

ETHAN ALLEN INTERIORS INC  
Form 10-Q  
February 02, 2011  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended December 31, 2010

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: 1-11692

## Ethan Allen Interiors Inc.

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**06-1275288**

(I.R.S. Employer Identification No.)

**Ethan Allen Drive, Danbury, Connecticut**

(Address of principal executive offices)

**06811**

(Zip Code)

**(203) 743-8000**

(Registrant's telephone number, including area code)

**N/A**

(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 during the preceding 12 months (or 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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

At January 28, 2011, there were 28,727,575 shares of Class A Common Stock, par value \$.01, outstanding.



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Table of Contents**PART I - FINANCIAL INFORMATION****Item 1. Financial Statements****ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES****Consolidated Balance Sheets**

(In thousands, except share data)

	December 31, 2010 (unaudited)	June 30, 2010
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 53,031	\$ 73,852
Marketable securities (note 5)	16,258	11,075
Accounts receivable, less allowance for doubtful accounts of \$1,138 at December 31, 2010 and \$1,160 at June 30, 2010	14,732	17,105
Inventories (note 6)	137,045	134,040
Prepaid expenses and other current assets	35,939	23,620
Total current assets	257,005	259,692
Property, plant and equipment, net	298,403	305,747
Goodwill and other intangible assets (notes 8 and 9)	45,128	45,128
Restricted cash and investments (note 4)	16,306	17,318
Other assets	3,342	3,892
Total assets	\$ 620,184	\$ 631,777
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Current maturities of long-term debt (note 10)	\$ 3,891	\$ 3,898
Customer deposits	39,633	52,605
Accounts payable	19,326	23,952
Accrued compensation and benefits	28,326	28,353
Accrued expenses and other current liabilities (note 7)	34,463	36,934
Total current liabilities	125,639	145,742
Long-term debt (note 10)	192,596	199,369
Other long-term liabilities	17,903	19,123
Deferred income taxes	11,939	9,084
Total liabilities	348,077	373,318
Shareholders' equity:		
Class A common stock, par value \$.01, 150,000,000 shares authorized; 48,345,607 shares issued at December 31, 2010 and 48,346,607 shares issued at June 30, 2010	483	483
Class B common stock, par value \$.01, 600,000 shares authorized; no shares issued and outstanding at December 31, 2010 and June 30, 2010		
Preferred stock, par value \$.01, 1,055,000 shares authorized; no shares issued and outstanding at December 31, 2010 and June 30, 2010		

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Additional paid-in capital	359,158	358,722
	359,641	359,205
Less: Treasury stock (at cost), 19,619,032 shares at December 31, 2010 and 19,414,746 shares at June 30, 2010	(584,119)	(581,331)
Retained earnings	495,026	479,341
Accumulated other comprehensive income (note 14)	1,559	1,244
Total shareholders' equity	272,107	258,459
Total liabilities and shareholders' equity	\$ 620,184	\$ 631,777

See accompanying notes to consolidated financial statements.

Table of Contents**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES****Consolidated Statements of Operations (Unaudited)****(In thousands, except per share data)**

	Three months ended December 31,		Six months ended December 31,	
	2010	2009	2010	2009
Net sales	\$ 173,345	\$ 143,302	\$ 338,186	\$ 279,492
Cost of sales	83,484	74,278	165,944	152,159
Gross profit	89,861	69,024	172,242	127,333
Operating expenses:				
Selling	40,068	36,286	79,395	72,220
General and administrative	39,259	37,244	76,702	74,895
Restructuring and impairment charge , net (note 7)	59	777	284	1,589
Total operating expenses	79,386	74,307	156,381	148,704
Operating income (loss)	10,475	(5,283)	15,861	(21,371)
Interest and other miscellaneous income, net	1,168	1,020	4,325	1,817
Interest and other related financing costs (note 10)	2,902	2,978	5,876	5,959
Income (loss) before income taxes	8,741	(7,241)	14,310	(25,513)
Income tax benefit (note 3)	(6,003)	(3,903)	(4,247)	(8,596)
Net income (loss)	\$ 14,744	\$ (3,338)	\$ 18,557	\$ (16,917)
Per share data (note 13):				
Basic earnings per common share:				
Net income (loss) per basic share	\$ 0.51	\$ (0.12)	\$ 0.65	\$ (0.58)
Basic weighted average common shares	28,728	28,917	28,753	28,922
Diluted earnings per common share:				
Net income (loss) per diluted share	\$ 0.51	\$ (0.12)	\$ 0.64	\$ (0.58)
Diluted weighted average common shares	28,921	28,917	28,936	28,922

See accompanying notes to consolidated financial statements.

Table of Contents**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES****Consolidated Statements of Cash Flows (Unaudited)**

(In thousands)

	<b>Six Months Ended December 31,</b>	
	<b>2010</b>	<b>2009</b>
<b>Operating activities:</b>		
Net income (loss)	\$ 18,557	\$ (16,917)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,929	18,330
Compensation expense related to share-based awards	436	1,075
Provision (benefit) for deferred income taxes	(11)	(8,967)
Restructuring and impairment charge (benefit), net		(161)
Loss (gain) on disposal of property, plant and equipment	273	(3)
Other	(90)	110
Change in assets and liabilities, net of the effects of acquired businesses:		
Accounts receivable	2,429	505
Inventories	(2,664)	14,528
Prepaid and other current assets	(10,726)	7,969
Other assets	388	406
Customer deposits	(13,843)	4,882
Accounts payable	(2,037)	1,037
Accrued expenses and other current liabilities	351	(2,275)
Other long-term liabilities	(1,220)	330
Net cash provided by operating activities	2,772	20,849
<b>Investing activities:</b>		
Proceeds from the disposal of property, plant & equipment	99	10,084
Capital expenditures and acquisitions	(4,157)	(5,315)
Decrease in restricted cash and investments	981	
Purchases of marketable securities	(6,358)	
Sales of marketable securities	1,000	
Other	(218)	19
Net cash provided by (used in) investing activities	(8,653)	4,788
<b>Financing activities:</b>		
Payments on long-term debt	(6,655)	(21)
Purchase and retirements of company stock	(5,377)	
Payment of deferred financing costs		(193)
Payment of cash dividends	(2,876)	(2,897)
Net cash used in financing activities	(14,908)	(3,111)
Effect of exchange rate changes on cash	(32)	652
Net increase (decrease) in cash & cash equivalents	(20,821)	23,178
Cash & cash equivalents - beginning of period	73,852	52,960
Cash & cash equivalents - end of period	\$ 53,031	\$ 76,138

See accompanying notes to consolidated financial statements.





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## ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

## Consolidated Statements of Shareholders' Equity

Six Months Ended December 31, 2010

(Unaudited)

(In thousands, except share data)

	Common Stock	Additional Paid-In Capital	Treasury Stock	Accumulated Other Comprehensive Income	Retained Earnings	Total
Balance at June 30, 2010	\$ 483	\$ 358,722	\$ (581,331)	\$ 1,244	\$ 479,341	\$ 258,459
Share-based compensation expense (note 12)		436				436
Purchase/retirement of 204,286 shares of company stock			(2,788)			(2,788)
Dividends declared on common stock					(2,872)	(2,872)
Other comprehensive income (note 14):						
Currency translation adjustments				303		303
Unrealized loss on investments				(20)		(20)
Amortization of loss on derivatives				32		32
Net income					18,557	18,557
Total comprehensive income						18,872
Balance at December 31, 2010	\$ 483	\$ 359,158	\$ (584,119)	\$ 1,559	\$ 495,026	\$ 272,107

See accompanying notes to consolidated financial statements.

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**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Unaudited)**

**(1) Basis of Presentation and Recent Accounting Pronouncements**

***Basis of Presentation***

Ethan Allen Interiors Inc. ( Interiors ) is a Delaware corporation incorporated on May 25, 1989. The consolidated financial statements include the accounts of Interiors, its wholly owned subsidiary Ethan Allen Global, Inc. ( Global ), and Global s subsidiaries (collectively We , Us , Our , Eth Allen , or the Company ). All intercompany accounts and transactions have been eliminated in the consolidated financial statements. All of Global s capital stock is owned by Interiors, which has no assets or operating results other than those associated with its investment in Global.

We prepare our consolidated financial statements in conformity with accounting principles generally accepted in the United States, which requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Due to the inherent uncertainty involved in making those estimates, actual results could differ from those estimates. Areas in which significant estimates have been made include, but are not limited to, revenue recognition, the allowance for doubtful accounts receivable, inventory obsolescence, tax valuation allowances, useful lives for property, plant and equipment and intangible assets, goodwill and indefinite-lived intangible asset impairment analyses, the evaluation of uncertain tax positions and the fair value of assets acquired and liabilities assumed in business combinations.

***Recently Adopted Accounting Pronouncements***

In June 2009, the Financial Accounting Standards Board ( FASB ) released additional guidance on Accounting Standards Codification Topic ( ASC ) 810, Consolidation which revised previous guidance applicable to variable interest entities ( VIEs ). ASC 810 requires ongoing assessments of whether an enterprise is the primary beneficiary of a VIE, as opposed to reconsideration only when specific events occurred, as under former rules. The new guidance also replaced the quantitative approach previously required for determining the primary beneficiary of a VIE with a qualitative approach, and changes some disclosure requirements. We have adopted these provisions effective July 1, 2010, and there was no significant impact on our financial statements and results of operations.

**(2) Interim Financial Presentation**

In our opinion, all adjustments, consisting only of normal recurring adjustments necessary for fair presentation, have been included in the consolidated financial statements. The results of operations for the three and six months ended December 31, 2010 are not necessarily indicative of results that may be expected for the entire fiscal year. The interim consolidated financial statements should be read in conjunction with the

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consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended June 30, 2010. Certain prior period amounts have been reclassified in order for them to conform to the current year's presentation.

### (3) **Income Taxes**

The Company reviews its expected annual effective income tax rates and makes changes on a quarterly basis as necessary based on certain factors such as changes in forecasted annual operating income; changes to actual or forecasted permanent book to tax differences; impacts from future tax audits with state, federal or foreign tax authorities; impacts from tax law changes; or change in judgment as to the realizability of deferred tax assets. The Company identifies items which are not normal and are non-recurring in nature and treats these as discrete events. The tax effect of discrete items is recorded in the quarter in which the discrete events occur. Due to the volatility of these factors, the Company's consolidated effective income tax rate can change significantly on a quarterly basis.

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**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Unaudited)**

The Company's consolidated effective tax rate was a negative 29.7% and a positive 33.7% for the six months ended December 31, 2010 and 2009 respectively. The current quarter effective tax rate was primarily impacted by a tax benefit from the reduction of the valuation allowance. The tax benefit was partially offset by the tax expense on the current quarter's net income.

The significant decrease in the valuation allowance recorded this quarter was due to a change in tax accounting methods applied in the Company's U.S. federal tax filing for the fiscal year ended June 30, 2010 which accelerated tax expenses for depreciation, inventory and professional fees that were previously treated as deferred tax assets. This change resulted in an increase in the U.S. federal and state net operating losses ( NOL ) reported for the fiscal year ended June 30, 2010. The federal NOL was carried back to fiscal year ended June 30, 2008 and other current assets have been adjusted to record a receivable for the additional expected cash refund which has been increased to approximately \$17.3 million.

The Company conducts business globally and, as a result, the Company or one or more of its subsidiaries files income tax returns in the U.S., various state, and foreign jurisdictions. In the normal course of business, the Company is subject to examination by the taxing authorities in such major jurisdictions as the U.S., Canada, and Mexico. As of December 31, 2010, certain subsidiaries of the Company are currently under U.S. audit from 2001 through 2007. It is reasonably possible that some of these audits may be completed during the next twelve months. It is reasonable to expect that various issues relating to uncertain tax benefits will be resolved within the next twelve months as exams are completed or as statutes expire and will impact the effective tax rate.

A full valuation allowance was established as of June 30, 2010 since the Company had a three year cumulative loss. As of December 31, 2010, the Company remains in a three year cumulative loss and the full valuation allowance remains in place, though at a reduced level after recording the impact of the changes in tax accounting methods made in the quarter ended December 31, 2010. The valuation allowance at December 31, 2010 was \$24.3 million vs. \$36.2 million at June 30, 2010, and \$10.2 million of the decrease is related to tax accounting method changes reported in the fiscal year ended 2010 tax returns.

Due to the economic times and recent losses and after considering both positive and negative evidence, management's assessment is that realization of tax assets is not reasonably assured due to a lack of available objective evidence. Management will continue to assess the realizability of the tax assets based on actual and forecasted operating results on a quarterly basis which will likely cause volatility in the effective tax rate of the Company.

**(4) Restricted Cash and Investments**

At December 31, 2010, we held \$16.3 million of restricted cash and investments in lieu of providing letters of credit for the benefit of the provider of our workmen's compensation and other insurance and for the benefit of the issuer of our private label credit card. These funds can be invested in high quality money market mutual funds, U.S. Treasuries and U.S. Government agency fixed income instruments, and cannot be withdrawn without the prior written consent of the secured party. These assets are carried at cost, which approximates market value and are

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classified as long-term assets because they are not expected to be used within one year to fund operations. See also Note 15, Financial Instruments .

### **(5) Marketable Securities**

At December 31, 2010, the Company held marketable securities of \$16.3 million classified as current assets, consisting of U.S. municipal bonds with maturities ranging from less than one year to less than two years, which were rated A+/A1 or better by the rating services Standard & Poors ( S&P ) and Moodys Investors Service

Table of Contents**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Unaudited)**

( Moody's ) respectively. There are no material unrealized gains or losses recorded in other comprehensive income and there have been no realized gains or losses for the six months ended December 31, 2010. We do not believe there are any impairments considered to be other than temporary at December 31, 2010. Also see Note 4, Restricted Cash and Investments and Note 15, Financial Instruments .

**(6) Inventories**

Inventories at December 31, 2010 and June 30, 2010 are summarized as follows (in thousands):

	<b>December 31, 2010</b>		<b>June 30, 2010</b>
Finished goods	\$ 107,340	\$	104,782
Work in process	8,008		8,421
Raw materials	21,697		20,837
	\$ 137,045	\$	134,040

Inventories are presented net of a related valuation allowance of \$1.6 million at December 31, 2010 and \$2.1 million at June 30, 2010.

**(7) Restructuring and Impairment Charges**

In recent years, we have announced and executed plans to consolidate our operations as part of an overall strategy to maximize production efficiencies and maintain our competitive advantage. Plans announced in fiscal 2008 and 2009 had no material impact on fiscal 2011 financial statements and the balance of reserves for these actions, primarily for non-cancellable lease obligations with expirations up to 23 years, totaled \$2.1 million at December 31, 2010.

**(8) Business Acquisitions**

No material acquisitions were completed in fiscal 2011 or 2010.

(9) **Goodwill, Other Intangible Assets and Goodwill Impairment**

There were no changes to our goodwill, other intangible assets or goodwill impairment during the six months ended December 31, 2010.

(10) **Borrowings**

Total debt obligations at December 31, 2010 and June 30, 2010 consist of the following (in thousands):

	<b>December 31, 2010</b>	<b>June 30, 2010</b>
5.375% Senior Notes due 2015	\$ 192,399	\$ 199,158
Industrial revenue bonds	3,855	3,855
Other debt	233	254
Total debt	196,487	203,267
Less current maturities	3,891	3,898
Total long-term debt	\$ 192,596	\$ 199,369



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**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Unaudited)**

In September 2005, we issued \$200.0 million in ten-year senior unsecured notes due 2015 (the Senior Notes). The Senior Notes were issued by Global, bearing an annual coupon rate of 5.375% with interest payable semi-annually in arrears on April 1 and October 1. We have used the net proceeds of \$198.4 million to improve our retail network, invest in our manufacturing and logistics operations, and for other general corporate purposes. During the current fiscal year, the Company repurchased \$6.9 million of the Senior Notes in several unsolicited open market transactions.

In fiscal 2009, the Company established a \$60 million, three-year senior secured, asset-based, revolving credit facility (the Facility). The Facility provides revolving credit financing of up to \$60 million, subject to borrowing base availability. Revolving loans under the Agreement bear, at the Company's option, interest at an annual rate of either:

(a) London Interbank Offered rate (LIBOR) plus 3.25% to 4.25%, based on the average availability, or

(b) the higher of (i) a prime rate, (ii) the federal funds effective rate plus 0.50%, or (iii) a LIBOR rate plus 1.00% plus, in each case, an additional 2.25% to 3.25%, based on average availability.

The Facility is secured by all property owned, leased or operated by the Company in the United States excluding any real property owned by the Company and contains customary covenants which may limit the Company's ability to incur debt; engage in mergers and consolidations; make restricted payments (including dividends); sell certain assets; and make investments. At December 31, 2010, we had no revolving loans and \$1.2 million of standby letters of credit outstanding under the Facility. Remaining availability under the revolver totaled \$58.8 million subject to limitations set forth in the agreement and as a result, the coverage charge ratio, and other restricted payment limitations did not apply.

As of December 31, 2010, we are in compliance with all covenants of the Facility and our Senior Notes.

**(11) Litigation**

Environmental Matters

We and our subsidiaries are subject to various environmental laws and regulations. Under these laws, we and/or our subsidiaries are, or may be, required to remove or mitigate the effects on the environment of the disposal or release of certain hazardous materials.

During fiscal 2009, three locations where we and/or our subsidiaries had been named as a Potentially Responsible Party ( PRP ) were resolved. In each case, we were not a major contributor based on the very small volume of waste generated by us in relation to total volume at those sites and were able to take part in de minimus settlement arrangements. One additional site in Carroll, New York continued to be evaluated as of December 31, 2010. We believe that we are not a major contributor. Liability under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended may be joint and several. As such, to the extent certain named PRPs are unable, or unwilling, to accept responsibility and pay their apportioned costs, we could be required to pay in excess of our pro rata share of incurred remediation costs. Our understanding of the financial strength of other PRPs has been considered, where appropriate, in the determination of our estimated liability. As of December 31, 2010, we believe that established reserves related to these environmental contingencies are adequate to cover probable and reasonably estimable costs associated with the remediation and restoration of these sites. We believe our currently anticipated capital expenditures for environmental control facility matters are not material.

We are subject to other federal, state and local environmental protection laws and regulations and are involved, from time to time, in investigations and proceedings regarding environmental matters. Such investigations and proceedings typically concern air emissions, water discharges, and/or management of solid and hazardous wastes. We believe that our facilities are in material compliance with all such applicable laws and regulations.

Table of Contents**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Unaudited)**

Regulations issued under the Clean Air Act Amendments of 1990 required the industry to reformulate certain furniture finishes or institute process changes to reduce emissions of volatile organic compounds. Compliance with many of these requirements has been facilitated through the introduction of high solids coating technology and alternative formulations. In addition, we have instituted a variety of technical and procedural controls, including reformulation of finishing materials to reduce toxicity, implementation of high velocity low pressure spray systems, development of storm water protection plans and controls, and further development of related inspection/audit teams, all of which have served to reduce emissions per unit of production. We remain committed to implementing new waste minimization programs and/or enhancing existing programs with the objective of (i) reducing the total volume of waste, (ii) limiting the liability associated with waste disposal, and (iii) continuously improving environmental and job safety programs on the factory floor which serve to minimize emissions and safety risks for employees. We will continue to evaluate the most appropriate, cost effective, control technologies for finishing operations and design production methods to reduce the use of hazardous materials in the manufacturing process.

**(12) Share-Based Compensation**

On July 20, 2010, in recognition of his extraordinary efforts during these challenging times for the Company, the Compensation Committee of the Company's board of directors awarded M. Farooq Kathwari, our President and Chief Executive Officer 11,000 service-based restricted shares which vest in two equal annual installments on the grant date anniversary. No other significant share based awards have been issued in fiscal 2011 to date.

**(13) Earnings Per Share**

Basic and diluted earnings per share are calculated using the following weighted average share data (in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2010	2009	2010	2009
Weighted average common shares outstanding for basic calculation	28,728	28,917	28,753	28,922
Effect of dilutive stock options and other share-based awards	193		183	
Weighted average common shares outstanding adjusted for dilution calculation	28,921	28,917	28,936	28,922

As of December 31, 2010 and 2009, stock options to purchase 1,922,853 and 2,251,389 common shares, respectively, were excluded from the respective diluted earnings per share calculation because their impact was anti-dilutive.

**(14) Comprehensive Income**

Our accumulated other comprehensive income, comprised of losses on certain derivative instruments and accumulated foreign currency translation adjustments, totaled \$1.6 million at December 31, 2010 and \$1.2 million at June 30, 2010. Foreign currency translation adjustments are the result of changes in foreign currency exchange rates related to our operations in Canada and Mexico. Foreign currency translation adjustments exclude income tax expense (benefit) given that the earnings of non-U.S. subsidiaries are deemed to be reinvested for an indefinite period of time.

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**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Unaudited)**

**(15) Financial Instruments**

We determine fair value as the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date and in the principal or most advantageous market for that asset or liability. The fair value is calculated based on assumptions that market participants use in pricing the asset or liability, and not on assumptions specific to the Company. In addition, the fair value of liabilities include consideration of non-performance risk including our own credit risk. Each fair value measurement is reported in one of three levels, determined by the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

Level 1 Inputs are based upon unadjusted quoted prices for identical instruments traded in active markets.

Level 2 Inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Inputs are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are therefore determined using model-based techniques that include option pricing models, discounted cash flow models, and similar techniques.

The following section describes the valuation methodologies we use to measure different financial assets and liabilities at fair value.

***Assets and Liabilities Measured at Fair Value on a Recurring Basis***

The following table presents our assets and liabilities measured at fair value on a recurring basis at December 31, 2010 (in thousands):

	Level 1	Level 2	Level 3	Balance
Cash equivalents	\$ 59,368	\$	\$	\$ 59,368
Available-for-sale securities		26,227		26,227

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Total	\$	59,368	\$	26,227	\$	85,595
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Cash equivalents consist of money market accounts and mutual funds in U.S. government and agency fixed income securities. We use quoted prices in active markets for identical assets or liabilities to determine fair value. At December 31, 2010, \$6.3 million of the cash equivalents were restricted, and classified as a long-term asset.

Available-for-sale securities consist of U.S. agency bonds with a maturity of five years, and U.S. municipal bonds with maturities of less than two years. The agency bonds are rated AAA/Aaa by S&P/Moodys, and the municipal bonds are rated A+/A1 or better by S&P/Moodys respectively. At December 31, 2010, \$10.0 million of the available-for-sale securities were restricted and classified as a long-term asset. We obtain fair value based upon quoted prices for similar instruments in active markets. As of December 31, 2010, there were no material gross unrealized gains or losses on available-for-sale securities.

As of December 31, 2010, the contractual maturities of our available-for-sale investments were as follows:

Table of Contents**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Unaudited)**

	Cost		Estimated Fair Value	
Due in one year or less	\$	8,204	\$	8,272
Due after one year through five years	\$	17,907	\$	17,955

No investments have been in a continuous loss position for more than one year, and no other-than-temporary impairments were recognized. Also see note 4, Restricted Cash and Investments, and note 5, Marketable Securities.

*Assets and Liabilities Measured at Fair Value on a Non-recurring Basis*

We measure certain assets at fair value on a non-recurring basis. These assets are recognized at fair value when they are deemed to be other-than-temporarily impaired. During the six months ended December 31, 2010, we did not record any other-than-temporary impairments on those assets required to be measured at fair value on a non-recurring basis.

**(16) Segment Information**

Our operations are classified into two operating segments: wholesale and retail. These operating segments represent strategic business areas that operate separately and provide their own distinctive services. These two segments enable us to effectively offer our complete line of home furnishings and accessories to different target markets.

The wholesale segment is principally involved in the development of the Ethan Allen brand, which encompasses the design, manufacture, domestic and offshore sourcing, sale and distribution of a full range of home furnishings and accessories to a network of independently operated and Ethan Allen operated design centers as well as related marketing and brand awareness efforts. Wholesale revenue is generated upon the wholesale sale and shipment of our product to all retail design centers, including those operated by Ethan Allen. Wholesale profitability includes (i) the wholesale gross margin, which represents the difference between the wholesale sales price and the cost associated with manufacturing and/or sourcing the related product, and (ii) other operating costs associated with wholesale segment activities.

The retail segment sells home furnishings and accessories to consumers through a network of Company operated design centers. Retail revenue is generated upon the retail sale and delivery of our product to our customers. Retail profitability includes (i) the retail gross margin, which represents the difference between the retail sales price and the cost of goods purchased from the wholesale segment, and (ii) other operating costs associated with retail segment activities.

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Inter-segment eliminations result, primarily, from the wholesale sale of inventory to the retail segment, including the related profit margin.

We evaluate performance of the respective segments based upon revenues and operating income. While the manner in which our home furnishings and accessories are marketed and sold is consistent, the nature of the underlying recorded sales (i.e. wholesale versus retail) and the specific services that each operating segment provides (i.e. wholesale manufacturing, sourcing, and distribution versus retail selling) are different. Within the wholesale segment, we maintain revenue information according to each respective product line (i.e. case goods, upholstery, or home accessories and other). The allocation of retail sales by product line is reasonably similar to that of the wholesale segment. A breakdown of wholesale sales by these product lines for the three and six months ended December 31, 2010 and 2009 is provided as follows:



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## ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements (Unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2010	2009	2010	2009
Case Goods	40%	42%	38%	41%
Upholstered Products	46%	44%	47%	44%
Home Accessories and Other	14%	14%	15%	15%
	100%	100%	100%	100%

Segment information for the three and six months ended December 31, 2010 and 2009 is provided below (in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2010	2009	2010	2009
<b>Net sales:</b>				
Wholesale segment	\$ 100,793	\$ 84,499	\$ 208,348	\$ 165,780
Retail segment	131,014	107,123	252,037	210,273
Elimination of inter-company sales	(58,462)	(48,320)	(122,199)	(96,561)
Consolidated Total	\$ 173,345	\$ 143,302	\$ 338,186	\$ 279,492
<b>Operating income (loss):</b>				
Wholesale segment (1)(2)	\$ 9,884	\$ 1,022	\$ 21,823	\$ (3,638)
Retail segment (3)(4)	(1,206)	(9,792)	(5,496)	(21,141)
Adjustment of inter-company profit (5)	1,797	3,487	(466)	3,408
Consolidated Total	\$ 10,475	\$ (5,283)	\$ 15,861	\$ (21,371)
<b>Capital expenditures:</b>				
Wholesale segment	\$ 1,595	\$ 835	\$ 2,686	\$ 1,636
Retail segment	873	1,992	1,286	3,679
Acquisitions (6)	185		185	
Consolidated Total	\$ 2,653	\$ 2,827	\$ 4,157	\$ 5,315

	December 31, 2010	June 30, 2010
<b>Total assets</b>		
Wholesale segment	\$ 310,467	\$ 296,363
Retail segment	335,378	360,413
Inventory profit elimination (7)	(25,661)	(24,999)
Consolidated Total	\$ 620,184	\$ 631,777

(1) Operating income (loss) for the wholesale segment for the three months ended December 31, 2009 includes a pre-tax restructuring and impairment net recovery of \$0.4 million.

(2) Operating income (loss) for the wholesale segment for the six months ended December 31, 2009 includes a pre-tax restructuring and impairment net recovery of \$0.2 million.

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- (3) Operating income (loss) for the retail segment for the three months ended December 31, 2010 and 2009 includes pre-tax restructuring and impairment charges of \$0.1 million and \$1.2 million, respectively.
- (4) Operating income (loss) for the retail segment for the six months ended December 31, 2010 and 2009 includes pre-tax restructuring and impairment charges of \$0.3 million and \$1.8 million, respectively.
- (5) Represents the change in wholesale profit contained in Ethan Allen operated design center inventory at the end of the period.
- (6) Acquisitions for the three and six months ended December 31, 2010 include the purchase of two retail design centers.
- (7) Represents the wholesale profit contained in Ethan Allen operated design center inventory that has not yet been realized. These profits are realized when the related inventory is sold.

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**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Unaudited)**

At December 31, 2010, there were 61 independent retail design centers located outside the United States compared with 50 at December 31, 2009. Approximately 6.2% of our net sales during the current six months were derived from sales to these retail design centers compared with less than five percent in the prior year.

**(17) Subsequent Events**

*Ethan Allen declares quarterly cash dividend*

Ethan Allen's Board of Directors has declared a quarterly cash dividend of \$0.05 per share, which will be payable to shareholders of record as of April 8, 2011 and paid on April 25, 2011.

**(18) Recently Issued Accounting Pronouncements**

There have been no recently issued accounting pronouncements during the six months ended December 31, 2010 or impending accounting changes that are expected to have a material effect on the Company's financial statements.

**(19) Financial Information About the Parent, the Issuer and the Guarantors**

On September 27, 2005, Global (the Issuer) issued \$200 million aggregate principal amount of Senior Notes which have been guaranteed on a senior basis by Interiors (the Parent), and other wholly owned domestic subsidiaries of the Issuer and the Parent, including Ethan Allen Retail, Inc., Ethan Allen Operations, Inc., Ethan Allen Realty, LLC, Lake Avenue Associates, Inc. and Manor House, Inc. The subsidiary guarantors (other than the Parent) are collectively called the Guarantors. The guarantees of the Guarantors are unsecured. All of the guarantees are full, unconditional and joint and several and the Issuer and each of the Guarantors are 100% owned by the Parent. Our other subsidiaries which are not guarantors are called the Non-Guarantors.

The following tables set forth the condensed consolidating balance sheets as of December 31, 2010 and June 30, 2010, the condensed consolidating statements of operations for the three and six months ended December 31, 2010 and 2009, and the condensed consolidating statements of cash flows for the six months ended December 31, 2010 and 2009 of the Parent, the Issuer, the Guarantors and the Non-Guarantors.



Table of Contents**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Unaudited)****CONDENSED CONSOLIDATING BALANCE SHEET**

(In thousands)

**December 31, 2010**

	Parent	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
<b>Assets</b>						
Current assets:						
Cash and cash equivalents	\$	\$ 50,864	\$ 1,178	\$ 989	\$	\$ 53,031
Marketable securities		16,258				16,258
Accounts receivable, net		13,885	202	645		14,732
Inventories			158,165	4,541	(25,661)	137,045
Prepaid expenses and other current assets		23,298	12,066	575		35,939
Intercompany receivables		785,287	242,639	(6,150)	(1,021,776)	
Total current assets		889,592	414,250	600	(1,047,437)	257,005
Property, plant and equipment, net		8,862	281,105	8,436		298,403
Goodwill and other intangible assets		37,905	7,223			45,128
Restricted cash and investments		16,306				16,306
Other assets		2,590	748	4		3,342
Investment in affiliated companies	590,721	(80,153)			(510,568)	
Total assets	\$ 590,721	\$ 875,102	\$ 703,326	\$ 9,040	\$ (1,558,005)	\$ 620,184
<b>Liabilities and Shareholders Equity</b>						
Current liabilities:						
Current maturities of long-term debt	\$	\$	\$ 3,891	\$	\$	\$ 3,891
Customer deposits			37,587	2,046		39,633
Accounts payable		5,564	13,623	139		19,326
Accrued expenses and other current liabilities	1,567	45,637	15,056	529		62,789
Intercompany payables	317,047	597	700,048	4,084	(1,021,776)	
Total current liabilities	318,614	51,798	770,205	6,798	(1,021,776)	125,639
Long-term debt		192,399	197			192,596
Other long-term liabilities		3,831	13,952	120		17,903
Deferred income taxes		11,939				11,939
Total liabilities	318,614	259,967	784,354	6,918	(1,021,776)	348,077
Shareholders equity	272,107	615,135	(81,028)	2,122	(536,229)	272,107
Total liabilities and shareholders equity	\$ 590,721	\$ 875,102	\$ 703,326	\$ 9,040	\$ (1,558,005)	\$ 620,184

Table of Contents**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Unaudited)****CONDENSED CONSOLIDATING BALANCE SHEET**

(In thousands)

**June 30, 2010**

	Parent	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
<b>Assets</b>						
Current assets:						
Cash and cash equivalents	\$	\$ 67,269	\$ 5,720	\$ 863	\$	\$ 73,852
Marketable securities		11,075				11,075
Accounts receivable, net		16,385	274	446		17,105
Inventories			154,621	4,418	(24,999)	134,040
Prepaid expenses and other current assets		11,018	12,011	591		23,620
Intercompany receivables		756,998	233,887	(4,815)	(986,070)	
Total current assets		862,745	406,513	1,503	(1,011,069)	259,692
Property, plant and equipment, net		9,659	289,031	7,057		305,747
Goodwill and other intangible assets		37,905	7,223			45,128
Restricted cash and investments		17,318				17,318
Other assets		3,179	709	4		3,892
Investment in affiliated companies	571,323	(69,963)			(501,360)	
Total assets	\$ 571,323	\$ 860,843	\$ 703,476	\$ 8,564	\$ (1,512,429)	\$ 631,777
<b>Liabilities and Shareholders Equity</b>						
Current liabilities:						
Current maturities of long-term debt	\$	\$	\$ 3,898	\$	\$	\$ 3,898
Customer deposits			49,990	2,615		52,605
Accounts payable	2,589	7,059	14,117	187		23,952
Accrued expenses and other current liabilities	1,559	44,642	18,540	546		65,287
Intercompany payables	308,716	597	672,644	4,113	(986,070)	
Total current liabilities	312,864	52,298	759,189	7,461	(986,070)	145,742
Long-term debt		199,158	211			199,369
Other long-term liabilities		4,912	14,084	127		19,123
Deferred income taxes		9,084				9,084
Total liabilities	312,864	265,452	773,484	7,588	(986,070)	373,318
Shareholders equity	258,459	595,391	(70,008)	976	(526,359)	258,459
Total liabilities and shareholders equity	\$ 571,323	\$ 860,843	\$ 703,476	\$ 8,564	\$ (1,512,429)	\$ 631,777



Table of Contents**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Unaudited)****CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS**

(In thousands)

**Three Months Ended December 31, 2010**

	<b>Parent</b>	<b>Issuer</b>	<b>Guarantors</b>	<b>Non-Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>						
Net sales	\$	\$	100,980	\$	182,505	\$	7,899	\$	(118,039)	\$	173,345	
Cost of sales			77,387		121,588		4,271		(119,762)		83,484	
Gross profit			23,593		60,917		3,628		1,723		89,861	
Selling, general and administrative expenses		45	11,789		64,358		3,135				79,327	
Restructuring and impairment charge, (credit) net					59						59	
Total operating expenses		45	11,789		64,417		3,135				79,386	
Operating income (loss)		(45)	11,804		(3,500)		493		1,723		10,475	
Interest and other miscellaneous income, net		14,789	(1,916)		(16)				(11,689)		1,168	
Interest and other related financing costs			2,825		77						2,902	
Income (loss) before income tax expense		14,744	7,063		(3,593)		493		(9,966)		8,741	
Income tax expense			(6,003)								(6,003)	
Net income (loss)	\$	14,744	\$	13,066	\$	(3,593)	\$	493	\$	(9,966)	\$	14,744

**Three Months Ended December 31, 2009**

	<b>Parent</b>	<b>Issuer</b>	<b>Guarantors</b>	<b>Non-Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>					
Net sales	\$	\$	84,465	\$	144,000	\$	5,527	\$	(90,690)	\$	143,302
Cost of sales			69,012		96,688		2,821		(94,243)		74,278
Gross profit			15,453		47,312		2,706		3,553		69,024
Selling, general and administrative expenses		42	10,738		60,189		2,561				73,530
Restructuring and impairment charge, (credit) net					777						777
Total operating expenses		42	10,738		60,966		2,561				74,307
Operating income (loss)		(42)	4,715		(13,654)		145		3,553		(5,283)



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Interest and other miscellaneous income, net	(3,296)	(12,550)	16	9	16,841	1,020
Interest and other related financing costs		2,902	76			2,978
Income (loss) before income tax expense	(3,338)	(10,737)	(13,714)	154	20,394	(7,241)
Income tax expense		(3,903)				(3,903)
Net income (loss)	\$ (3,338)	\$ (6,834)	\$ (13,714)	\$ 154	\$ 20,394	\$ (3,338)

Table of Contents**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Unaudited)****CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS**

(In thousands)

**Six Months Ended December 31, 2010**

	<b>Parent</b>	<b>Issuer</b>	<b>Guarantors</b>	<b>Non-Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
Net sales	\$	\$ 208,498	\$ 357,475	\$ 14,812	\$ (242,599)	\$ 338,186
Cost of sales		159,821	240,150	7,910	(241,937)	165,944
Gross profit		48,677	117,325	6,902	(662)	172,242
Selling, general and administrative expenses	90	22,051	127,879	6,077		156,097
Restructuring and impairment charge, (credit) net			284			284
Total operating expenses	90	22,051	128,163	6,077		156,381
Operating income (loss)	(90)	26,626	(10,838)	825	(662)	15,861
Interest and other miscellaneous income, net	18,647	(5,841)	(29)	5	(8,457)	4,325
Interest and other related financing costs		5,723	153			5,876
Income (loss) before income tax expense	18,557	15,062	(11,020)	830	(9,119)	14,310
Income tax expense		(4,247)				(4,247)
Net income (loss)	\$ 18,557	\$ 19,309	\$ (11,020)	\$ 830	\$ (9,119)	\$ 18,557

**Six Months Ended December 31, 2009**

	<b>Parent</b>	<b>Issuer</b>	<b>Guarantors</b>	<b>Non-Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
Net sales	\$	\$ 165,875	\$ 280,996	\$ 10,426	\$ (177,805)	\$ 279,492
Cost of sales		135,973	191,888	5,524	(181,226)	152,159
Gross profit		29,902	89,108	4,902	3,421	127,333
Selling, general and administrative expenses	83	21,770	120,162	5,100		147,115
Restructuring and impairment charge, net			1,589			1,589
Total operating expenses	83	21,770	121,751	5,100		148,704
Operating income (loss)	(83)	8,132	(32,643)	(198)	3,421	(21,371)

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Interest and other miscellaneous income, net	(16,834)	(31,146)	49	9	49,739	1,817
Interest and other related financing costs		5,807	152			5,959
Income before income tax expense	(16,917)	(28,821)	(32,746)	(189)	53,160	(25,513)
Income tax expense		(8,596)				(8,596)
Net income (loss)	\$ (16,917)	\$ (20,225)	\$ (32,746)	\$ (189)	\$ 53,160	\$ (16,917)

Table of Contents**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Unaudited)****CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS**

(In thousands)

**Six Months Ended December 31, 2010**

	Parent	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
Net cash provided by (used in) operating activities	\$ 8,253	\$ (4,790)	\$ (2,135)	\$ 1,444	\$	\$ 2,772
Cash flows from investing activities:						
Capital expenditures and acquisitions		(387)	(2,484)	(1,286)		(4,157)
Proceeds from the disposal of property, plant and equipment			99			99
Decrease in restricted cash and investments		981				981
Purchases of marketable securities		(6,358)				(6,358)
Sales of marketable securities		1,000				1,000
Other		(218)				(218)
Net cash used in investing activities		(4,982)	(2,385)	(1,286)		(8,653)
Cash flows from financing activities:						
Payments on long-term debt		(6,633)	(22)			(6,655)
Purchase and other retirements of company stock	(5,377)					(5,377)
Dividends paid	(2,876)					(2,876)
Net cash provided by (used in) financing activities	(8,253)	(6,633)	(22)			(14,908)
Effect of exchange rate changes on cash				(32)		(32)
Net decrease in cash and cash equivalents		(16,405)	(4,542)	126		(20,821)
Cash and cash equivalents beginning of period		67,269	5,720	863		73,852
Cash and cash equivalents end of period	\$	\$ 50,864	\$ 1,178	\$ 989	\$	\$ 53,031

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## ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements (Unaudited)

## CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

(In thousands)

Six Months Ended December 31, 2009

	Parent	Issuer	Guarantors	Non-Guarantors	Eliminations	Consolidated
Net cash provided by (used in) operating activities	\$ 2,897	\$ 25,505	\$ (7,501)	\$ (52)	\$	\$ 20,849
Cash flows from investing activities:						
Capital expenditures		(241)	(4,029)	(1,045)		(5,315)
Acquisitions						
Proceeds from the disposal of property, plant and equipment			10,084			10,084
Other		19				19
Net cash used in investing activities		(222)	6,055	(1,045)		4,788
Cash flows from financing activities:						
Payments on long-term debt			(21)			(21)
Increase in deferred financing costs		(193)				(193)
Proceeds from issuance of common stock						
Excess tax benefits from share-based payment arrangements						
Dividends paid	(2,897)					(2,897)
Net cash provided by (used in) financing activities	(2,897)	(193)	(21)			(3,111)
Effect of exchange rate changes on cash				652		652
Net decrease in cash and cash equivalents		25,090	(1,467)	(445)		23,178
Cash and cash equivalents beginning of period		47,712	3,592	1,656		52,960
Cash and cash equivalents end of period	\$	\$ 72,802	\$ 2,125	\$ 1,211	\$	\$ 76,138

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**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**

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

The following discussion of financial condition and results of operations should be read in conjunction with (i) our Consolidated Financial Statements, and notes thereto, as set forth in this Quarterly Report on Form 10-Q and (ii) our Annual Report on Form 10-K for the year ended June 30, 2010.

**Forward-Looking Statements**

Management's discussion and analysis of financial condition and results of operations and other sections of this Quarterly Report contain forward-looking statements relating to our future results. Such forward-looking statements are identified by use of forward-looking words such as anticipates, believes, plans, estimates, expects, and intends or words or phrases of similar expression. These forward-looking statements are subject to management decisions and various assumptions, risks and uncertainties, including, but not limited to: the effects of terrorist attacks or conflicts or wars involving the United States or its allies or trading partners; the effects of labor strikes; weather conditions that may affect sales; volatility in fuel, utility, transportation and security costs; changes in global or regional political or economic conditions, including changes in governmental and central bank policies; changes in business conditions in the furniture industry, including changes in consumer spending patterns and demand for home furnishings; effects of our brand awareness and marketing programs, including changes in demand for our existing and new products; our ability to locate new design center sites and/or negotiate favorable lease terms for additional design centers or for the expansion of existing design centers; competitive factors, including changes in products or marketing efforts of others; pricing pressures; fluctuations in interest rates and the cost, availability and quality of raw materials; those matters discussed in Items 1A and 7A of our Annual Report on Form 10-K for the year ended June 30, 2010 and in our SEC filings; and our future decisions. Accordingly, actual circumstances and results could differ materially from those contemplated by the forward-looking statements.

**Critical Accounting Policies**

The Company's consolidated financial statements are based on the accounting policies used. Certain accounting policies require that estimates and assumptions be made by management for use in the preparation of the financial statements. Critical accounting policies are those that are central to the presentation of the Company's financial condition and results and that require subjective or complex estimates by management. There have been no material changes with respect to the Company's critical accounting policies from those disclosed in its 2010 Annual Report on Form 10-K filed with the SEC on August 19, 2010.

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**Results of Operations**

Our Company and the furniture industry have been dramatically affected by the Great Recession in the United States and abroad. High unemployment, volatile capital markets, depressed housing markets and tight consumer spending all put negative stress on the economy, which has significantly affected our business. In response, we took many actions that significantly reduced costs and changed many aspects of our business. We consolidated our manufacturing footprint to seven facilities in North America where approximately 75% of our products are made. We also converted our case goods manufacturing to custom, made to order manufacturing, providing a significant differentiating factor in the market. We believe we have retained sufficient scalable capacity to meet higher volumes of demand. We consolidated our logistics for both our wholesale and retail divisions resulting in one major wholesale distribution center and 17 retail service centers operated by the Company.

We have also changed our retail footprint. Where it made sense, we consolidated multiple design centers serving the same market into one, prominently located design center and closed underperforming locations. At December 31, 2010, the Company operated 143 design centers compared with 159 at June 30, 2009. Independent retailers operated 138 design centers at December 31, 2010 compared with 134 at June 30, 2009, with fifteen more international design centers than at June 30, 2009. The increase in international design centers improved our international net sales to 5.9% of our consolidated net sales in the quarter ended December 31, 2010.

In the current fiscal year, we continue to see year-over-year improvement in new orders and had our first two consecutive quarterly profits since December 2008. We have been hiring associates to support the ramping up of production in our manufacturing, adding highly skilled interior designers in our retail division, and increasing our spending in advertising to drive consumer traffic. In taking these actions to grow the business, we remain cautious but optimistic.

***Quarter Ended December 31, 2010 Compared to Quarter Ended December 31, 2009***

**Consolidated revenue** for the three months ended December 31, 2010 increased 21.0% to \$173.3 million, from \$143.3 million for the three months ended December 31, 2009, with increases in both the wholesale and retail segments. Written orders and backlogs also increased over the prior year for both segments. We attribute this growth to (i) a continued refresh of our marketing initiatives including promotional pricing and our interactive web site ethanalleninc.com, (ii) the continued use of national television media and an increase in direct mail media, emphasizing to targeted audiences our interior design services and the full line of our quality product offerings, (iii) increased use of digital communication including periodic distribution of e-magazines to increase client exposures and drive traffic to our website and design centers and (iv) the positive effects of repositioning the retail network.

**Wholesale revenue** for the second quarter of fiscal 2011 increased 19.3% to \$100.8 million from \$84.5 million in the prior year comparable period. The increase was primarily attributable to an increase in the incoming order rate due to our special savings promotions as well as our ability to increase production through operating efficiencies and increased staffing. These favorable factors were partially offset by a decrease in the number of total design centers globally from 284 last year to 281, and continued challenging conditions in the home furnishings market. The independently operated retail network grew by four design centers to 138 at December 31, 2010 but there were seven fewer Ethan Allen-operated design centers as noted below. There was also one less shipping day in the current quarter compared to last year.

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**Retail revenue** from Ethan Allen-operated design centers for the three months ended December 31, 2010 increased 22.3% to \$131.0 million from \$107.1 million for the three months ended December 31, 2009. We believe the increase in retail sales by Ethan Allen-operated design centers is due to our promotional marketing campaigns and the design solutions approach of our interior design professionals, our use of national television and direct



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mail media, our digital communications to prospective clients, and the positive effects of repositioning the retail network. These favorable factors were partially offset by a net decline of seven Ethan Allen-operated design centers between December 31, 2009 and December 31, 2010. We ended the current quarter with 143 Ethan Allen-operated design centers; two were closed during the quarter.

Comparable design centers are those which have been operating for at least 15 months. Minimal net sales, derived from the delivery of customer ordered product, are generated during the first three months of operations of newly opened (including relocated) design centers. Design centers acquired by us from independent retailers are included in comparable design centers sales in their 13th full month of Ethan Allen-owned operations. Quarter-over-quarter, written business of Ethan Allen-operated design centers increased 5.7% while comparable design centers written business increased 10.7%. Over that same period, there was a 4.5% increase in wholesale orders. The frequency of our promotional events as well as the timing of the end of those events can impact the orders booked in a given period.

We have made considerable investment within the retail network to strengthen the level of service, professionalism, interior design competence, efficiency, and effectiveness of the retail design center personnel. We believe that over time, we will continue to benefit from (i) our repositioning of the retail network, (ii) new product introductions, (iii) new marketing promotions, and our interior design affiliate (IDA) program, (iv) continued use of technology including our state-of-the-art website coupled with personal service from our design professionals, and (v) ongoing use of national television and other targeted advertising media.

**Gross profit** increased during the quarter to \$89.9 million (51.8% of net sales) from \$69.0 million (48.2% of net sales) in the prior year comparable quarter. The 30.2% increase in gross profit was primarily attributable to (i) the increase in net sales of 21.0%, with an overall increase in shipments in both market segments, (ii) streamlined and more efficient manufacturing including lower fixed costs with fewer manufacturing plants, and (iii) net improved pricing. The sales mix had a slightly favorable shift with retail sales representing a higher proportionate share of total sales in the current quarter (76%) compared to the prior year period (75%).

**Operating profit**, the elements of which are discussed in greater detail below, was impacted by the following items during the three months ended December 31, 2010 and 2009:

**Operating expenses** increased 6.8% to \$79.4 million from \$74.3 million in the prior year quarter and decreased as a percent of sales to 45.8% from 51.9% of sales in the prior year quarter. The dollar increase was driven primarily by higher selling and delivery costs from the higher net sales and an increase in advertising expenses.

**Consolidated operating income (loss)** for the three month period ended December 31, 2010 was income of \$10.5 million, or 6.0% of sales, as compared to a loss of \$5.3 million, or a negative 3.7% of sales, for the three months ended December 31, 2009. This improvement of \$15.8 million is due mostly to increased sales and operating efficiencies noted earlier.

**Wholesale operating income** for the three months ended December 31, 2010 was \$9.9 million, or 9.8% of sales, as compared to \$1.0 million, or 1.2% of sales, in the prior year comparable quarter. The increase of \$8.9 million was primarily attributable to an increase in sales volume and operating efficiencies of our manufacturing plants and wholesale logistics operations.

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**Retail operating loss** was \$1.2 million, or a negative 0.9% of sales, for the second quarter of fiscal 2011 compared to a loss of \$9.8 million, or a negative 9.1% of sales, for the second quarter of fiscal 2010. The improvement was primarily due to higher sales and cost savings from cost cutting actions taken.

**Interest and other miscellaneous income, net** increased \$0.1 million from the prior year comparable quarter.

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**Interest and other related financing costs** amounted to \$2.9 million in the current quarter as compared to \$3.0 million in the prior year comparable quarter. This amount consists primarily of interest expense on our senior unsecured debt. During the current quarter \$6.9 million of this debt was repurchased.

**Income tax benefit** for the three months ended December 31, 2010 totaled \$6.0 million as compared to a benefit of \$3.9 million for the three months ended December 31, 2009. Our effective tax rate for the current quarter was a negative 68.7% compared to a positive 53.9% in the prior year quarter. The current quarter effective tax rate was primarily impacted by a tax benefit from partial utilization of deferred tax assets previously subject to a full valuation allowance. The tax benefit was decreased by the tax expense on the current quarter's net income. The prior period effective tax rate was primarily impacted by the tax benefit recorded on the quarterly loss for the prior year quarter. The tax benefit was partially offset by the foreign valuation allowance on the Canadian net operating losses, state valuation allowance on certain state net operating losses, and by state income tax expense in states where the Company's subsidiaries file on a separate company basis.

**Net income (loss)** for the three months ended December 31, 2010, was income of \$14.7 million as compared to a loss of \$3.3 million in the prior year comparable period. This resulted in net income per diluted share of \$0.51 in the current quarter compared to a loss per diluted share of \$0.12 in the prior year quarter.

***Six Months Ended December 31, 2010 Compared to Six Months Ended December 31, 2009***

**Consolidated revenue** for the six months ended December 31, 2010 increased 21.0% to \$338.2 million, from \$279.5 million for the six months ended December 31, 2009, with increases in both the wholesale and retail segments for both the first and second quarters. This improvement partly reflects the strong increase in new orders, as well as our ability to increase production to service our backlog. We attribute this growth to (i) a continued refresh of our marketing initiatives including promotional pricing and our interactive web site ethanalleninc.com, (ii) the continued use of national television media and an increase in direct mail media, emphasizing to targeted audiences our interior design services and the full line of our quality product offerings, and (iii) increased use of digital communication including periodic distribution of e-magazines to increase client exposures and drive traffic to our website and design centers and (iv) the positive effects of repositioning the retail network.

**Wholesale revenue** for the first six months of fiscal 2011 increased 25.7% to \$208.3 million from \$165.8 million in the prior year comparable period. The increase was primarily attributable to an increase in the incoming order rate due to our special savings promotions as well as our ability to increase production through operating efficiencies and increased staffing. These favorable factors were partially offset by a decrease in the number of total design centers globally from 284 last year to 281 and continued challenging conditions in the home furnishings market. The independently operated retail network grew by four design centers to 138 at December 31, 2010 but there were seven fewer Ethan Allen-operated design centers as noted below. There was also one less shipping day in the current six month period than last year.

**Retail revenue** from Ethan Allen-operated design centers for the six months ended December 31, 2010 increased 19.9% to \$252.0 million from \$210.3 million for the six months ended December 31, 2009. We believe the increase in retail sales by Ethan Allen-operated design centers is due to our promotional marketing campaigns, our use of national television and direct mail media, our digital communications to prospective clients, and the positive effects of repositioning the retail network. There was a net decrease in the number of Ethan Allen-operated design centers to 143 as of December 31, 2010 as compared to 150 as of December 31, 2009. We closed ten design centers since December 31, 2009, including four in the current fiscal year.

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Comparable design centers are those which have been operating for at least 15 months. Minimal net sales, derived from the delivery of customer ordered product, are generated during the first three months of operations of newly opened (including relocated) design centers. Design centers acquired by us from independent retailers

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are included in comparable design centers sales in their 13th full month of Ethan Allen-owned operations. Year-over-year, written business of Ethan Allen-operated design centers increased 1.4% while comparable design centers written business increased 6.9%. Over that same period, there was a 3.1% increase in wholesale orders.

We have made considerable investment within the retail network to strengthen the level of service, professionalism, interior design competence, efficiency, and effectiveness of the retail design center personnel. We believe that over time, we will benefit from (i) our repositioning of the retail network, (ii) new product introductions, (iii) new marketing initiatives such as our special savings and one piece at a time advertising campaigns, and our interior design affiliate (IDA) program, (iv) continued use of technology including our state-of-the-art website coupled with personal service from our design professionals, and (v) ongoing use of national television and other targeted advertising media.

**Gross profit** increased during the period to \$172.2 million (50.9% of net sales) from \$127.3 million (45.6% of net sales) in the prior year comparable period. The 35.3% increase in gross profit was primarily attributable to (i) the increase in net sales of 21.0%, with an overall increase in shipments in both market segments, and (ii) streamlined and more efficient manufacturing, resulting in decreased fixed costs due to fewer manufacturing plants, including a \$6.6 million reduction due to prior year accelerated depreciation charges related to restructuring actions, and (iii) a modest sales price increase. The sales mix of retail sales to total sales in the period remained relatively constant (75%).

**Operating profit**, the elements of which are discussed in greater detail below, was impacted by the following items during the six months ended December 31, 2010 and 2009:

**Operating expenses** increased 5.2% to \$156.4 million from \$148.7 million in the prior year period, and decreased as a percent of sales to 46.2% from 53.2% of sales in the prior year period. Operating expenses increased in total due to the impact of increased sales on selling expenses and an increase in advertising expenses, but were down as a percentage of sales due to the higher volume of sales.

**Consolidated operating income (loss)** for the six month period ended December 31, 2010 was income of \$15.9 million, or 4.7% of sales, as compared to a loss of \$21.4 million, or a negative 7.6% of sales, for the six months ended December 31, 2009. This improvement of \$37.2 million is due mostly to increased sales as well as cost savings realized this year.

**Wholesale operating income** for the six months ended December 31, 2010 was \$21.8 million, or 10.5% of sales, as compared to a loss of \$3.6 million, or a negative 2.2% of sales, in the prior year comparable period. The increase of \$25.5 million was primarily attributable to an increase in sales volume and current year efficiencies and savings relating to the closure of certain manufacturing plants, including the accelerated depreciation incurred in the prior year.

**Retail operating loss** was \$5.5 million, or a negative 2.2% of sales, for the first six months of fiscal 2011 compared to a loss of \$21.1 million, or a negative 10.1% of sales, for the comparable period of fiscal 2010. The improvement was primarily due to current year improvement in sales as well as cost savings due to the benefit of the cost cutting actions taken.

**Interest and other miscellaneous income, net** increased \$2.5 million from the prior year comparable period. The increase was primarily due to the recording of a \$1.5 million out of period adjustment related to non-operating income recorded in the first quarter of the current fiscal year.

**Interest and other related financing costs** amounted \$5.9 million in the current year and \$6.0 million in the prior year. This amount consists primarily of interest expense on our senior unsecured debt.

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**Income tax benefit** for the six months ended December 31, 2010 totaled \$4.2 million as compared to a benefit of \$8.6 million for the six months ended December 31, 2009. Our effective tax rate for the current period was a negative 29.7% compared to a positive 33.7% in the prior year to date. The current period effective tax rate was primarily impacted by a tax benefit from partial utilization of deferred tax assets previously subject to a full valuation allowance. The tax benefit was decreased by the tax expense on the current period's net income.

**Net income (loss)** for the six months ended December 31, 2010, was income of \$18.6 million as compared to a loss of \$16.9 million in the prior year comparable period. This resulted in net income per diluted share of \$0.64 in the current period compared to a loss per diluted share of \$0.58 in the prior year period.

**Liquidity and Capital Resources**

At December 31, 2010, we held cash and cash equivalents of \$53.0 million, marketable securities of \$16.3 million, and restricted cash and investments of \$16.3 million. Our principal sources of liquidity include cash and cash equivalents, marketable securities, cash flow from operations, the Facility (as defined below), and borrowings.

In September 2005, we issued \$200.0 million in ten-year senior unsecured notes due 2015 (the Senior Notes). The Senior Notes were issued by Global, bearing an annual coupon rate of 5.375% with interest payable semi-annually in arrears on April 1 and October 1. We have used the net proceeds of \$198.4 million to improve our retail network, invest in our manufacturing and logistics operations, and for other general corporate purposes. During the current fiscal year, the Company repurchased \$6.9 million of the Senior Notes in several unsolicited open market transactions.

In fiscal 2009, the Company established a \$60 million, three-year senior secured, asset-based, revolving credit facility (the Facility). The Facility provides revolving credit financing of up to \$60 million, subject to borrowing base availability. Revolving loans under the Agreement bear, at the Company's option, interest at an annual rate of either:

(a) London Interbank Offered rate (LIBOR) plus 3.25% to 4.25%, based on the average availability, or

(b) the higher of (i) a prime rate, (ii) the federal funds effective rate plus 0.50%, or (iii) a LIBOR rate plus 1.00% plus, in each case, an additional 2.25% to 3.25%, based on average availability.

The Facility is secured by all property owned, leased or operated by the Company in the United States excluding any real property owned by the Company and contains customary covenants which may limit the Company's ability to incur debt; engage in mergers and consolidations; make restricted payments (including dividends); sell certain assets; and make investments. At December 31, 2010, we had no revolving loans and \$1.2 million of standby letters of credit outstanding under the Facility. Remaining availability under the revolver totaled \$58.8 million subject to limitations set forth in the agreement and as a result, the coverage charge ratio, or other restricted payment limitations did not apply.

As of December 31, 2010, we are in compliance with all covenants of the Facility and our Senior Notes.



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A summary of net cash provided by (used in) operating, investing, and financing activities for the six month periods ended December 31, 2010 and 2009 is provided below (in millions):

	Six Months Ended December 31,	
	2010	2009
<b>Operating Activities</b>		
Net income plus depreciation and amortization	\$ 29.5	\$ 1.4
Working capital	(26.5)	26.6
Other (non-cash items, long-term assets and liabilities)	(0.2)	(7.2)
Total provided by operating activities	\$ 2.8	\$ 20.8
<b>Investing Activities</b>		
Capital expenditures	\$ (4.0)	\$ (5.3)
Acquisitions	(0.2)	
Asset sales	0.1	10.1
Decrease in restricted cash and investments	1.0	
Net purchases of marketable securities	(5.4)	
Other	(0.2)	
Total provided by (used in) investing activities	\$ (8.7)	\$ 4.8
<b>Financing Activities</b>		
Common share repurchases	\$ (5.4)	\$
Early extinguishment of debt	(6.6)	
Payment of dividends	(2.9)	(2.9)
Payment of deferred financing costs		(0.2)
Total used in financing activities	\$ (14.9)	\$ (3.1)

### *Operating Activities*

Compared to the same six month period in fiscal year 2010, cash provided by operating activities decreased \$18.0 million. This occurred due to a \$53.1 million decrease in cash generated from working capital (accounts receivable, inventories, prepaid and other current assets, customer deposits, payables, accrued expenses, and other current liabilities). The decrease in cash generated from working capital was primarily attributable to (i) a \$13.8 million decrease in customer deposits during the six months ended December 31, 2010 as a result of increased production to reduce the backlog, compared to a \$4.9 million increase during the six months ended December 31, 2009 (or a net decline in cash generated of \$18.7 million), (ii) a prepaid and other current assets increase of \$10.7 million during the six months ended December 31, 2010 due primarily to an increase in income taxes receivable related to a change in tax method, compared to a \$8.0 million decrease in the comparable prior year period due to a tax refund received, and (iii) relatively steady inventory levels during the six months ended December 31, 2010 compared to substantial decreases in inventory levels which occurred during the six months ended December 31, 2009, in response to the economic environment (which resulted in a decrease in \$17.2 million in cash generated from inventory in the six months ended December 31, 2010). Partly offsetting the decrease in working capital was a \$35.5 million improvement in net income (including \$6.6 million in accelerated depreciation in fiscal 2010).

### *Investing Activities*

Investing activities went from a source of funds of \$4.8 during the six months ended December 31, 2009 to a use of funds of \$8.7 million during the six months ended December 31, 2010. This net change of approximately \$13.5 million was primarily attributable to a decrease in proceeds from the sale of retail properties compared to the first six months of fiscal 2010, and the purchase of additional marketable securities during the

first six months of fiscal

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2011 in order to improve our investment earnings. During the period ended December 31, 2010, we continued our capital spending at a reduced rate. We anticipate that cash from operations will be sufficient to fund future capital expenditures.

***Financing Activities***

As compared to the same period in fiscal year 2010, \$11.8 million more cash was used in financing activities during the six months ended December 31, 2010, primarily as a result of Senior Note repurchases, and the resumption of our stock repurchase activity. We repurchased \$6.9 million of our Senior Notes in several unsolicited open market transactions during the first six months of fiscal 2011. We may make additional unsolicited repurchases of our Senior Notes from time to time in the future, but we have no specific plans to do so. We also repurchased 386,886 shares of our common stock due to our ability to generate excess cash and the favorable stock price. The total number of shares repurchased includes shares which were repurchased in transactions initiated during the fourth quarter of fiscal year 2010 but which settled during the first quarter of fiscal year 2011. The Company has continuously paid dividends every quarter since 1996. On November 16, 2010, the Board declared a dividend of \$0.05 per common share, payable on January 25, 2011, to shareholders of record as of January 10, 2011. If economic conditions worsen, the Company may reduce our quarterly dividends.

As of December 31, 2010, our outstanding debt totaled \$196.5 million, the current and long-term portions of which amounted to \$3.9 million and \$192.6 million, respectively. The aggregate scheduled maturities of long-term debt for each of the next five fiscal years are: \$3.9 million in fiscal 2011, and less than \$0.1 million in each of fiscal 2012 through 2015. The balance of our long-term Senior Notes (\$192.4 million) matures in September 2015 (fiscal 2016).

There has been no material change to the amount or timing of cash payments related to our outstanding contractual obligations as set forth in Part II, Item 7 *Management's Discussion and Analysis of Financial Condition and Results of Operation* of our Annual Report on Form 10-K for the year ended June 30, 2010 as filed with the Securities and Exchange Commission on August 19, 2010.

We believe that our cash flow from operations, together with our other available sources of liquidity, will be adequate to make all required payments of principal and interest on our debt, to permit anticipated capital expenditures, and to fund working capital and other cash requirements. As of December 31, 2010, we had working capital of \$131.4 million compared to \$114.0 million at June 30, 2010, an increase of \$17.4 million (15.3%). The Company had a current ratio of 2.0 to 1 at December 31, 2010 and 1.8 to 1 at June 30, 2010.

In addition to using available cash to fund changes in working capital, necessary capital expenditures, acquisition activity, the repayment of debt, and the payment of dividends, we have been authorized by our Board of Directors to repurchase our common stock, from time to time, either directly or through agents, in the open market at prices and on terms satisfactory to us. All of our common stock repurchases and retirements are recorded as treasury stock and result in a reduction of shareholders' equity.

During the six months ended December 31, 2010 and 2009, we repurchased and/or retired the following shares of our common stock:

<b>Six Months Ended</b>	
<b>December 31,</b>	
<b>2010</b>	<b>2009</b>

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Common shares repurchased		204,286
Cost to repurchase common shares	\$	2,787,777
Average price per share	\$	13.65

As of December 31, 2010, we had a remaining Board authorization to repurchase 1,180,783 shares.

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**Off-Balance Sheet Arrangements and Other Commitments, Contingencies and Contractual Obligations**

We do not utilize or employ any off-balance sheet arrangements, including special-purpose entities, in operating our business. As such, we do not maintain any (i) retained or contingent interests, (ii) derivative instruments (other than as specified below), or (iii) variable interests which could serve as a source of potential risk to our future liquidity, capital resources and results of operations.

We may, from time to time in the ordinary course of business, provide guarantees on behalf of selected affiliated entities or become contractually obligated to perform in accordance with the terms and conditions of certain business agreements. The nature and extent of these guarantees and obligations may vary based on our underlying relationship with the benefiting party and the business purpose for which the guarantee or obligation is being provided. Details of those arrangements for which we act as guarantor or obligor are provided below.

**Retailer-Related Guarantees**

***Independent Retailer Credit Facility***

In June 2009, we obligated ourselves, on behalf of one of our independent retailers, with respect to a \$0.5 million credit facility (the Amended Credit Facility). This obligation requires us, in the event of the retailer's default under the Amended Credit Facility, to repurchase the retailer's inventory at cost, applying such purchase price to the retailer's outstanding indebtedness under the Amended Credit Facility. Our obligation remains in effect for the life of the term loan. The agreement expires in April 2011. We believe this obligation will expire without requiring funding by us.

***Ethan Allen Consumer Credit Program***

The terms and conditions of our consumer credit program, which is financed and administered by a third-party financial institution on a non-recourse basis to Ethan Allen, are set forth in an agreement between the Company and that financial service provider (the Program Agreement). In February and June 2010, the Company modified the Program Agreement to comply with recent changes in laws and made certain other changes to fees payable to the service provider. Any independent retailer choosing to participate in the consumer credit program is required to enter into a separate agreement with that same third-party financial institution which sets forth the terms and conditions under which the retailer is to perform in connection with its offering of consumer credit to its customers (the Retailer Agreement). We have obligated ourselves on behalf of any independent retailer choosing to participate in our consumer credit program by agreeing, in the event of default, breach, or failure of the independent retailer to perform under such Retailer Agreement, to take on certain responsibilities of the independent retailer, including, but not limited to, delivery of goods and reimbursement of customer deposits. Customer receivables originated by independent retailers remain non-recourse to Ethan Allen. Our obligation remains in effect for the term of the Program Agreement that expires in July 2014. While the maximum potential amount of future payments (undiscounted) that we could be required to make under this obligation is indeterminable, recourse provisions exist that would enable us to recover, from the independent retailer, any amount paid or incurred by us related to our performance. Based on the underlying creditworthiness of our independent retailers, including their historical ability to satisfactorily perform in connection with the terms of our consumer credit program, we believe this obligation will expire without requiring funding by us. To ensure funding for delivery of products sold, the terms of this agreement also contain a right for the credit card issuer to demand from the Company collateral of up to \$12 million if the Company does not meet certain covenants. As of December 31, 2010, the Company had established a restricted cash and investment collateral account of \$6 million to satisfy the current collateral requirement.

**Product Warranties**

Our products, including our case goods, upholstery and home accents, generally carry explicit product warranties that extend from one to ten years and are provided based on terms that are generally accepted in the industry. All of our domestic independent retailers are required to enter into, and perform in accordance with the terms and

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conditions of, a warranty service agreement. We record provisions for estimated warranty and other related costs at time of sale based on historical warranty loss experience and make periodic adjustments to those provisions to reflect actual experience. On rare occasion, certain warranty and other related claims involve matters of dispute that ultimately are resolved by negotiation, arbitration or litigation. In certain cases, a material warranty issue may arise which is beyond the scope of our historical experience. We provide for such warranty issues as they become known and are deemed to be both probable and estimable. It is reasonably possible that, from time to time, additional warranty and other related claims could arise from disputes or other matters beyond the scope of our historical experience. As of December 31, 2010, our product warranty liability totaled \$0.8 million.

***Business Outlook***

While there have been signs of improvement in the overall economy including strong equity markets performance and slight improvements in unemployment, we cannot forecast when other economic factors important to our customer base including depressed housing values and housing turnover and tight consumer credit, all of which have a negative impact on our business, will improve meaningfully. As business conditions have gradually improved, we continue to hire for both our manufacturing and retail operations and continue to invest in incremental advertising to drive traffic to our design centers. While optimistic about our long-term outlook, we remain cautious.

As macro-economic factors change, it is also possible that our costs associated with production (including raw materials and labor), distribution (including freight and fuel charges), and retail operations (including compensation and benefits, delivery and warehousing, occupancy, and advertising expenses) may increase. We may also experience production difficulties as we continue to increase capacity of our remaining manufacturing plants to match demand, and to improve efficiency in our custom case goods production. We cannot reasonably predict when, or to what extent, such events may occur or what effect, if any, such events may have on our consolidated financial condition or results of operations.

The home furnishings industry remains extremely competitive with respect to both the sourcing of products and the wholesale and retail sale of those products. Domestic manufacturers continue to face pricing pressures because of the manufacturing capabilities of other countries, particularly within Asia. In response to these pressures, a large number of U.S. furniture manufacturers have increased their overseas sourcing to retain market share. While we have also turned to overseas sourcing to remain competitive, we choose to differentiate ourselves by maintaining a substantial domestic manufacturing base. Consequently, we make and/or assemble approximately 75% of our products domestically. We continue to believe that a balanced approach to product sourcing, which includes the domestic manufacture of certain product offerings coupled with the import of other selected products, provides the greatest degree of flexibility and is the most effective approach to ensuring that acceptable levels of quality, service and value are attained.

Our retail strategy involves (i) a continued focus on providing a wide array of product solutions and superior customer service, (ii) the opening of new or relocated design centers in more prominent locations, while encouraging independent retailers to do the same, and (iii) leveraging the use of technology and personal service within our retail network, and (iv) further expansion internationally. We believe this strategy provides an opportunity to grow our business.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

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There have been no material changes to the market risks disclosed in our Annual Report on Form 10-K for the year ended June 30, 2010 as filed with the Securities and Exchange Commission on August 19, 2010.



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**Item 4. Controls and Procedures**

**Management's Report on Disclosure Controls and Procedures**

Our management, including the Chairman of the Board and Chief Executive Officer ( CEO ) and the Vice President-Finance ( VPF ), conducted an evaluation of the effectiveness of disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act )) as of the end of the period covered by this report. Based on such evaluation, the CEO and VPF have concluded that, as of December 31, 2010, our disclosure controls and procedures were effective in ensuring that material information relating to us (including our consolidated subsidiaries), which is required to be disclosed by us in our periodic reports filed or submitted under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (ii) accumulated and communicated to management, including the CEO and VPF, as appropriate, to allow timely decisions regarding required disclosure.

**Changes in Internal Control over Financial Reporting**

There have been no changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter ended December 31, 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II - OTHER INFORMATION**

**Item 1. Legal Proceedings**

There have been no material changes to the matters discussed in Part I, Item 3 - *Legal Proceedings* in our Annual Report on Form 10-K for the year ended June 30, 2010 as filed with the Securities and Exchange Commission on August 19, 2010.

**Item 1A. Risk Factors**

There have been no material changes to the market risks disclosed in our Annual Report on Form 10-K for the year ended June 30, 2010 as filed with the Securities and Exchange Commission on August 19, 2010.

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

*Issuer Purchases of Equity Securities*

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There were no purchases made by or on behalf of the Company or any affiliated purchaser (as defined in Rule 10b-18(a)(3) under the Exchange Act) of our common stock during the three months ended December 31, 2010. The maximum number of shares that may yet be purchased under the plans or program is 1,180,783.

### **Item 3. Defaults Upon Senior Securities**

Not applicable.

### **Item 4. Reserved**

### **Item 5. Other Information**

Not applicable.

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**Item 6. Exhibits**

<b>Exhibit Number</b>		<b>Description</b>
31.1	Rule 13a-14(a)	Certification of Principal Executive Officer
31.2	Rule 13a-14(a)	Certification of Principal Financial Officer
32.1	Section 1350	Certification of Principal Executive Officer
32.2	Section 1350	Certification of Principal Financial Officer

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ETHAN ALLEN INTERIORS INC.  
(Registrant)

DATE: February 2, 2011

BY: /s/ M. Farooq Kathwari  
M. Farooq Kathwari  
Chairman, President and Chief Executive Officer  
(Principal Executive Officer)

DATE: February 2, 2011

BY: /s/ David R. Callen  
David R. Callen  
Vice President, Finance & Treasurer  
(Principal Financial Officer and Principal Accounting Officer)

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EXHIBIT INDEX

<b>Exhibit Number</b>		<b>Exhibit</b>
31.1	Rule 13a-14(a) Certification of Principal Executive Officer	
31.2	Rule 13a-14(a) Certification of Principal Financial Officer	
32.1	Section 1350 Certification of Principal Executive Officer	
32.2	Section 1350 Certification of Principal Financial Officer	