularly those related to South American exotic hardwoods, increased certain product costs. We significantly strengthened our inspection efforts over milling in the country of origin. We believe that, over time, these efforts will benefit gross profit through a stronger customer value proposition of quality, price and fewer product performance issues.

Table of Contents**Operating Income and Operating Margin**

	For the three months ended		For the six months ended	
	June 30, 2011	June 30, 2010	June 30, 2011	June 30, 2010
	(dollars in thousands)			
Gross Profit	\$ 59,724	\$ 58,540	\$ 117,517	\$ 112,044
SG&A Expenses	51,051	43,863	99,504	86,076
Operating Income	\$ 8,673	\$ 14,677	\$ 18,013	\$ 25,968
Operating Margin	4.9%	8.7%	5.4%	8.1%

Operating income for the second quarter ended June 30, 2011 decreased \$6.0 million over the second quarter of 2010 as the \$1.2 million increase in gross profit discussed above was fully offset by a \$7.2 million increase in SG&A expenses. Operating income for the six months ended June 30, 2011 decreased \$8.0 million over the same period in 2010 as the \$5.5 million increase in gross profit discussed above was fully offset by a \$13.4 million increase in SG&A expenses. The increases in SG&A expenses were principally due to the following factors:

Salaries, commissions and benefits increased \$2.3 million and \$4.9 million for the three and six months ended June 30, 2011, respectively, from the comparable prior year periods. As a percentage of net sales, salaries, commissions and benefits increased to 11.3% and 11.8% for the three and six months ended June 30, 2011, respectively, from 10.4% and 10.8% for the three and six months ended June 30, 2010, respectively, due primarily to the following:

Store base growth, including Canada, which increased salaries and commission expense as a percentage of net sales by approximately 65 basis points, in comparing both the second quarter and first six months of 2011 to 2010.

Increased benefit costs, including payroll taxes, insurance and other benefits, resulting in an increase as a percentage of net sales of approximately 35 basis points and 30 basis points, respectively, in comparing the second quarter and first six months of 2011 to 2010.

A greater commitment to in-store management and staffing at certain smaller stores, as well as an expanded training program.

Continued investment in our corporate infrastructure, partially offset by a reduction in our management bonus accrual.

Advertising expenses increased \$1.9 million to \$15.0 million, or 8.6% of net sales, for the three months ended June 30, 2011, from \$13.2 million, or 7.8% of net sales, for the comparable prior year period. For the six months ended June 30, 2011, advertising expenses increased \$2.4 million to \$28.3 million, or 8.4% of net sales, up from 8.1% of net sales for the six months ended June 30, 2010. We continued to expand the breadth of certain promotional programs to provide a coordinated value of product, service and financing offerings. In the second quarter of 2011, we increased the number of promotional events in comparison to the second quarter of 2010, including the marketing surrounding the launch of the Bellawood 100-year transferable warranty.

Occupancy costs increased \$1.0 million to \$6.4 million, or 3.7% of net sales, in the three months ended June 30, 2011, from \$5.4 million, or 3.2% of net sales, in the second quarter of 2010. For the six months ended June 30, 2011, occupancy costs increased \$2.2 million to \$12.9 million, or 3.8% of net sales, from \$10.7 million, or 3.4% of net sales, for the first six months of 2010. These increases were primarily due to the 47 stores opened between June 30, 2010 and June 30, 2011, but also included approximately 10 to 15 basis points in

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additional warehousing and distribution, including in Canada, for both the three and six months ended June 30, 2011.

Depreciation and amortization expenses were \$2.1 million and \$4.0 million in the three and six months ended June 30, 2011, respectively. As a percentage of net sales, depreciation and amortization expenses were 1.2% in both the three and six months ended June 30, 2011, and 0.7% and 0.8% in the three and six months ended June 30, 2010, respectively. The increase is primarily related to our integrated information technology solution, which we generally began depreciating in August 2010.

Stock-based compensation expense was 0.6% of net sales for both the three and six months ended June 30, 2011, compared to 0.5% of net sales for the comparable periods in the prior year. The increase as a percentage of net sales is primarily due to equity granted to certain newly-hired executives.

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Other SG&A expenses increased \$1.1 million and \$1.9 million for the three and six months ended June 30, 2011, respectively, from the comparable prior year periods. As a percentage of net sales, these expenses were 3.8% in both the three and six months ended June 30, 2011, and 3.3% and 3.4%, respectively, for the three and six months ended June 30, 2010. The increase was primarily due to store-base growth, certain bankcard discount rate fees, which increased due to greater consumer preference for certain extended-term promotional programs, and other professional services, including support of our integrated information technology solution.

Our sourcing initiatives resulted in a net reduction in SG&A expenses of approximately 10 to 15 basis points for the second quarter of 2011 and 20 to 30 basis points for the six months ended June 30, 2011.

Provision for Income Taxes

	For the three months ended		For the six months ended	
	June 30, 2011	2010	June 30, 2011	2010
	(dollars in thousands)			
Provision for income taxes	\$ 3,453	\$ 5,719	\$ 7,104	\$ 10,135
Effective tax rate	39.5%	38.6%	39.1%	38.7%

The effective income tax rate increases in comparing 2011 to 2010 are primarily due to increases in certain reserves and higher state income taxes.

Net Income

	For the three months ended		For the six months ended	
	June 30, 2011	2010	June 30, 2011	2010
	(dollars in thousands)			
Net Income	\$ 5,287	\$ 9,093	\$ 11,064	\$ 16,061
As a percentage of net sales	3.0%	5.4%	3.3%	5.0%

Net income decreased 41.9% comparing the second quarter of 2011 to 2010, and decreased 31.1% comparing the six months ended June 30, 2011 to the six months ended June 30, 2010.

Seasonality

Our net sales fluctuate slightly as a result of seasonal factors, and we adjust merchandise inventories in anticipation of those factors, causing variations in our build of merchandise inventories. We experience slightly higher net sales in spring and fall, when more home remodeling activities are taking place, and slightly lower net sales in holiday periods and during the hottest summer months. These seasonal fluctuations, however, are minimized to some extent by our national presence, as markets experience different seasonal characteristics.

Liquidity and Capital Resources

Our principal liquidity requirements have been to meet our working capital and capital expenditure needs. Our principal sources of liquidity are \$33.4 million of cash and cash equivalents at June 30, 2011, our cash flow from operations, and our \$25.0 million of availability under a revolving credit facility. We expect to use this liquidity for general corporate purposes, including providing additional long-term capital to support the growth of our business (primarily through opening new stores) and maintaining our existing stores. We believe that our cash flow from operations, together with our existing liquidity sources, will be sufficient to fund our operations and anticipated capital expenditures over at least the next 24 months.

In 2011, we now expect capital expenditures to total between \$15 million and \$17 million. In addition to general capital requirements, we intend to:

open between 40 and 44 new store locations;

continue to invest in our integrated information technology solution;

continue remodeling existing store showrooms;

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invest in our finishing line; and

continue to enhance the online customer experience through our website.

Cash and Cash Equivalents

During the first six months of 2011, cash and cash equivalents decreased \$1.5 million to \$33.4 million. The decrease of cash and cash equivalents was primarily due to \$3.5 million of net cash provided by operating activities and \$3.5 million in proceeds from the exercise of stock options, offset by the use of \$8.3 million to purchase property and equipment.

During the first six months of 2010, cash and cash equivalents increased \$6.5 million to \$42.2 million. The increase of cash and cash equivalents was primarily due to \$12.6 million of net cash provided by operating activities and \$2.4 million in proceeds from the exercise of stock options, partially offset by the use of \$8.4 million to purchase property and equipment.

Merchandise Inventories

Merchandise inventories at June 30, 2011 increased \$27.2 million from December 31, 2010, as an increase in available for sale inventory of \$21.6 million combined with an increase in inbound in-transit inventory of \$5.6 million. We consider merchandise inventories either available for sale or inbound in-transit, based on whether we have physically received and inspected the products.

Merchandise inventories and available inventory per store in operation were as follows:

	As of June 30, 2011	As of December 31, 2010 <i>(in thousands)</i>	As of June 30, 2010
Inventory Available for Sale	\$ 157,734	\$ 136,179	\$ 118,637
Inventory Inbound In-Transit	24,545	18,952	24,509
Total Merchandise Inventories	\$ 182,279	\$ 155,131	\$ 143,146
Available Inventory Per Store	\$ 631	\$ 611	\$ 584

The increase in available inventory per store is primarily due to weaker than expected net sales. However, available inventory levels are also higher in certain merchandise categories, including moldings and accessories, certain engineered and exotic hardwoods and liquidation deals due to a combination of our commitment to strengthening in-stock positions, new product launches and opportunistic purchases designed for future periods. We continue to expect our available inventory per store at December 31, 2011 to be lower than the level at December 31, 2010.

Cash Flows

Operating Activities. Net cash provided by operating activities was \$3.5 million for the six months ended June 30, 2011, and \$12.6 million for the six months ended June 30, 2010. Net cash provided by operating activities decreased primarily due to a larger build in merchandise inventories net of the change in accounts payable, partially offset by net changes in other working capital items.

Investing Activities. Net cash used in investing activities was \$8.3 million for the six months ended June 30, 2011 and \$8.4 million for the six months ended June 30, 2010. Net cash used in investing activities for the first six months of 2011 and 2010 included \$2.2 million and \$4.6 million, respectively, in capital purchases of computer software relating to our integrated information technology solution. In addition, net cash used in investing activities during the first half of both 2011 and 2010 included capital purchases of store fixtures, equipment and leasehold improvements for stores opened, relocated or remodeled in the first six months, routine capital purchases of computer hardware and software, and certain leasehold improvements in our Corporate Headquarters.

Financing Activities. Net cash provided by financing activities was \$3.4 million for the six months ended June 30, 2011 and \$2.3 million for the six months ended June 30, 2010, primarily attributable to proceeds from the exercise of stock options.

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External Factors Impacting Our Business

Our Market. The wood flooring market for homeowners is highly fragmented and dependent on home-related discretionary spending, which is influenced by a number of complex economic and demographic factors that may vary locally, regionally and nationally. We are impacted by home remodeling activity, employment levels, housing turnover, real estate prices, new housing starts, consumer confidence, credit availability and the general health of consumer discretionary spending. Many of the economic indicators associated with the wood flooring market and more generally associated with consumer discretionary spending are weak. Though we believe we have periodically seen signs of stabilization, the wood flooring market is likely to remain in a weakened state during 2011. The pressures challenging large-ticket purchasing decisions may continue to be volatile into the second half of the year, potentially resulting in continued consumer caution. We believe the number of independent retailers serving the homeowner-based segment of the wood flooring market will continue to decline, however, presenting us with an opportunity for market share growth, primarily through store base expansion.

Antidumping and Countervailing Duties Investigation. In October 2010, a conglomeration of domestic manufacturers of multilayered wood flooring filed a Petition for the Imposition of Antidumping and Countervailing Duties (the Petition) with the United States Department of Commerce (the DOC) and the United States International Trade Commission (the ITC) against imports of multilayered wood flooring from China. In December 2010, the ITC made a preliminary determination that there is a reasonable indication that imports of multilayered wood flooring from China have caused injury to the domestic suppliers and, as a result, the DOC continued its investigation. Approximately 7% to 9% of our net sales in 2010 were products that currently fall within the scope of the investigation.

On March 22, 2011, the DOC announced its preliminary determination in the countervailing duty investigation that Chinese producers have received subsidies ranging from zero to 27.01%. More specifically, two producers received a subsidy rate of zero, 127 companies received a rate of 27.01% due to their failure to respond to requests for information, and all other Chinese producers/exporters received a rate of 2.25%. These preliminary rates became effective April 6, 2011.

On May 20, 2011, the DOC announced its preliminary determination in the antidumping duty investigation and imposed dumping rates ranging from zero to 82.65%. These rates became effective May 26, 2011. Subsequently, on June 20, 2011, the DOC determined that it made significant ministerial errors in calculating the preliminary antidumping rates. Accordingly, the rates were amended such that they ranged from zero to 27.12%. More specifically, three producers received a dumping rate of zero, 73 producers received a rate of 6.78%, and all other Chinese producers/exporters received a rate of 27.12%.

Importers of products within the current scope of the investigation are required to pay these duties into escrow pending final determinations by both the DOC and the ITC. At the final determination, if the rates are increased, the new rates will apply prospectively but not retroactively. If the final rates are lower than the preliminary rates, the new rates will be applied prospectively and rebates may be pursued through subsequent proceedings. Currently, our suppliers of the subject products are exposed to countervailing duties of either zero or 2.25%, and antidumping duties of either zero or 6.78%. Based on these rates and our current sourcing structure, this matter is not expected to have a material adverse effect on our results of operations, financial position or cash flows.

The DOC is currently scheduled to make its final determination in October 2011 and the ITC is scheduled to make its final injury determination in November 2011.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements or other financing activities with special-purpose entities.

Critical Accounting Policies and Estimates

Critical accounting policies are those that we believe are both significant and that require us to make difficult, subjective or complex judgments, often because we need to estimate the effect of inherently uncertain matters. We base our estimates and judgments on historical experiences and various other factors that we believe to be appropriate under the circumstances. Actual results may differ from these estimates, and we might obtain different estimates if we used different assumptions or conditions. We have had no significant changes in our critical accounting policies and estimates since our annual report on Form 10-K for the year ended December 31, 2010.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Interest Rates.

We are exposed to interest rate risk through the investment of our cash and cash equivalents. We invest our cash in short-term investments with maturities of three months or less. Changes in interest rates affect the interest income we earn, and therefore impact our cash flows and results of operations. In addition, any future borrowings under our revolving credit agreement would be exposed to interest rate risk due to the variable rate of the facility.

We currently do not engage in any interest rate hedging activity and currently have no intention to do so in the foreseeable future. However, in the future, in an effort to mitigate losses associated with these risks, we may at times enter into derivative financial instruments, although we have not historically done so. We do not, and do not intend to, engage in the practice of trading derivative securities for profit.

Item 4. Controls and Procedures.

Evaluation of disclosure controls and procedures. Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this quarterly report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

Changes in internal control over financial reporting. There was no change in our internal control over financial reporting that occurred during the period covered by this quarterly report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II

OTHER INFORMATION

Item 1. Legal Proceedings.

On September 3, 2009, a former store manager and an assistant store manager (together, the Plaintiffs) filed a putative class action suit against LLI in the Superior Court of California in and for the County of Alameda. The Plaintiffs allege that with regard to certain groups of current and former employees in LLI's California stores, LLI violated California law by failing to calculate and pay overtime wages properly, provide meal breaks, compensate for unused vacation time, reimburse for certain expenses and maintain required employment records. The Plaintiffs also claim that LLI did not calculate and pay overtime wages properly for certain of LLI's non-exempt employees, both in and out of California, in violation of federal law. In their suit, the Plaintiffs seek compensatory damages, certain statutory penalties, costs, attorney's fees and injunctive relief. LLI removed the case to the United States District Court for the Northern District of California. In an order dated March 2, 2011, the court denied without prejudice the Plaintiffs' motion for conditional class certification of non-exempt employees throughout the country. LLI intends to continue to defend the claims in this suit vigorously. While there is a reasonable possibility that a material loss may be incurred, we cannot estimate the loss or range of loss, if any, to us at this time.

We also are, from time to time, subject to claims and disputes arising in the normal course of business. In the opinion of management, while the outcome of any such claims and disputes cannot be predicted with certainty, our ultimate liability in connection with these matters is not expected to have a material adverse effect on our results of operations, financial position or cash flows.

Item 1A. Risk Factors.

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A, Risk Factors, in our annual report on Form 10-K for the year ended December 31, 2010, which could materially affect our business, financial condition or future results. There have been no material changes to those risk factors since we filed our fiscal 2010 annual report on Form 10-K. The risks described in our annual report on Form 10-K are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or results of operations.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. (Removed and Reserved).

Item 5. Other Information.

None.

Item 6. Exhibits.

The exhibits listed in the exhibit index following the signature page are furnished as part of this report.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

LUMBER LIQUIDATORS HOLDINGS, INC.

(Registrant)

Date: July 26, 2011

By: /s/ Daniel E. Terrell
Daniel E. Terrell
Chief Financial Officer

(Principal Financial and Principal Accounting Officer)

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EXHIBIT INDEX

Exhibit	
Number	Exhibit Description
31.01	Certification of Principal Executive Officer of Lumber Liquidators Holdings, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.02	Certification of Principal Financial Officer of Lumber Liquidators Holdings, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.01	Certification of Principal Executive Officer and Principal Financial Officer of Lumber Liquidators Holdings, Inc. pursuant to Section 906 of the Sarbanes-Oxley act of 2002
101*	The following financial statements from the Company's Form 10-Q for the quarter ended June 30, 2011, formatted in XBRL: (i) Condensed Consolidated Balance Sheets, (ii) Condensed Consolidated Statements of Income, (iii) Condensed Consolidated Statements of Cash Flows (iv) Notes to Condensed Consolidated Financial Statements

* Furnished herewith.