

BASSETT FURNITURE INDUSTRIES INC

Form 10-Q

March 31, 2016

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

**For the quarterly period ended February 27, 2016**

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 No. 0-209

**BASSETT FURNITURE INDUSTRIES, INCORPORATED**

(Exact name of Registrant as specified in its charter)

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Virginia 54-0135270  
(State or other jurisdiction (I.R.S. Employer  
of incorporation or organization) Identification No.)

3525 Fairystone Park Highway

Bassett, Virginia 24055

(Address of principal executive offices)

(Zip Code)

(276) 629-6000

(Registrant's telephone number, including area code)

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, 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 for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company.

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

At March 18, 2016, 10,892,609 shares of common stock of the Registrant were outstanding.



BASSETT FURNITURE INDUSTRIES, INCORPORATED AND SUBSIDIARIES

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(In thousands except per share data)

|  | <b>Quarter Ended</b>             |                                  |
|--|----------------------------------|----------------------------------|
|  | <b>February<br/>27,<br/>2016</b> | <b>February<br/>28,<br/>2015</b> |
| Sales revenue:   |                                  |                                  |
| Furniture and accessories  | \$92,402                         | \$89,548                         |
| Logistics  | 14,471                           | 3,259                            |
| Total sales revenue  | 106,873                          | 92,807                           |
| Cost of furniture and accessories sold   | 41,986                           | 41,930                           |
| Selling, general and administrative expenses excluding new store pre-opening costs | 58,957                           | 47,475                           |
| New store pre-opening costs  | 139                              | -                                |
| Lease exit costs   | -                                | 419                              |
| Asset impairment charges   | -                                | 106                              |
| Income from operations   | 5,791                            | 2,877                            |
| Remeasurement gain on acquisition of affiliate                                     | -                                | 7,212                            |
| Other loss, net  | (657 )                           | (622 )                           |
| Income before income taxes   | 5,134                            | 9,467                            |
| Income tax expense   | 1,900                            | 3,511                            |
| Net income   | \$3,234                          | \$5,956                          |
| Retained earnings-beginning of period  | 120,904                          | 106,339                          |
| Cash dividends   | (962 )                           | (821 )                           |
| Retained earnings-end of period  | \$123,176                        | \$111,474                        |
| Basic earnings per share   | \$0.30                           | \$0.57                           |

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|                            |        |        |
|----------------------------|--------|--------|
| Diluted earnings per share | \$0.30 | \$0.56 |
| Dividends per share        | \$0.09 | \$0.08 |

The accompanying notes to condensed consolidated financial statements are an integral part of the condensed consolidated financial statements.

PART I – FINANCIAL INFORMATION – CONTINUED

ITEM 1. FINANCIAL STATEMENTS

BASSETT FURNITURE INDUSTRIES, INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

FOR THE PERIODS ENDED FEBRUARY 27, 2016 AND FEBRUARY 28, 2015 – UNAUDITED

(In thousands)

|  | <b>Quarter Ended</b> |                 |
|--|----------------------|-----------------|
|  | <b>February</b>      | <b>February</b> |
|  | <b>27,</b>           | <b>28,</b>      |
|  | <b>2016</b>          | <b>2015</b>     |
| Net income   | \$3,234              | \$ 5,956        |
| Other comprehensive income:  |                      |                 |
| Amortization associated with supplemental executive retirement defined benefit plan (SERP) | 91                   | 59              |
| Income taxes related to SERP   | (34 )                | (22 )           |
| Other comprehensive income, net of tax   | 57                   | 37              |
| Total comprehensive income   | \$3,291              | \$ 5,993        |

The accompanying notes to condensed consolidated financial statements are an integral part of the condensed consolidated financial statements.

PART I – FINANCIAL INFORMATION – CONTINUEDITEM 1. FINANCIAL STATEMENTSBASSETT FURNITURE INDUSTRIES, INCORPORATED AND SUBSIDIARIESCONDENSED CONSOLIDATED BALANCE SHEETSFEBRUARY 27, 2016 AND NOVEMBER 28, 2015

(In thousands)

|  | <b>(Unaudited)</b>                    |                                       |
|--|---------------------------------------|---------------------------------------|
|  | <b>February<br/>27,<br/><br/>2016</b> | <b>November<br/>28,<br/><br/>2015</b> |
| <b><u>Assets</u></b>                               |                                       |                                       |
| <b>Current assets</b>                              |                                       |                                       |
| Cash and cash equivalents                          | \$ 25,113                             | \$ 36,268                             |
| Short-term investments                             | 23,125                                | 23,125                                |
| Accounts receivable, net                           | 19,741                                | 21,197                                |
| Inventories  | 57,539                                | 59,896                                |
| Other current assets                               | 8,124                                 | 6,798                                 |
| Total current assets                               | 133,642                               | 147,284                               |
| Property and equipment, net                        | 101,810                               | 96,104                                |
| Deferred income taxes                              | 12,634                                | 13,471                                |
| Goodwill and other intangible assets               | 17,601                                | 17,682                                |
| Other  | 7,967                                 | 8,002                                 |
| Total long-term assets                             | 38,202                                | 39,155                                |
| <b>Total assets</b>                                | <b>\$ 273,654</b>                     | <b>\$ 282,543</b>                     |
| <b><u>Liabilities and Stockholders' Equity</u></b> |                                       |                                       |
| <b>Current liabilities</b>                         |                                       |                                       |
| Accounts payable                                   | \$ 20,234                             | \$ 20,916                             |
| Accrued compensation and benefits                  | 11,472                                | 14,345                                |
| Customer deposits                                  | 23,284                                | 23,999                                |
| Dividends payable                                  | -                                     | 2,184                                 |
| Current portion of long-term debt                  | 5,855                                 | 5,273                                 |
| Other accrued liabilities                          | 10,191                                | 13,133                                |
| Total current liabilities                          | 71,036                                | 79,850                                |
| <b>Long-term liabilities</b>                       |                                       |                                       |
| Post employment benefit obligations                | 12,674                                | 12,694                                |



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|                             |        |        |
|-----------------------------|--------|--------|
| Notes payable               | 7,793  | 8,500  |
| Other long-term liabilities | 3,918  | 4,133  |
| Total long-term liabilities | 24,385 | 25,327 |

**Stockholders' equity**

|   |                   |                   |
|---|-------------------|-------------------|
| Common stock                                      | 54,463            | 54,580            |
| Retained earnings                                 | 123,176           | 120,904           |
| Additional paid-in capital                        | 3,215             | 4,560             |
| Accumulated other comprehensive loss              | (2,621 )          | (2,678 )          |
| Total stockholders' equity                        | 178,233           | 177,366           |
| <b>Total liabilities and stockholders' equity</b> | <b>\$ 273,654</b> | <b>\$ 282,543</b> |

The accompanying notes to condensed consolidated financial statements are an integral part of the condensed consolidated financial statements.

PART I – FINANCIAL INFORMATION – CONTINUEDITEM 1. FINANCIAL STATEMENTSBASSETT FURNITURE INDUSTRIES, INCORPORATED AND SUBSIDIARIESCONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWSFOR THE PERIODS ENDED FEBRUARY 27, 2016 AND FEBRUARY 28, 2015 – UNAUDITED

(In thousands)

|   | <b>Quarter Ended</b>     |                          |
|---|--------------------------|--------------------------|
|   | <b>February 27, 2016</b> | <b>February 28, 2015</b> |
| <b>Operating activities:</b>  |                          |                          |
| Net income  | \$3,234                  | \$5,956                  |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |                          |                          |
| Depreciation and amortization   | 2,817                    | 2,146                    |
| Equity in undistributed income of investments and unconsolidated affiliated companies       | -                        | (220 )                   |
| Provision for restructuring and asset impairment charges                                    | -                        | 106                      |
| Non-cash portion of lease exit costs  | -                        | 419                      |
| Remeasurement gain on acquisition of affiliate  | -                        | (7,212 )                 |
| Deferred income taxes   | 803                      | 4,278                    |
| Other, net  | 294                      | 549                      |
| Changes in operating assets and liabilities:  |                          |                          |
| Accounts receivable   | 1,509                    | 1,021                    |
| Inventories   | 2,357                    | (4,404 )                 |
| Other current assets  | (1,326 )                 | (2,325 )                 |
| Customer deposits   | (715 )                   | 3,122                    |
| Accounts payable and accrued liabilities  | (6,553 )                 | (4,341 )                 |
| <b>Net cash provided by (used in) operating activities</b>                                  | <b>2,420</b>             | <b>(905 )</b>            |
| <b>Investing activities:</b>  |                          |                          |
| Purchases of property and equipment   | (8,568 )                 | (3,918 )                 |
| Proceeds from sales of property and equipment   | 20                       | -                        |
| Cash paid for business acquisition, net of cash acquired                                    | -                        | (7,374 )                 |
| Capital contribution to affiliate   | -                        | (1,345 )                 |
| <b>Net cash used in investing activities</b>  | <b>(8,548 )</b>          | <b>(12,637 )</b>         |
| <b>Financing activities:</b>  |                          |                          |
| Cash dividends  | (3,146 )                 | (2,923 )                 |
| Proceeds from the exercise of stock options   | -                        | 1,410                    |
| Other issuance of common stock  | 84                       | 85                       |
| Repurchases of common stock   | (1,774 )                 | (191 )                   |
| Excess tax benefits from stock-based compensation   | -                        | 456                      |

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|  |                 |                  |
|--|-----------------|------------------|
| Repayments of notes payable                            | (4,395 )        | (372 )           |
| Proceeds from equipment loans                          | 4,204           | 660              |
| <b>Net cash used in financing activities</b>           | <b>(5,027 )</b> | <b>(875 )</b>    |
| <b>Change in cash and cash equivalents</b>             | <b>(11,155)</b> | <b>(14,417 )</b> |
| <b>Cash and cash equivalents - beginning of period</b> | <b>36,268</b>   | <b>26,673</b>    |
|  |                 | .                |
| <b>Cash and cash equivalents - end of period</b>       | <b>\$25,113</b> | <b>\$12,256</b>  |

The accompanying notes to condensed consolidated financial statements are an integral part of the condensed consolidated financial statements.

PART I-FINANCIAL INFORMATION-CONTINUED

BASSETT FURNITURE INDUSTRIES, INCORPORATED AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-UNAUDITED

FEBRUARY 27, 2016

(Dollars in thousands except share and per share data)

**1. Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and footnotes required by accounting principles generally accepted in the United States (“GAAP”) for complete financial statements. In our opinion, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included.

References to “ASC” included hereinafter refer to the Accounting Standards Codification established by the Financial Accounting Standards Board as the source of authoritative GAAP.

The condensed consolidated financial statements include the accounts of Bassett Furniture Industries, Incorporated (“Bassett”, “we”, “our”, or the “Company”) and our wholly-owned subsidiaries of which we have a controlling interest. The equity method of accounting was used for our investment in an affiliated company in which we exercised significant influence but did not maintain a controlling interest prior to the Zenith acquisition mentioned below. In accordance with ASC Topic 810, we have evaluated our licensees and certain other entities to determine whether they are variable interest entities (“VIEs”) of which we are the primary beneficiary and thus would require consolidation in our financial statements. To date we have concluded that none of our licensees nor any other of our counterparties represent VIEs.

Revenue from the sale of furniture and accessories is reported in the accompanying condensed consolidated statements of income net of estimates for returns and allowances.

***Zenith Acquisition***

Prior to February 2, 2015 we held a 49% interest in Zenith Freight Lines, LLC (“Zenith”) for which we used the equity method of accounting. On February 2, 2015 we acquired the remaining 51% ownership interest (see Note 3, Business Combinations). Accordingly, the results of Zenith have been consolidated with our results since the date of the acquisition. Sales of logistical services from Zenith to our wholesale and retail segments have been eliminated, and Zenith’s operating costs and expenses since the date of acquisition are included in selling, general and administrative expenses in our condensed consolidated statements of income. Our equity in the earnings of Zenith prior to the date of the acquisition is included in other loss, net, in the accompanying condensed consolidated statements of income.

## **2. Interim Financial Presentation**

All intercompany accounts and transactions have been eliminated in the condensed consolidated financial statements. The results of operations for the three months ended February 27, 2016 are not necessarily indicative of results for the full fiscal year. These interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended November 28, 2015.

We calculate an anticipated effective tax rate for the year based on our annual estimates of pretax income and use that effective tax rate to record our year-to-date income tax provision. Any change in annual projections of pretax income could have a significant impact on our effective tax rate for the respective quarter. Our effective tax rates for the quarters ended February 27, 2016 and February 28, 2015 differ from the federal statutory rate primarily due to the effects of state income taxes and various permanent differences.

PART I-FINANCIAL INFORMATION-CONTINUED

BASSETT FURNITURE INDUSTRIES, INCORPORATED AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-UNAUDITED

FEBRUARY 27, 2016

(Dollars in thousands except share and per share data)

**3. Business Combination – Acquisition of Zenith**

Prior to February 2, 2015 we held a 49% interest in Zenith for which we used the equity method of accounting. Zenith provides domestic transportation and warehousing services primarily to furniture manufacturers and distributors and also provides home delivery services to furniture retailers. We historically have contracted with Zenith to provide substantially all of our domestic freight, transportation and warehousing needs for the wholesale business. In addition, Zenith provides home delivery services for many of our Company-owned retail stores. On February 2, 2015, we acquired the remaining 51% of Zenith in exchange for cash, Bassett common stock and a note payable with a total fair value of \$19,111. The value of the Bassett common stock was based on the closing market price of our shares on the acquisition date, discounted for lack of marketability due to restrictions on the seller's ability to transfer the shares. The restrictions on one half of the shares expired on the first anniversary of the acquisition, with the remainder expiring on the second anniversary. The note is payable in three annual installments of \$3,000 each beginning February 2, 2016, and has been discounted to its fair value as of the date of the acquisition based on our estimated borrowing rate.

The carrying value of our 49% interest in Zenith prior to the acquisition was \$9,480 (see Note 8, unconsolidated affiliated company). In connection with the acquisition, this investment was remeasured to a fair value of \$16,692 resulting in the recognition of a gain of \$7,212 during the quarter ended February 28, 2015. The impact of this gain upon our basic and diluted earnings per share was approximately \$0.42, net of the related tax expense. The remeasured fair value of our prior interest in Zenith was estimated based on the fair value of the consideration transferred to acquire the remaining 51% of Zenith less an estimated control premium.

Under the acquisition method of accounting, the fair value of the consideration transferred along with the fair value of our previous 49% interest in Zenith was allocated to the tangible and intangible assets acquired and the liabilities assumed based on their estimated fair values as of the acquisition date with the remaining unallocated amount recorded as goodwill.

The total fair value of the acquired business was determined as follows:

|  |          |
|--|----------|
| Fair value of consideration transferred in exchange for 51% of Zenith:                                   |          |
| Cash   | \$9,000  |
| Bassett common stock, 89,485 shares, par value \$5.00 per share, fair value at closing \$18.72 per share | 1,675    |
| Note payable   | 8,436    |
| Total fair value of consideration transferred to seller  | 19,111   |
| Less effective settlement of previous amounts payable to Zenith at acquisition                           | (3,622 ) |
| Total fair value of consideration net of effective settlement  | 15,489   |
| Fair value of Bassett's previous 49% interest in Zenith  | 16,692   |
| <br>   |          |
| Total fair value of acquired business  | \$32,181 |

PART I-FINANCIAL INFORMATION-CONTINUED

BASSETT FURNITURE INDUSTRIES, INCORPORATED AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-UNAUDITED

FEBRUARY 27, 2016

(Dollars in thousands except share and per share data)

The allocation of the fair value of the acquired business is as follows:

|   |          |
|---|----------|
| Identifiable assets acquired:             |          |
| Acquired cash and cash equivalents        | \$1,677  |
| Accounts receivable, net                  | 3,399    |
| Prepaid expenses and other current assets | 496      |
| Property and equipment                    | 18,110   |
| Other long-term assets                    | 646      |
| Intangible assets                         | 6,362    |
| Total identifiable assets acquired        | 30,690   |
| Liabilities assumed:                      |          |
| Accounts payable and accrued liabilities  | (4,038 ) |
| Notes payable                             | (4,329 ) |
| Total liabilities assumed                 | (8,367 ) |
| Net identifiable assets acquired          | 22,323   |
| Goodwill                                  | 9,858    |
| Total net assets acquired                 | \$32,181 |

Goodwill was determined based on the residual difference between the fair value of the consideration transferred and the value assigned to tangible and intangible assets and liabilities. Approximately \$6,982 of the acquired goodwill is deductible for tax purposes. Among the factors that contributed to a purchase price resulting in the recognition of goodwill were Zenith's reputation for best-in-class, fully integrated logistical services which are uniquely tailored to the needs of the furniture industry, as well as their ability to provide expedited delivery service which is increasingly in demand in the furniture industry.

A portion of the fair value of consideration transferred was assigned to identifiable intangible assets as follows:

**Useful  
Life**



| <b>Description:</b>                  | <b>In Years</b> | <b>Fair Value</b> |
|--------------------------------------|-----------------|-------------------|
| Customer relationships               | 15              | \$3,038           |
| Trade names                          | Indefinite      | 2,490             |
| Technology - customized applications | 7               | 834               |
| Total acquired intangible assets     |                 | \$6,362           |

The finite-lived intangible assets are being amortized on a straight-line basis over their useful lives. The indefinite-lived intangible asset and goodwill are not amortized but will be tested for impairment annually or between annual tests if an indicator of impairment exists.

The fair values of consideration transferred and net assets acquired were determined using a combination of Level 2 and Level 3 inputs as specified in the fair value hierarchy in ASC 820, *Fair Value Measurements and Disclosures*. See Note 4.

Acquisition costs related to the Zenith acquisition totaled \$121 during the quarter ended February 28, 2015 and are included in selling, general and administrative expenses in the condensed consolidated statements of income. The acquisition costs are primarily related to legal, accounting and valuation services.

The revenue of Zenith since February 2, 2015 that is included in our condensed consolidated statements of income for the quarters ended February 27, 2016 and February 28, 2015 is \$14,471 and \$3,259, respectively after the elimination of intercompany transactions. Pre-tax income (loss) of Zenith that is included in our condensed consolidated statements of income for the quarters ended February 27, 2016 and February 28, 2015 is \$695 and \$(20), respectively. The pro forma results of operations for the acquisition of Zenith have not been presented because they are not material to our consolidated results of operations.

PART I-FINANCIAL INFORMATION-CONTINUED

BASSETT FURNITURE INDUSTRIES, INCORPORATED AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-UNAUDITED

FEBRUARY 27, 2016

(Dollars in thousands except share and per share data)

**4. Financial Instruments and Fair Value Measurements**

*Financial Instruments*

Our financial instruments include cash and cash equivalents, short-term investments in certificates of deposit, accounts receivable, cost method investments, accounts payable and notes payable/long-term debt. Because of their short maturities, the carrying amounts of cash and cash equivalents, short-term investments in certificates of deposit, accounts receivable, and accounts payable approximate fair value. Our cost method investments generally involve entities for which it is not practical to determine fair values.

*Investments*

Our short-term investments of \$23,125 at both February 27, 2016 and November 28, 2015 consisted of certificates of deposit (CDs) with original terms of twelve months, bearing interest at rates ranging from 0.28% to 1.00%. At February 27, 2016, the weighted average remaining time to maturity of the CDs was approximately four months and the weighted average yield of the CDs was approximately 0.42%. Each CD is placed with a Federally insured financial institution and all deposits are within Federal deposit insurance limits. Due to the nature of these investments and their relatively short maturities, the carrying amount of the short-term investments at February 27, 2016 and November 28, 2015 approximates their fair value.

*Fair Value Measurement*

The Company accounts for items measured at fair value in accordance with ASC Topic 820, *Fair Value Measurements and Disclosures*. ASC 820's valuation techniques are based on observable and unobservable inputs.

Observable inputs reflect readily obtainable data from independent sources, while unobservable inputs reflect our market assumptions. ASC 820 classifies these inputs into the following hierarchy:

*Level 1 Inputs*– Quoted prices for identical instruments in active markets.

*Level 2 Inputs*– Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

*Level 3 Inputs*– Instruments with primarily unobservable value drivers.

We believe that the carrying amounts of our current assets and current liabilities approximate fair value due to the short-term nature of these items. The recurring estimate of the fair value of our notes payable for disclosure purposes (see Note 9) involves Level 3 inputs. Our primary non-recurring fair value estimates typically involve business acquisitions (Note 3) which involve a combination of Level 2 and Level 3 inputs, and asset impairments (Note 11) which utilize Level 3 inputs.

PART I-FINANCIAL INFORMATION-CONTINUED

BASSETT FURNITURE INDUSTRIES, INCORPORATED AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-UNAUDITED

FEBRUARY 27, 2016

(Dollars in thousands except share and per share data)

**5. Accounts Receivable**

Accounts receivable consists of the following:

|                                 | February<br>27, | November<br>28, |
|---------------------------------|-----------------|-----------------|
|                                 | 2016            | 2015            |
| Gross accounts receivable       | \$20,863        | \$ 22,372       |
| Allowance for doubtful accounts | (1,122 )        | (1,175 )        |
| Accounts receivable, net        | \$ 19,741       | \$ 21,197       |

At February 27, 2015 and November 28, 2015 approximately 35% and 34%, respectively, of gross accounts receivable, and approximately 33% and 32%, respectively, of the allowance for doubtful accounts were attributable to amounts owed to us by our licensees. Our remaining receivables are primarily due from national account customers, traditional distribution channel customers and logistical services customers.

Activity in the allowance for doubtful accounts for the three months ended February 27, 2016 was as follows:

|                                 | 2016     |
|---------------------------------|----------|
| Balance at November 28, 2015    | \$ 1,175 |
| Reductions credited to income   | (50 )    |
| Write-offs and other reductions | (3 )     |
| Balance at February 27, 2016    | \$ 1,122 |

We believe that the carrying value of our net accounts receivable approximates fair value. The inputs into these fair value estimates reflect our market assumptions and are not observable. Consequently, the inputs are considered to be Level 3 as specified in the fair value hierarchy in ASC Topic 820, *Fair Value Measurements and Disclosures*. See Note 4.

## 6. Inventories

Inventories are valued at the lower of cost or market. Cost is determined for domestic furniture inventories using the last-in, first-out (LIFO) method. The costs for imported inventories are determined using the first-in, first-out (FIFO) method.

Inventories were comprised of the following:

|   | February<br>27, | November<br>28, |
|---|-----------------|-----------------|
|   | 2016            | 2015            |
| Wholesale finished goods                        | \$28,555        | \$ 31,253       |
| Work in process                                 | 346             | 318             |
| Raw materials and supplies                      | 10,637          | 9,793           |
| Retail merchandise                              | 27,576          | 27,680          |
| Total inventories on first-in, first-out method | 67,114          | 69,044          |
| LIFO adjustment                                 | (7,864 )        | (7,751 )        |
| Reserve for excess and obsolete inventory       | (1,711 )        | (1,397 )        |
|   | \$57,539        | \$ 59,896       |

PART I-FINANCIAL INFORMATION-CONTINUEDBASSETT FURNITURE INDUSTRIES, INCORPORATED AND SUBSIDIARIESNOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-UNAUDITEDFEBRUARY 27, 2016(Dollars in thousands except share and per share data)

We estimate an inventory reserve for excess quantities and obsolete items based on specific identification and historical write-offs, taking into account future demand, market conditions and the respective valuations at LIFO. The need for these reserves is primarily driven by the normal product life cycle. As products mature and sales volumes decline, we rationalize our product offerings to respond to consumer tastes and keep our product lines fresh. If actual demand or market conditions in the future are less favorable than those estimated, additional inventory write-downs may be required. In determining reserves, we calculate separate reserves on our wholesale and retail inventories. Our wholesale inventories tend to carry the majority of the reserves for excess quantities and obsolete inventory due to the nature of our distribution model. These wholesale reserves primarily represent design and/or style obsolescence. Typically, product is not shipped to our retail warehouses until a consumer has ordered and paid a deposit for the product. We do not typically hold retail inventory for stock purposes. Consequently, floor sample inventory and inventory for delivery to customers account for the majority of our inventory at retail. Retail reserves are based on accessory and clearance floor sample inventory in our stores and any inventory that is not associated with a specific customer order in our retail warehouses.

Activity in the reserves for excess quantities and obsolete inventory by segment are as follows:

|                              | Wholesale<br>Segment | Retail<br>Segment | Total   |
|------------------------------|----------------------|-------------------|---------|
| Balance at November 28, 2015 | \$ 1,087             | \$ 310            | \$1,397 |
| Additions charged to expense | 712                  | 140               | 852     |
| Write-offs                   | (429 )               | (109 )            | (538 )  |
| Balance at February 27, 2016 | \$ 1,370             | \$ 341            | \$1,711 |

Our estimates and assumptions have been reasonably accurate in the past. We have not made any significant changes to our methodology for determining inventory reserves in 2016 and do not anticipate that our methodology is likely to

change in the future.

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PART I-FINANCIAL INFORMATION-CONTINUED

BASSETT FURNITURE INDUSTRIES, INCORPORATED AND SUBSIDIARIES

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**7. Goodwill and Other Intangible Assets**

Goodwill and other intangible assets consisted of the following:

|   | <b>February 27, 2016</b> |                     |                   |
|---|--------------------------|---------------------|-------------------|
|   | <b>Gross</b>             |                     | <b>Intangible</b> |
|   | <b>Carrying</b>          | <b>Accumulated</b>  | <b>Assets,</b>    |
|   | <b>Amount</b>            | <b>Amortization</b> | <b>Net</b>        |
| Intangibles subject to amortization             |                          |                     |                   |
| Customer relationships                          | \$3,038                  | \$ (220 )           | \$ 2,818          |
| Technology - customized applications            | 834                      | (129 )              | 705               |
| Total intangible assets subject to amortization | 3,872                    | (349 )              | 3,523             |
| Intangibles not subject to amortization:        |                          |                     |                   |
| Trade names                                     | 2,490                    | -                   | 2,490             |
| Goodwill  | 11,588                   | -                   | 11,588            |
| Total goodwill and other intangible assets      | \$17,950                 | \$ (349 )           | \$ 17,601         |

|  | <b>November 28, 2015</b> |                     |                   |
|--|--------------------------|---------------------|-------------------|
|  | <b>Gross</b>             |                     | <b>Intangible</b> |
|  | <b>Carrying</b>          | <b>Accumulated</b>  | <b>Assets,</b>    |
|  | <b>Amount</b>            | <b>Amortization</b> | <b>Net</b>        |



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|   |          |         |             |
|---|----------|---------|-------------|
| Intangibles subject to amortization             |          |         |             |
| Customer relationships                          | \$3,038  | \$ (169 | ) \$ 2,869  |
| Technology - customized applications            | 834      | (99     | ) 735       |
| Total intangible assets subject to amortization | 3,872    | (268    | ) 3,604     |
| Intangibles not subject to amortization:        |          |         |             |
| Trade names                                     | 2,490    | -       | 2,490       |
| Goodwill  | 11,588   | -       | 11,588      |
| Total goodwill and other intangible assets      | \$17,950 | \$ (268 | ) \$ 17,682 |

The carrying amounts of goodwill by reportable segment at both February 27, 2016 and November 28, 2015 were as follows:

|                     |          |
|---------------------|----------|
| Wholesale           | \$4,839  |
| Retail              | 1,820    |
| Logistical services | 4,929    |
| Total goodwill      | \$11,588 |

There were no accumulated impairment losses on goodwill as of February 27, 2016 or November 28, 2015.

Amortization expense associated with intangible assets during the quarters ended February 27, 2016 and February 28, 2015 was \$81 and \$42, respectively.

PART I-FINANCIAL INFORMATION-CONTINUEDBASSETT FURNITURE INDUSTRIES, INCORPORATED AND SUBSIDIARIESNOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-UNAUDITEDFEBRUARY 27, 2016(Dollars in thousands except share and per share data)**8. Unconsolidated Affiliate**

Prior to February 2, 2015 we owned 49% of Zenith and accounted for our investment under the equity method. The balance of our investment in Zenith was adjusted for our equity in the earnings of Zenith through February 2, 2015 of \$220 (included in other loss, net in our condensed consolidated statement of income for the quarter ended February 28, 2015), and increased by \$1,345 representing our 49% share of a \$2,745 capital contribution made to Zenith, a portion of which was used for retirement of certain of Zenith's debt prior to the acquisition. This activity resulted in a carrying value for our investment in Zenith of \$9,480 on the date of acquisition. See Note 3 regarding the remeasurement of this carrying value to fair value in connection with the acquisition and the resulting remeasurement gain of \$7,212.

**9. Notes Payable and Bank Credit Facility**

Our notes payable consist of the following:

|  | <b>February 27, 2016</b>     |                 | <b>Net</b>      |
|--|------------------------------|-----------------|-----------------|
|  | <b>Principal Unamortized</b> |                 | <b>Carrying</b> |
|  | <b>Balance</b>               | <b>Discount</b> | <b>Amount</b>   |
| Zenith acquisition note payable        | \$6,000                      | \$ (246         | ) \$ 5,754      |
| Transportation equipment notes payable | 5,112                        | -               | 5,112           |
| Real estate notes payable              | 2,782                        | -               | 2,782           |
| <b>Total Debt</b>                      | <b>13,894</b>                | <b>(246</b>     | <b>) 13,648</b> |
| Less current portion                   | (6,030 )                     | 175             | (5,855 )        |

|  |                              |                 |   |                 |
|--|------------------------------|-----------------|---|-----------------|
| Total long-term debt                   | \$7,864                      | \$ (71          | ) | \$ 7,793        |
| <b>November 28, 2015</b>               |                              |                 |   |                 |
|  | <b>Principal Unamortized</b> |                 |   | <b>Net</b>      |
|  |                              |                 |   | <b>Carrying</b> |
|  | <b>Balance</b>               | <b>Discount</b> |   | <b>Amount</b>   |
| Zenith acquisition note payable        | \$9,000                      | \$ (312         | ) | \$ 8,688        |
| Transportation equipment notes payable | 2,152                        | -               |   | 2,152           |
| Real estate notes payable              | 2,933                        | -               |   | 2,933           |
| Total Debt                             | 14,085                       | (312            | ) | 13,773          |
| Less current portion                   | (5,477 )                     | 204             |   | (5,273 )        |
| Total long-term debt                   | \$8,608                      | \$ (108         | ) | \$ 8,500        |

The future maturities of our notes payable are as follows:

|                          |          |
|--------------------------|----------|
| Remainder of fiscal 2016 | \$2,534  |
| Fiscal 2017              | 4,809    |
| Fiscal 2018              | 4,515    |
| Fiscal 2019              | 1,509    |
| Fiscal 2020              | 527      |
| Fiscal 2021              | -        |
| Thereafter               | -        |
|                          | \$13,894 |

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*Zenith Acquisition Note Payable*

As part of the consideration given for our acquisition of Zenith on February 2, 2015, we issued an unsecured note payable to the former owner in the amount of \$9,000, payable in three annual installments of \$3,000 due on each anniversary of the note, the first installment having been paid on February 2, 2016. Interest is payable annually at the one year LIBOR rate, which was established at 0.62% on February 2, 2015 and resets on each anniversary of the note, having reset to the current rate of 1.14% on February 2, 2016. The note was recorded at its fair value in connection with the acquisition resulting in a debt discount that is amortized to the principal amount through the recognition of non-cash interest expense over the term of the note. Interest expense resulting from the amortization of the discount for the quarters ended February 27, 2016 and February 28, 2015 was \$66 and \$24, respectively. The current portion of the note due within one year, including unamortized discount, was \$2,825 and \$2,796 at February 27, 2016 and November 28, 2015, respectively.

*Transportation Equipment Notes Payable*

Certain of the transportation equipment operated in our logistical services segment is financed by notes payable in the amount of \$5,112 and \$2,152 at February 27, 2016 and November 28, 2015, respectively. These notes are payable in fixed monthly payments of principal and interest at fixed and variable rates ranging from 2.60% to 3.75% at February 27, 2016, with remaining terms of fifteen to forty-five months. The current portion of these notes due within one year was \$1,514 and \$901 at February 27, 2016 and November 28, 2015, respectively. The notes are secured by tractors, trailers and local delivery trucks with a total net book value of \$6,552 and \$3,796 at February 27, 2016 and November 28, 2015, respectively.

*Real Estate Notes Payable*

Certain of our retail real estate properties have been financed through commercial mortgages with outstanding principal totaling \$1,623 and \$1,709 at February 27, 2016 and November 28, 2015, respectively. The mortgages bear interest at fixed rates of 6.73%. They are collateralized by the respective properties with net book values totaling approximately \$5,959 and \$5,993 at February 27, 2016 and November 28, 2015, respectively. The current portion of these mortgages due within one year was \$357 and \$351 as of February 27, 2016 and November 28, 2015, respectively.

Certain of the real estate located in Conover, NC and operated in our logistical services segment is subject to a note payable in the amount of \$1,159 and \$1,224 at February 27, 2016 and November 28, 2015, respectively. The note is payable in monthly installments of principal and interest at the fixed rate of 3.75% through October 2016, at which time the remaining balance on the note of approximately \$1,004 will be due. Therefore, the entire balance of this note is included in the current portion of our long-term debt at February 27, 2016 and November 28, 2015. The note is secured by land and buildings with a total net book value of \$6,191 and \$6,226 at February 27, 2016 and November 28, 2015, respectively.

#### *Fair Value*

We believe that the carrying amount of our notes payable approximates fair value at both February 27, 2016 and November 28, 2015. In estimating the fair value, we utilize current market interest rates for similar instruments. The inputs into these fair value calculations reflect our market assumptions and are not observable. Consequently, the inputs are considered to be Level 3 as specified in the fair value hierarchy in ASC Topic 820, *Fair Value Measurements and Disclosures*. See Note 3.

#### *Bank Credit Facility*

Effective December 5, 2015, we entered into a new credit facility with our bank which provides for a line of credit of up to \$15,000. This credit facility, which matures in December of 2018, is unsecured and contains covenants requiring us to maintain certain key financial ratios. We are in compliance with all covenants under the agreement and expect to remain in compliance for the foreseeable future.

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At February 27, 2016, we had \$1,970 outstanding under standby letters of credit against our line, leaving availability under our credit line of \$13,030. In addition, we have outstanding standby letters of credit with another bank totaling \$356.

**10. Post Employment Benefit Obligations**

We have an unfunded Supplemental Retirement Income Plan (the “Supplemental Plan”) that covers one current and certain former executives. The liability for this plan was \$11,683 and \$11,678 as of February 27, 2016 and November 28, 2015, respectively, and is recorded as follows in the condensed consolidated balance sheets:

|                                     | February<br>27,<br>2016 | November<br>28,<br>2015 |
|-------------------------------------|-------------------------|-------------------------|
| Accrued compensation and benefits   | \$ 749                  | \$ 749                  |
| Post employment benefit obligations | 10,934                  | 10,929                  |
| Total pension liability             | \$ 11,683               | \$ 11,678               |

Components of net periodic pension costs are as follows:

Quarter Ended

|                                       | February<br>27, | February<br>28, |
|---------------------------------------|-----------------|-----------------|
|                                       | 2016            | 2015            |
| Service cost                          | \$36            | \$ 26           |
| Interest cost                         | 106             | 94              |
| Amortization of transition obligation | 11              | 11              |
| Amortization of loss                  | 81              | 48              |
| Net periodic pension cost             | \$234           | \$ 179          |

We have an unfunded Deferred Compensation Plan that covers one current executive and certain former executives and provides for voluntary deferral of compensation. This plan has been frozen with no additional participants or deferrals permitted. We recognized expense of \$57 and \$54 for the quarters ended February 27, 2016 and February 28, 2015, respectively. Our liability under this plan was \$2,060 and \$2,085 as of February 27, 2016 and November 28, 2015, respectively, and is recorded as follows in the condensed consolidated balance sheets:

|                                       | February<br>27, | November<br>28, |
|---------------------------------------|-----------------|-----------------|
|                                       | 2016            | 2015            |
| Accrued compensation and benefits     | \$ 320          | \$ 320          |
| Post employment benefit obligations   | 1,740           | 1,765           |
| Total deferred compensation liability | \$ 2,060        | \$ 2,085        |

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**11. Impairment Charges and Accrued Lease Exit Costs**

During the quarter ended February 28, 2015 we announced the closing of our Company-owned retail store location in Memphis, Tennessee. In connection with this closing, we recognized non-cash charges of \$419 for the accrual of lease exit costs and \$106 for the write off of abandoned leasehold improvements and other store assets.

The following table summarized the activity related to our accrued lease exit costs:

|   |       |
|---|-------|
| <b>Balance at November 28, 2015</b>                       | \$566 |
| Provisions made to adjust previous estimates              | 27    |
| Payments and other  | (130) |
| Accretion of interest on obligations and other            | 3     |
| <b>Balance at February 27, 2016</b>                       | \$466 |
| Current portion included in other accrued liabilities     | \$277 |
| Long-term portion included in other long-term liabilities | 189   |
|   | \$466 |

**12. Commitments and Contingencies**

We are involved in various legal and environmental matters, which arise in the normal course of business. Although the final outcome of these matters cannot be determined, based on the facts presently known, we believe that the final resolution of these matters will not have a material adverse effect on our financial position or future results of



operations.

We lease land and buildings that are used in the operation of our Company-owned retail stores as well as in the operation of certain of our licensee-owned stores, and we lease land and buildings at various locations throughout the continental United States for warehousing and distribution hubs used in our logistical services segment. We also lease tractors, trailers and local delivery trucks used in our logistical services segment. Our real estate lease terms range from one to 15 years and generally have renewal options of between five and 15 years. Some store leases contain contingent rental provisions based upon sales volume. Our transportation equipment leases have terms ranging from two to seven years with fixed monthly rental payments plus variable charges based upon mileage. The following schedule shows future minimum lease payments under non-cancellable operating leases with terms in excess of one year as of February 27, 2016:

|                                     | <b>Retail<br/>Stores</b> | <b>Distribution<br/>Centers</b> | <b>Transportation<br/>Equipment</b> | <b>Total</b> |
|-------------------------------------|--------------------------|---------------------------------|-------------------------------------|--------------|
| Remainder of fiscal 2016            | \$ 13,755                | \$ 3,041                        | \$ 2,543                            | \$ 19,339    |
| Fiscal 2017                         | 17,167                   | 3,984                           | 2,672                               | 23,823       |
| Fiscal 2018                         | 14,787                   | 2,736                           | 1,447                               | 18,970       |
| Fiscal 2019                         | 12,906                   | 1,745                           | 1,420                               | 16,071       |
| Fiscal 2020                         | 11,578                   | 1,230                           | 1,355                               | 14,163       |
| Fiscal 2021                         | 8,920                    | 1,254                           | 781                                 | 10,955       |
| Thereafter                          | 19,347                   | 3,023                           | 668                                 | 23,038       |
| Total future minimum lease payments | \$98,460                 | \$ 17,013                       | \$ 10,886                           | \$ 126,359   |

We also have guaranteed certain lease obligations of licensee operators. Lease guarantees range from one to ten years. We were contingently liable under licensee lease obligation guarantees in the amount of \$2,386 and \$2,494 at February 27, 2016 and November 28, 2015, respectively.

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In the event of default by an independent dealer under the guaranteed lease, we believe that the risk of loss is mitigated through a combination of options that include, but are not limited to, arranging for a replacement dealer, liquidating the collateral (primarily inventory), and pursuing payment under the personal guarantees of the independent dealer. The proceeds of the above options are expected to cover the estimated amount of our future payments under the guarantee obligations, net of recorded reserves. The fair value of lease guarantees (an estimate of the cost to the Company to perform on these guarantees) at February 27, 2016 and November 28, 2015 was not material.

**13. Earnings Per Share**

The following reconciles basic and diluted earnings per share:

|  | Net<br>Income | Weighted<br>Average<br>Shares | Net<br>Income<br>Per<br>Share |
|--|---------------|-------------------------------|-------------------------------|
| <u>For the quarter ended February 27, 2016:</u>                  |               |                               |                               |
| Basic earnings per share   | \$ 3,234      | 10,780,229                    | \$ 0.30                       |
| Add effect of dilutive securities: Options and restricted shares | -             | 104,327                       | -                             |
| Diluted earnings per share                                       | \$ 3,234      | 10,884,556                    | \$ 0.30                       |
| <u>For the quarter ended February 28, 2015:</u>                  |               |                               |                               |
| Basic earnings per share   | \$ 5,956      | 10,480,656                    | \$ 0.57                       |
| Add effect of dilutive securities: Options and restricted shares | -             | 175,856                       | (0.01 )                       |

|                            |          |            |         |
|----------------------------|----------|------------|---------|
| Diluted earnings per share | \$ 5,956 | 10,656,512 | \$ 0.56 |
|----------------------------|----------|------------|---------|

For the three months ended February 27, 2016 and February 28, 2015, the following potentially dilutive shares were excluded from the computations as their effect was anti-dilutive:

|                 | Quarter Ended |          |
|-----------------|---------------|----------|
|                 | February      | February |
|                 | 27,           | 28,      |
|                 | 2016          | 2015     |
| Unvested shares | 2,000         | 46,000   |

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**14. Segment Information**

We have strategically aligned our business into three reportable segments as defined in ASC 280, *Segment Reporting*, and as described below:

**Wholesale.** The wholesale home furnishings segment is involved principally in the design, manufacture, sourcing, sale and distribution of furniture products to a network of Bassett stores (Company-owned and licensee-owned retail stores) and independent furniture retailers. Our wholesale segment includes our wood and upholstery operations as well as all corporate selling, general and administrative expenses, including those corporate expenses related to both Company- and licensee-owned stores. Also included in our wholesale segment are our short-term investments and our holdings of retail real estate previously leased as licensee stores. The earnings and costs associated with these assets are included in other income (loss), net, in our condensed consolidated statements of income.

**Retail – Company-owned stores.** Our retail segment consists of Company-owned stores and includes the revenues, expenses, assets and liabilities and capital expenditures directly related to these stores.

**Logistical services.** With our acquisition of Zenith on February 2, 2015, we created the logistical services operating segment which reflects the operations of Zenith. In addition to providing shipping, delivery and warehousing services for the Company, Zenith also provides similar services to other customers, primarily in the furniture industry. Revenue from the performance of these services to other customers is included in logistical services revenue in our condensed consolidated statement of income. Zenith's operating costs are included in selling, general and administrative expenses and total \$23,934 for the three months ended February 27, 2016 and \$6,007 from the date of acquisition through February 28, 2015. Amounts charged by Zenith to the Company for logistical services prior to the date of acquisition are included in selling, general and administrative expenses, and our equity in the earnings of Zenith prior to the date of acquisition is included in other income (loss), net, in the accompanying statements of income.

Inter-company net sales elimination represents the elimination of wholesale sales to our Company-owned stores and the elimination of Zenith logistics revenue from our wholesale and retail segments. Inter-company income elimination includes the embedded wholesale profit in the Company-owned store inventory that has not been realized. These profits will be recorded when merchandise is delivered to the retail consumer. The inter-company income elimination also includes rent paid by our retail stores occupying Company-owned real estate, and the elimination of shipping and handling charges from Zenith for services provided to our wholesale and retail operations.

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The following table presents our segment information:

|                                      | Quarter Ended<br>February 27,<br>2016 | February 28,<br>2015 |   |
|--------------------------------------|---------------------------------------|----------------------|---|
| <b>Sales Revenue</b>                 |                                       |                      |   |
| Wholesale                            | \$ 59,576                             | \$ 58,805            |   |
| Retail - Company-owned stores        | 61,595                                | 57,183               |   |
| Logistical services                  | 24,679                                | 5,999                |   |
| Inter-company eliminations:          |                                       |                      |   |
| Furniture and accessories            | (28,769)                              | (26,440)             | ) |
| Logistical services                  | (10,208)                              | (2,740)              | ) |
| Consolidated                         | \$ 106,873                            | \$ 92,807            |   |
| <b>Income (loss) from Operations</b> |                                       |                      |   |
| Wholesale                            | \$ 4,398                              | \$ 2,927             |   |
| Retail - Company-owned stores        | 316                                   | (42)                 | ) |
| Logistical services                  | 744                                   | (8)                  | ) |
| Inter-company elimination            | 333                                   | 525                  |   |
| Lease exit costs                     | -                                     | (419)                | ) |
| Asset impairment charges             | -                                     | (106)                | ) |
| Consolidated                         | \$ 5,791                              | \$ 2,877             |   |
| <b>Depreciation and Amortization</b> |                                       |                      |   |
| Wholesale                            | \$ 456                                | \$ 534               |   |
| Retail - Company-owned stores        | 1,531                                 | 1,355                |   |
| Logistical services                  | 830                                   | 257                  |   |
| Consolidated                         | \$ 2,817                              | \$ 2,146             |   |
| <b>Capital Expenditures</b>          |                                       |                      |   |
| Wholesale                            | \$ 1,537                              | \$ 961               |   |

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|                               |    |       |    |       |
|-------------------------------|----|-------|----|-------|
| Retail - Company-owned stores |    | 2,021 |    | 2,111 |
| Logistical services           |    | 5,010 |    | 846   |
| Consolidated                  | \$ | 8,568 | \$ | 3,918 |

|                               | As of     | As of     |
|-------------------------------|-----------|-----------|
| <b>Identifiable Assets</b>    | February  | November  |
|                               | 27,       | 28,       |
|                               | 2016      | 2015      |
| Wholesale                     | \$132,623 | \$146,878 |
| Retail - Company-owned stores | 91,548    | 88,878    |
| Logistical services           | 49,483    | 46,787    |
| Consolidated                  | \$273,654 | \$282,543 |

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**15. Recent Accounting Pronouncements**

In May 2014, the FASB issued Accounting Standards Update No. 2014-09 (ASU 2014-09), which creates ASC Topic 606, Revenue from Contracts with Customers, and supersedes the revenue recognition requirements in Topic 605, Revenue Recognition, including most industry-specific revenue recognition guidance throughout the Industry Topics of the Codification. In addition, ASU 2014-09 supersedes the cost guidance in Subtopic 605-35, Revenue Recognition—Construction-Type and Production-Type Contracts, and creates new Subtopic 340-40, Other Assets and Deferred Costs—Contracts with Customers. In summary, the core principle of Topic 606 is to recognize revenue when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. Companies are allowed to select between two transition methods: (1) a full retrospective transition method with the application of the new guidance to each prior reporting period presented, or (2) a retrospective transition method that recognizes the cumulative effect on prior periods at the date of adoption together with additional footnote disclosures. The amendments in ASU 2014-09 are effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period, and early application is not permitted. Therefore the amendments in ASU 2014-09 will become effective for us as of the beginning of our 2019 fiscal year. We are currently evaluating the impact that the adoption of ASU 2014-09 will have on our consolidated financial statements and have not made any decision on the method of adoption.

In July 2015, the FASB issued Accounting Standards Update No. 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory. ASU 2015-11 requires that inventory within the scope of this Update be measured at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The amendments in this Update do not apply to inventory that is measured using last-in, first-out (LIFO) or the retail inventory method. The amendments apply to all other inventory, which includes inventory that is measured using first-in, first-out (FIFO) or average cost. For all entities, the guidance is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2016. Early adoption is permitted. Therefore the amendments in ASU 2015-11 will become effective for us as of the beginning of our 2018 fiscal year. The adoption of this guidance is not expected to have a material impact upon our financial condition or results of operations.



In July 2015, the FASB issued Accounting Standards Update No. 2015-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement Period Adjustments. ASU 2015-16 requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The amendments in this Update require that the acquirer record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. Any current period adjustments to provisional amounts that would have impacted a prior period's earnings had they been recognized at the acquisition date are required to be presented separately on the face of the income statement or disclosed in the notes. The amendments in this Update are effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. The amendments in this Update should be applied prospectively to adjustments to provisional amounts that occur after the effective date of this Update with earlier application permitted for financial statements that have not been issued. Therefore the amendments in ASU 2015-16 will become effective for us as of the beginning of our 2017 fiscal year. The adoption of this guidance is not expected to have a material impact upon our financial condition or results of operations.

PART I-FINANCIAL INFORMATION-CONTINUED

BASSETT FURNITURE INDUSTRIES, INCORPORATED AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS-UNAUDITED

FEBRUARY 27, 2016

(Dollars in thousands except share and per share data)

In January 2016, the FASB issued Accounting Standards Update No. 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01 requires that equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) are to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. Furthermore, equity investments without readily determinable fair values are to be assessed for impairment using a quantitative approach. The amendments in ASU 2016-01 should be applied by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption, with other amendments related specifically to equity securities without readily determinable fair values applied prospectively. The amendments in ASU 2016-01 will become effective for us as of the beginning of our 2019 fiscal year. The adoption of this guidance is not expected to have a material impact upon our financial condition or results of operations.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, Leases (Topic 842). The guidance in ASU 2016-02 requires that a lessee recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. As with previous guidance, there continues to be a differentiation between finance leases and operating leases, however this distinction now primarily relates to differences in the manner of expense recognition over time and in the classification of lease payments in the statement of cash flows. Lease assets and liabilities arising from both finance and operating leases will be recognized in the statement of financial position. ASU 2016-02 leaves the accounting for leases by lessors largely unchanged from previous GAAP. The transitional guidance for adopting the requirements of ASU 2016-02 calls for a modified retrospective approach that includes a number of optional practical expedients that entities may elect to apply. The guidance in ASU 2016-02 will become effective for us as of the beginning of our 2020 fiscal year. We are currently evaluating the impact that the adoption of ASU 2016-02 will have on our consolidated financial statements, which we expect will have a material effect on our statement of financial position, and have not made any decision on the method of adoption with respect to the optional practical expedients.



PART I-FINANCIAL INFORMATION-CONTINUED

BASSETT FURNITURE INDUSTRIES, INCORPORATED AND SUBSIDIARIES

FEBRUARY 27, 2016

(Dollars in thousands except share and per share data)

**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Overview**

Bassett is a leading retailer, manufacturer and marketer of branded home furnishings. Our products are sold primarily through a network of Company-owned and licensee-owned branded stores under the Bassett Home Furnishings (“BHF”) name, with additional distribution through other wholesale channels including multi-line furniture stores, many of which feature Bassett galleries or design centers, specialty stores and mass merchants. We were founded in 1902 and incorporated under the laws of Virginia in 1930. Our rich 114-year history has instilled the principles of quality, value, and integrity in everything that we do, while simultaneously providing us with the expertise to respond to ever-changing consumer tastes and to meet the demands of a global economy.

With 91 BHF stores at February 27, 2016, we have leveraged our strong brand name in furniture into a network of corporate and licensed stores that focus on providing consumers with a friendly environment for buying furniture and accessories. We created our store program in 1997 to provide a single source home furnishings retail store that provides a unique combination of stylish, quality furniture and accessories with a high level of customer service. The store features custom order furniture ready for delivery in less than 30 days, more than 1,000 upholstery fabrics, free in-home design visits, and coordinated decorating accessories. We believe that our capabilities in custom upholstery have become unmatched in recent years. Our manufacturing team takes great pride in the breadth of its options, the precision of its craftsmanship, and the speed of its delivery. The selling philosophy in the stores is based on building strong long-term relationships with each customer. Sales people are referred to as Design Consultants and are each trained to evaluate customer needs and provide comprehensive solutions for their home decor. We continue to strengthen the sales and design talent within our Company-owned retail stores. Our Design Consultants undergo extensive Design Certification training. This training has strengthened their skills related to our house call and design business, and is intended to increase business with our most valuable customers.

In order to reach markets that cannot be effectively served by our retail store network, we also distribute our products through other wholesale channels including multi-line furniture stores, many of which feature Bassett galleries or design centers, specialty stores and mass merchants. We use a network of over 25 independent sales representatives

who have stated geographical territories. These sales representatives are compensated based on a standard commission rate. We believe this blended strategy provides us the greatest ability to effectively distribute our products throughout the United States and ultimately gain market share.

For many years we owned 49% of Zenith Freight Lines, LLC (“Zenith”). During that time the strategic significance of our partnership with Zenith had risen to include the over-the-road transportation of furniture, the operation of regional freight terminal, warehouse and distribution facilities in eleven states, and the management of various home delivery facilities that service Bassett Home Furnishings stores and other clients in local markets around the United States. On February 2, 2015, we acquired the remaining 51% of Zenith, which now operates as a wholly-owned subsidiary of Bassett. Our acquisition of Zenith brings to our Company the ability to deliver best-of-class shipping and logistical support services that are uniquely tailored to the needs of the furniture industry, as well as the ability to provide the expedited delivery service which is increasingly demanded by our industry. We believe that our ownership of Zenith will not only enhance our own wholesale and retail distribution capabilities, but will provide additional growth opportunities as Zenith continues to expand its service to other customers.

In September of 2011, we announced the formation of a strategic partnership with HGTV (Home and Garden Television), a division of Scripps Networks, LLC, which combines our heritage in the furniture industry with the penetration of 96 million households in the United States that HGTV enjoys today. As part of this alliance, the in-store design centers have been co-branded with HGTV to more forcefully market the concept of a “home makeover”, an important point of differentiation for our stores that also mirrors much of the programming content on the HGTV network. We believe the new co-branded design centers coupled with the targeted national advertising on HGTV have played a key role in our improved comparable store sales since their introduction. In October of 2015, we announced the extension of our partnership with HGTV through 2019. While continuing to feature HGTV branded custom upholstery products in our HGTV Home Design Studios in Bassett Home Furnishings stores, we will now expand the concept to select independent dealers. We believe this will provide additional growth outside our BHF store network.

PART I-FINANCIAL INFORMATION-CONTINUED

BASSETT FURNITURE INDUSTRIES, INCORPORATED AND SUBSIDIARIES

FEBRUARY 27, 2016

(Dollars in thousands except share and per share data)

At February 27, 2016, our BHF store network included 59 Company-owned stores and 32 licensee-owned stores. During the first quarter of 2016, we closed one underperforming store in Tucson, Arizona. We also expect to close two additional underperforming stores during the second quarter in Egg Harbor, New Jersey and Fountain Valley, California at the end of their respective lease terms. In addition, we expect to open a new store in Sterling, Virginia during the second quarter of 2016 and Hunt Valley, Maryland late in 2016.

Due to the improved operating performance of our retail network along with continued improvement in underlying economic factors such as the housing market and consumer confidence, we have been expanding our retail presence in various parts of the country. As part of this expansion, we opened one new store and relocated two stores during fiscal 2015 and opened six new stores and relocated two stores in fiscal 2014. Our plan is to average opening three to five new stores, net of closings, over the next five years, primarily in underpenetrated markets where we currently have stores.

As with any retail operation, prior to opening a new store we incur such expenses as rent, training costs and other payroll related costs. These costs generally range between \$100 to \$300 per store depending on the overall rent costs for the location and the period between the time when we take physical possession of the store space and the time of the store opening. Generally, rent payments during a buildout period between delivery of possession and opening of a new store are deferred and therefore straight line rent expense recognized during that time does not require cash. Inherent in our retail business model, we also incur losses in the two to three months of operation following a new store opening. Like other furniture retailers, we do not recognize a sale until the furniture is delivered to our customer. Because our retail business model does not involve maintaining a stock of retail inventory that would result in quick delivery and because of the custom nature of many of our furniture offerings, delivery to our customers usually occurs about 30 days after an order is placed. We generally require a deposit at the time of order and collect the remaining balance when the furniture is delivered, at which time the sale is recognized. Coupled with the previously discussed store pre-opening costs, total start-up losses can range from \$300 to \$500 per store. While our retail expansion is initially costly, we believe our site selection and new store presentation will generally result in locations that operate at or above a retail break-even level within a reasonable period of time following store opening. Factors affecting the length of time required to achieve this goal on a store-by-store basis may include the level of brand recognition, the degree of local competition and the depth of penetration in a particular market. Even as new stores ramp up to break-even, we do realize additional wholesale sales volume that leverages the fixed costs in our wholesale business.

Our wholesale operations include an upholstery plant in Newton, North Carolina that produces a wide range of upholstered furniture. In February 2016, we began production in a new manufacturing facility in Grand Prairie, Texas. The new plant is producing a portion of the upholstery assortment for customers and stores in the Texas area and the western United States. We believe that we are an industry leader with our quick-ship custom upholstery offerings. We also operate a custom dining manufacturing facility in Martinsville, Virginia. Most of our wood furniture and certain of our upholstery offerings are sourced through several foreign plants, primarily in Vietnam, Indonesia and China. We define imported product as fully finished product that is sourced internationally. For the first quarter of fiscal 2016, approximately 35% of our wholesale sales were of imported product compared to 38% for the first quarter of fiscal 2015.

An important new product introduction in 2015 was “Bench Made”, a selection of American dining furniture that appeared in retail showrooms during the second quarter of 2015. Partnering with nearby hardwood component manufacturers, we are preparing, distressing, finishing, and assembling an assortment of solid maple tables and chairs in our newly renovated Company-owned facility in Bassett, Virginia. During 2016 we are expanding “Bench Made” offerings to include bedroom and occasional furniture. Also in 2016 we have begun moving to a living area centric floor plan for our retail locations that will focus more on the upholstery products that are driving our sales today complemented by both imported and domestically produced entertainment and occasional furnishings. All of these new products have been carefully designed in coordination with our merchants, designers, engineers and finishing technicians to achieve the upscale casual decor that we believe speaks to today’s consumer.

PART I-FINANCIAL INFORMATION-CONTINUEDBASSETT FURNITURE INDUSTRIES, INCORPORATED AND SUBSIDIARIESFEBRUARY 27, 2016(Dollars in thousands except share and per share data)**Results of Operations – Quarter ended February 27, 2016 compared with quarter ended February 28, 2015:**

Net sales of furniture and accessories, logistics revenue, cost of furniture and accessories sold, selling, general and administrative (SG&A) expense, other charges and income from operations were as follows for the periods ended February 27, 2016 and February 28, 2015:

|  | Quarter Ended |        | February 28, |        |
|--|---------------|--------|--------------|--------|
|  | February 27,  |        | February 28, |        |
|  | 2016          |        | 2015         |        |
| Sales revenue:                         |               |        |              |        |
| Furniture and accessories              | \$92,402      | 86.5 % | \$89,548     | 96.5 % |
| Logistics revenue                      | 14,471        | 13.5 % | 3,259        | 3.5 %  |
| Total sales revenue                    | 106,873       | 100.0% | 92,807       | 100.0% |
| Cost of furniture and accessories sold | 41,986        | 39.3 % | 41,930       | 45.2 % |
| SG&A expenses                          | 58,957        | 55.2 % | 47,475       | 51.2 % |
| New store pre-opening costs            | 139           | 0.1 %  | -            | 0.0 %  |
| Other charges                          | -             | 0.0 %  | 525          | 0.5 %  |
| Income from operations                 | \$5,791       | 5.4 %  | \$2,877      | 3.1 %  |

On a consolidated basis, we reported total sales revenue for the first quarter of 2016 of \$106,873 as compared to \$92,807 for the first quarter of 2015. Total revenues for the first quarter of 2016 include \$14,471 of logistics revenue for the full quarter as compared to \$3,259 for the first quarter of 2015 from the date of our acquisition of Zenith, February 2, 2015, through February 28, 2015. Revenue from sales of furniture and accessories, net of estimates for returns and allowances, for the first quarter of 2016 were \$92,402, an increase of \$2,854, or 3.2%, over the first quarter of 2015. Gross profit on the sale of furniture and accessories for the first quarter of 2016 was \$50,416, or 54.6% of the respective revenue, as compared with \$47,618, or 53.2%, for the comparable prior year period. Improved margins at wholesale were partially offset by lower margins at retail resulting from store closure activity. Operating



income was \$5,791 for the first quarter of 2016 as compared to \$2,877 for the first quarter of 2015, an increase of \$2,914 driven primarily by greater leveraging of fixed costs and \$525 of charges recorded in the first quarter of 2015 related to the closing of our Company-owned retail store in Memphis, Tennessee. In addition, Zenith contributed \$744 to our operating income for the first quarter of 2016, whereas the impact of Zenith's one month of operations following acquisition upon our operating results for the first quarter of 2015 was not significant.

PART I-FINANCIAL INFORMATION-CONTINUED

BASSETT FURNITURE INDUSTRIES, INCORPORATED AND SUBSIDIARIES

FEBRUARY 27, 2016

(Dollars in thousands except share and per share data)

*Segment Information*

We have strategically aligned our business into three reportable segments as described below:

**Wholesale.** The wholesale home furnishings segment is involved principally in the design, manufacture, sourcing, sale and distribution of furniture products to a network of Bassett stores (Company-owned and licensee-owned retail stores) and independent furniture retailers. Our wholesale segment includes our wood and upholstery operations as well as all corporate selling, general and administrative expenses, including those corporate expenses related to both Company- and licensee-owned stores. We eliminate the sales between our wholesale and retail segments as well as the imbedded profit in the retail inventory for the consolidated presentation in our financial statements. Also included in our wholesale segment are our short-term investments and our holdings of retail real estate previously leased as licensee stores. The earnings and costs associated with these assets are included in other income (loss), net, in our condensed consolidated statements of income.

**Retail – Company-owned stores.** Our retail segment consists of Company-owned stores and includes the revenues, expenses, assets and liabilities (including real estate) and capital expenditures directly related to these stores.

**Logistical services.** With our acquisition of Zenith on February 2, 2015, we created the logistical services operating segment which reflects the operations of Zenith. In addition to providing shipping, delivery and warehousing services for the Company, Zenith also provides similar services to other customers, primarily in the furniture industry. Revenue from the performance of these services to other customers is included in logistical services revenue in our condensed consolidated statement of income. Zenith's operating costs are included in selling, general and administrative expenses. Amounts charged by Zenith to the Company for transportation and logistical services prior to February 2, 2015 are included in selling, general and administrative expenses, and our equity in the earnings of Zenith prior to the date of acquisition is included in other income (loss), net, in the accompanying statements of income.



PART I-FINANCIAL INFORMATION-CONTINUEDBASSETT FURNITURE INDUSTRIES, INCORPORATED AND SUBSIDIARIESFEBRUARY 27, 2016(Dollars in thousands except share and per share data)

The following tables illustrate the effects of various intercompany eliminations on income (loss) from operations in the consolidation of our segment results:

|  | Quarter Ended February 27, 2016 |          |           |              |      |              |
|--|---------------------------------|----------|-----------|--------------|------|--------------|
|  | Wholesale                       | Retail   | Logistics | Eliminations |      | Consolidated |
| Sales revenue:                         |                                 |          |           |              |      |              |
| Furniture & accessories                | \$59,576                        | \$61,595 | \$-       | \$ (28,769   | )(1) | \$ 92,402    |
| Logistics                              | -                               | -        | 24,679    | (10,208      | )(2) | 14,471       |
| Total sales revenue                    | 59,576                          | 61,595   | 24,679    | (38,977      | )    | 106,873      |
| Cost of furniture and accessories sold | 39,298                          | 31,315   | -         | (28,627      | )(3) | 41,986       |
| SG&A expense                           | 15,880                          | 29,825   | 23,935    | (10,683      | )(4) | 58,957       |
| New store pre-opening costs            | -                               | 139      | -         | -            |      | 139          |
| Income from operations                 | \$4,398                         | \$316    | \$ 744    | \$ 333       |      | \$ 5,791     |

|  | Quarter Ended February 28, 2015 |          |           |              |      |              |
|--|---------------------------------|----------|-----------|--------------|------|--------------|
|  | Wholesale                       | Retail   | Logistics | Eliminations |      | Consolidated |
| Sales revenue:                         |                                 |          |           |              |      |              |
| Furniture & accessories                | \$58,805                        | \$57,183 | \$-       | \$ (26,440   | )(1) | \$ 89,548    |
| Logistics                              | -                               | -        | 5,999     | (2,740       | )(2) | 3,259        |
| Total sales revenue                    | 58,805                          | 57,183   | 5,999     | (29,180      | )    | 92,807       |
| Cost of furniture and accessories sold | 39,982                          | 28,400   | -         | (26,452      | )(3) | 41,930       |
| SG&A expense                           | 15,896                          | 28,825   | 6,007     | (3,253       | )(4) | 47,475       |
| New store pre-opening costs            | -                               | -        | -         | -            |      | -            |
| Income (loss) from operations (5)      | \$2,927                         | \$(42    | ) \$ (8   | ) \$ 525     |      | \$ 3,402     |

(1) Represents the elimination of sales from our wholesale segment to our Company-owned BHF stores.

(2) Represents the elimination of logistical services billed to our wholesale and retail segments.

(3) Represents the elimination of purchases by our Company-owned BHF stores from our wholesale segment, as well as the change for the period in the elimination of intercompany profit in ending retail inventory.

(4) Represents the elimination of rent paid by our retail stores occupying Company-owned real estate, and the elimination of logistical services charged by Zenith to Bassett's retail and wholesale segments as follows:

|                                  | Quarter ended |            |
|----------------------------------|---------------|------------|
|                                  | February      | February   |
|                                  | 27,           | 28,        |
|                                  | 2016          | 2015       |
| Intercompany logistical services | \$(10,208)    | \$(2,740 ) |
| Intercompany rents               | (475 )        | (513 )     |
| Total SG&A expense elimination   | \$(10,683)    | \$(3,253 ) |

(5) Excludes the effects of asset impairment charges and lease exit costs, which are not allocated to our segments.

PART I-FINANCIAL INFORMATION-CONTINUEDBASSETT FURNITURE INDUSTRIES, INCORPORATED AND SUBSIDIARIESFEBRUARY 27, 2016(Dollars in thousands except share and per share data)

The following is a discussion of operating results for our wholesale, retail and logistical services segments:

Wholesale segment

Results for the wholesale segment for the three months ended February 27, 2016 and February 28, 2015 are as follows:

|                        | Quarter Ended |        |              |        |
|------------------------|---------------|--------|--------------|--------|
|                        | February 27,  |        | February 28, |        |
|                        | 2016          |        | 2015         |        |
| Net sales              | \$59,576      | 100.0% | \$58,805     | 100.0% |
| Gross profit           | 20,278        | 34.0 % | 18,823       | 32.0 % |
| SG&A expenses          | 15,880        | 26.6 % | 15,896       | 27.0 % |
| Income from operations | \$4,398       | 7.4 %  | \$2,927      | 5.0 %  |

Net sales for the wholesale segment were \$59,576 for the first quarter of 2016 as compared to \$58,805 for the first quarter of 2015, an increase of \$771 or 1.3%. This sales increase was driven by a 5.1% increase in shipments to the BHF store network partially offset by a 5.2% decrease in open market shipments (outside the BHF store network). The decrease in the sales to the open market was due to lower sales of the HGTV Home Collections brand that was discontinued in late 2015. Gross margins for the wholesale segment increased to 34.0% for the first quarter of 2016 as compared to 32.0% for the first quarter of 2015 driven largely by higher margins in the domestic upholstery operation from improved pricing strategies and improved margins in the import wood operation from lower levels of discounting. SG&A as a percentage of sales decreased to 26.6% as compared to 27.0% for the first quarter of 2015 primarily due to lower spending in various sales and marketing activities and other fixed costs. The prior year period also included \$121 of costs associated with the acquisition of Zenith Freight Lines, LLC. Operating income was \$4,398 or 7.4% of sales as compared to \$2,927 or 5.0% of sales in the prior year quarter.

| Wholesale shipments by type: | Quarter Ended        |         |                      |         |
|------------------------------|----------------------|---------|----------------------|---------|
|                              | February 27,<br>2016 |         | February 28,<br>2015 |         |
| Wood                         | \$22,232             | 37.3 %  | \$20,313             | 34.5 %  |
| Upholstery                   | 36,762               | 61.7 %  | 37,872               | 64.4 %  |
| Other                        | 582                  | 1.0 %   | 620                  | 1.1 %   |
| Total                        | \$59,576             | 100.0 % | \$58,805             | 100.0 % |

*Wholesale Backlog*

The dollar value of wholesale backlog, representing orders received but not yet shipped to dealers and Company stores, was \$15,645 at February 27, 2016 as compared with \$17,715 at February 28, 2015.

PART I-FINANCIAL INFORMATION-CONTINUEDBASSETT FURNITURE INDUSTRIES, INCORPORATED AND SUBSIDIARIESFEBRUARY 27, 2016(Dollars in thousands except share and per share data)Retail – Company-owned stores segment

Results for the retail segment for the three months ended February 27, 2016 and February 28, 2015 are as follows:

|                               | Quarter Ended |        |              |        |
|-------------------------------|---------------|--------|--------------|--------|
|                               | February 27,  |        | February 28, |        |
|                               | 2016          |        | 2015         |        |
| Net sales                     | \$61,595      | 100.0% | \$57,183     | 100.0% |
| Gross profit                  | 30,280        | 49.2 % | 28,783       | 50.3 % |
| SG&A expenses                 | 29,825        | 48.4 % | 28,825       | 50.4 % |
| New store pre-opening costs   | 139           | 0.2 %  | -            | 0.0 %  |
| Income (loss) from operations | \$316         | 0.5 %  | \$(42 )      | -0.1 % |

Results for the 58 comparable stores<sup>†</sup> are as follows:

|                        | Quarter Ended |        |              |        |
|------------------------|---------------|--------|--------------|--------|
|                        | February 27,  |        | February 28, |        |
|                        | 2016          |        | 2015         |        |
| Net sales              | \$59,660      | 100.0% | \$56,256     | 100.0% |
| Gross profit           | 29,562        | 49.6 % | 28,349       | 50.4 % |
| SG&A expenses          | 28,727        | 48.2 % | 28,201       | 50.1 % |
| Income from operations | \$835         | 1.4 %  | \$148        | 0.3 %  |

<sup>†</sup>“Comparable” stores include those locations that have been open and operated by the Company for all of each respective comparable period.



Results for all other stores are as follows:

|                             | Quarter Ended        |         |                      |         |
|-----------------------------|----------------------|---------|----------------------|---------|
|                             | February 27,<br>2016 |         | February 28,<br>2015 |         |
| Net sales                   | \$1,935              | 100.0%  | \$927                | 100.0%  |
| Gross profit                | 718                  | 37.1 %  | 434                  | 46.8 %  |
| SG&A expenses               | 1,098                | 56.7 %  | 624                  | 67.3 %  |
| New store pre-opening costs | 139                  | 7.2 %   | -                    | 0.0 %   |
| Loss from operations        | \$(519 )             | -26.8 % | \$(190)              | -20.5 % |

Net sales for the 59 Company-owned BHF stores were \$61,595 for the first quarter of 2016 as compared to \$57,183 for the first quarter of 2015, an increase of \$4,412 or 7.7%. The increase was primarily due to a \$3,404 or 6.1% increase in comparable store sales coupled with a \$1,008 increase in non-comparable store sales.

While we do not recognize sales until goods are delivered to the consumer, management tracks written sales (the retail dollar value of sales orders taken, rather than delivered) as a key store performance indicator. Written sales for comparable stores decreased by 0.9% for the first quarter of 2016 as compared to the first quarter of 2015.

PART I-FINANCIAL INFORMATION-CONTINUED

BASSETT FURNITURE INDUSTRIES, INCORPORATED AND SUBSIDIARIES

FEBRUARY 27, 2016

(Dollars in thousands except share and per share data)

The consolidated retail operating income for the first quarter of 2016 was \$316 as compared to a loss of \$42 for the first quarter of 2015. The 58 comparable stores generated operating income of \$835 for the quarter, or 1.4% of sales, as compared to \$148, or 0.3% of sales, for the prior year quarter. Gross margins were 49.6% for the first quarter of 2016 compared to 50.4% for the first quarter of 2015. Lower gross margins were due primarily to two store closing sales that began in the first quarter of 2016 and will be completed during the second quarter. Also, Company-owned stores experienced increased clearance activity in reducing imported wood furniture placements to make room for more upholstery on its retail floors. SG&A expenses for comparable stores increased \$526 to \$28,727 or 48.2% of sales as compared to 50.1% of sales for the first quarter of 2015. This decrease as a percentage of sales is primarily due to greater leverage of fixed costs due to higher sales volumes.

Losses from the non-comparable stores in the first quarter of fiscal 2016 were \$519 compared with \$190 for the first quarter of fiscal 2015, an increase of \$329. This increase includes \$139 of pre-opening costs recognized in the first quarter of 2016 associated with the Sterling, Virginia store expected to open during the second quarter of 2016. These costs include rent, training costs and other payroll-related costs specific to a new store location incurred during the period leading up to its opening and generally range between \$100 to \$300 per store based on the overall rent costs for the location and the period between the time when the Company takes possession of the physical store space and the time of the store opening. Also included in the non-comparable store loss for the first quarter of 2016 are post-opening losses from the Woodland Hills, California store which opened during the fourth quarter of 2015, and losses arising from the closure of our store in Tucson, Arizona. We incur losses in the first two to three months of operation following a store opening as sales are not recognized in the income statement until the furniture is delivered to its customers resulting in operating expenses without the normal sales volume. Because we do not maintain a stock of retail inventory that would result in quick delivery, and because of the custom nature of the furniture offerings, such deliveries are generally not made until after 30 days from when the furniture is ordered by the customer. Coupled with the pre-opening costs, total start-up losses typically amount to \$300 to \$500 per store.

Each addition to our Company-owned store network results in incremental fixed overhead costs, primarily associated with local store personnel, occupancy costs and warehousing expenses. The incremental SG&A expenses associated with each new store will be ongoing.

*Retail Backlog*

The dollar value of our retail backlog, representing orders received but not yet delivered to customers, was \$31,290, or an average of \$530 per open store at February 27, 2016 as compared with was \$33,836, or an average of \$564 per open store at February 28, 2015.

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PART I-FINANCIAL INFORMATION-CONTINUED

BASSETT FURNITURE INDUSTRIES, INCORPORATED AND SUBSIDIARIES

FEBRUARY 27, 2016

(Dollars in thousands except share and per share data)

Logistical services segment

Results for our logistical services segment for the quarters ended February 27, 2016 and February 28, 2015 are as follows:

|                               | Quarter Ended |        |              |         |
|-------------------------------|---------------|--------|--------------|---------|
|                               | February 27,  |        | February 28. |         |
|                               | 2016          |        | 2015 (1)     |         |
| Logistical services revenue   | \$24,679      | 100.0% | \$5,999      | 100.0%  |
| Operating expenses            | 23,935        | 97.0 % | 6,007        | 100.1 % |
| Income (loss) from operations | \$744         | 3.0 %  | \$(8 )       | -0.1 %  |

(1) Results for logistical services for the quarter ended February 28, 2015 include approximately one month of operations from the date of acquisition, February 2, 2015.

Operating expenses for the quarters ended February 27, 2016 and February 28, 2015 include depreciation and amortization of \$830 and \$257, respectively.

Other items affecting Net Income

*Acquisition of Zenith*

On February 2, 2015 we acquired the remaining 51% ownership interest in Zenith in exchange for cash, Bassett common stock and a note payable with a total fair value of \$19,111 which, along with the fair value of our prior 49% interest in Zenith, results in a total enterprise value for Zenith of \$35,803. In accordance with the acquisition method of accounting, we recognized a gain of \$7,212 during the first quarter of fiscal 2015 for the remeasurement of our previous interest in Zenith. For additional information regarding our acquisition of Zenith, see Note 3 to our condensed consolidated financial statements.

*Other loss, net*

Prior to our acquisition of Zenith on February 2, 2015, we owned a 49% interest in the company for which we used the equity method of accounting. Accordingly, our equity in the income of Zenith prior to the acquisition date was included in other loss, net, and was \$220 for the quarter ended February 28, 2015.

Other loss, net, for the first quarter of fiscal 2016 was \$657 as compared to \$622 for the first quarter of fiscal 2015. This change is primarily attributable to the \$220 decline in equity method income attributable to Zenith noted above, partially offset by a \$182 charge recorded during the first quarter of 2015 to write down the carrying value of retail real estate in Sugarland, Texas, which was held for sale at February 28, 2015.

*Income taxes*

We calculate an anticipated effective tax rate for the year based on our annual estimates of pretax income or loss and use that effective tax rate to record our year-to-date income tax provision. Any change in annual projections of pretax income or loss could have a significant impact on our effective tax rate for the respective quarter. Our effective tax rate for the quarter ended February 27, 2016 differs from the federal statutory rate primarily due to the effects of state income taxes and various permanent differences.

PART I-FINANCIAL INFORMATION-CONTINUED

BASSETT FURNITURE INDUSTRIES, INCORPORATED AND SUBSIDIARIES

FEBRUARY 27, 2016

(Dollars in thousands except share and per share data)

**Liquidity and Capital Resources**

We are committed to maintaining a strong balance sheet in order to weather difficult industry conditions, to allow us to take advantage of opportunities as market conditions improve, and to execute our long-term retail strategies.

*Cash Flows*

Cash provided by operations for the first three months of 2016 was \$2,420 compared to cash used in operations of \$905 for the first three months of 2015, representing an increase of \$3,325 in cash flows from operations. The increase is primarily due to the fact that the first quarter of 2015 included increases in inventory levels due to the introduction of new products and increased purchase activity to support higher order volume and backlog levels. In addition, a significant amount of trade payables arising from inventory build-up that occurred during the fourth quarter of fiscal 2014 were paid during the first quarter of 2015.

Our overall cash position decreased by \$11,155 during the first quarter of 2016. Offsetting cash provided by operations, we used \$8,548 of cash in investing activities, primarily consisting of capital expenditures which included the purchase of freight transportation equipment, retail store relocations, retail store remodels, in-process spending on new stores, and expanding and upgrading our manufacturing capabilities. Our expenditure for new tractors and trailers totaled \$4,858 during the first quarter and is expected to average significantly less over the remaining quarters of fiscal 2016. Net cash used in financing activities was \$5,027, including dividend payments of \$3,146 and stock repurchases of \$1,774 under our existing share repurchase plan, of which \$16,155 remains authorized at February 27, 2016. In addition, repayments of debt were substantially offset by proceeds from loans secured by new transportation equipment. With cash and cash equivalents and short-term investments totaling \$48,238 on hand at February 27, 2016, we believe we have sufficient liquidity to fund operations for the foreseeable future.

Debt and Other Obligations

Effective December 5, 2015, we entered into a new credit facility with our bank which provides for a line of credit of up to \$15,000. This credit facility, which matures in December of 2018, is unsecured and contains covenants requiring us to maintain certain key financial ratios. We are in compliance with all covenants under the agreement and expect to remain in compliance for the foreseeable future. At February 27, 2016, we had \$1,970 outstanding under standby letters of credit against our line, leaving availability under our credit line of \$13,030. In addition, we have outstanding standby letters of credit with another bank totaling \$356.

At February 27, 2016 we have outstanding principal totaling \$13,894, excluding discounts, under notes payable of which \$6,030 matures within one year of the balance sheet date. See Note 9 to our condensed consolidated financial statements for additional details regarding these notes, including collateral and future maturities. We expect to satisfy these obligations as they mature using cash flow from operations or our available cash on hand.

We lease land and buildings that are used in the operation of our Company-owned retail stores as well as in the operation of certain of our licensee-owned stores, and we lease land and buildings at various locations throughout the continental United States for warehousing and distribution hubs used in our logistical services segment. We also lease tractors, trailers and local delivery trucks used in our logistical services segment. We had obligations of \$126,359 at February 27, 2016 for future minimum lease payments under non-cancelable operating leases having remaining terms in excess of one year. We also have guaranteed certain lease obligations of licensee operators. Remaining terms under these lease guarantees range from approximately one to five years. We were contingently liable under licensee lease obligation guarantees in the amount of \$2,386 at February 27, 2016. See Note 12 to our condensed consolidated financial statements for additional details regarding our leases and lease guarantees.

PART I-FINANCIAL INFORMATION-CONTINUEDBASSETT FURNITURE INDUSTRIES, INCORPORATED AND SUBSIDIARIESFEBRUARY 27, 2016(Dollars in thousands except share and per share data)*Investment in Retail Real Estate*

We have a substantial investment in real estate acquired for use as retail locations. To the extent such real estate is occupied by Company-owned retail stores, it is included in property and equipment, net, in the accompanying condensed consolidated balance sheets and is considered part of our retail segment. The net book value of such retail real estate occupied by Company-owned stores was \$26,993 at February 27, 2016. All other retail real estate that we own, consisting of locations formerly leased to our licensees and now leased to others, is included in other assets in the accompanying condensed consolidated balance sheets. The net book value of such real estate, which is considered part of our wholesale segment, was \$3,082 at February 27, 2016.

The following table summarizes our total investment in retail real estate owned at February 27, 2016:

|  | Number<br>of<br>Locations | Aggregate<br>Square<br>Footage | Net<br>Book<br>Value |
|--|---------------------------|--------------------------------|----------------------|
| Real estate occupied by Company-owned and operated stores, included in property and equipment, net (1) | 11                        | 276,887                        | \$26,993             |
| Investment real estate leased to others, included in other assets                                      | 2                         | 41,021                         | 3,082                |
| Total Company investment in retail real estate   | 13                        | 317,908                        | \$30,075             |

(1) Includes two properties encumbered under mortgages totalling \$1,623 at February 27, 2016.



### **Critical Accounting Policies and Estimates**

There have been no material changes to our critical accounting policies and estimates from the information provided in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations", included in our Annual Report on Form 10-K for the fiscal year ended November 28, 2015.

### **Off-Balance Sheet Arrangements**

We utilize stand-by letters of credit in the procurement of certain goods in the normal course of business. We lease land and buildings that are primarily used in the operation of both Company-owned and licensee stores as well as land and buildings used in our logistical services segment. We also lease transportation equipment used in our logistical services segment. We have guaranteed certain lease obligations of licensee operators of the stores, as part of our retail expansion strategy. See Note 12 to our condensed consolidated financial statements for further discussion of operating leases and lease guarantees, including descriptions of the terms of such commitments and methods used to mitigate risks associated with these arrangements.

### **Contingencies**

We are involved in various legal and environmental matters, which arise in the normal course of business. Although the final outcome of these matters cannot be determined, based on the facts presently known, it is our opinion that the final resolution of these matters will not have a material adverse effect on our financial position or future results of operations. See Note 12 to our condensed consolidated financial statements for further information regarding certain contingencies as of February 27, 2016.

PART I-FINANCIAL INFORMATION-CONTINUED

BASSETT FURNITURE INDUSTRIES, INCORPORATED AND SUBSIDIARIES

FEBRUARY 27, 2016

(Dollars in thousands except share and per share data)

**Item 3. Quantitative and Qualitative Disclosure about Market Risk:**

We are exposed to market risk from changes in the value of foreign currencies. Substantially all of our imports purchased outside of North America are denominated in U.S. dollars. Therefore, we believe that gains or losses resulting from changes in the value of foreign currencies relating to foreign purchases not denominated in U.S. dollars would not be material to our results from operations in fiscal 2016.

We are exposed to market risk from changes in the cost of raw materials used in our manufacturing processes, principally wood, woven fabric, and foam products. A recovery in home construction could result in increases in wood and fabric costs from current levels, and the cost of foam products, which are petroleum-based, is sensitive to changes in the price of oil.

We are also exposed to commodity price risk related to diesel fuel prices for fuel used in our logistical services segment. We manage our exposure to that risk primarily through the application of fuel surcharges to our customers.

We have potential exposure to market risk related to conditions in the commercial real estate market. Our retail real estate holdings of \$3,082 at February 27, 2016 for stores formerly operated by licensees as well as our holdings of \$26,993 at February 27, 2016 for Company-owned stores could suffer significant impairment in value if we are forced to close additional stores and sell or lease the related properties during periods of weakness in certain markets. Additionally, if we are required to assume responsibility for payment under the lease obligations of \$2,386 which we have guaranteed on behalf of licensees as of February 27, 2016, we may not be able to secure sufficient sub-lease income in the current market to offset the payments required under the guarantees.

**Item 4. Controls and Procedures:**

The Company's principal executive officer and principal accounting officer have evaluated the Company's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based upon their evaluation, the principal executive officer and principal accounting officer concluded that the Company's disclosure controls and procedures are effective at a reasonable assurance level. There has been no change in the Company's internal control over financial reporting during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART I-FINANCIAL INFORMATION-CONTINUED

BASSETT FURNITURE INDUSTRIES, INCORPORATED AND SUBSIDIARIES

FEBRUARY 27, 2016

(Dollars in thousands except share and per share data)

Safe-harbor, forward-looking statements:

The discussion in items 2 and 3 above contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 with respect to the financial condition, results of operations and business of Bassett Furniture Industries, Incorporated and subsidiaries. Such forward-looking statements are identified by use of forward-looking words such as “*anticipates*”, “*believes*”, “*plans*”, “*estimates*”, “*expects*”, “*aims*” and “*intends*” or words or phrases of similar expression. These forward-looking statements involve certain risks and uncertainties. No assurance can be given that any such matters will be realized. Important factors that could cause actual results to differ materially from those contemplated by such forward-looking statements are listed in our Annual Report on Form 10-K for fiscal 2015 and include:

• competitive conditions in the home furnishings industry

• general economic conditions

• overall retail traffic levels and consumer demand for home furnishings

• ability of our customers and consumers to obtain credit

• Bassett store openings

• store closings and the profitability of the stores (independent licensees and Company-owned retail stores)

• ability to implement our Company-owned retail strategies and realize the benefits from such strategies as they are implemented

fluctuations in the cost and availability of raw materials, fuel, labor and sourced products

results of marketing and advertising campaigns

information and technology advances

future tax legislation, or regulatory or judicial positions

ability to efficiently manage the import supply chain to minimize business interruption

concentration of domestic manufacturing, particularly of upholstery products, and the resulting exposure to business interruption from accidents, weather and other events and circumstances beyond our control

general risks associated with providing freight transportation and other logistical services due to our acquisition of Zenith Freight Lines, LLC

PART II - OTHER INFORMATION

BASSETT FURNITURE INDUSTRIES INCORPORATED AND SUBSIDIARIES

FEBRUARY 27, 2016

(Dollars in thousands except share and per share data)

**Item 1. Legal Proceedings**

None

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

|   | <b>Total<br/>Shares<br/><br/>Purchased</b> | <b>Average<br/>Price<br/>Paid</b> | <b>Total Number of Shares<br/>Purchased as Part of Publicly<br/>Announced Plans or Programs<br/>(1)</b> | <b>Approximate Dollar Value of<br/>Shares that May Yet Be<br/>Purchased Under the Plans or<br/>Programs (1)</b> |
|---|--|-----------------------------------|---|---|
| November 29,<br>2015 - January 2,<br>2016 | 40,250                                     | \$ 26.84                          | 40,250  | \$16,849  |
| January 3 -<br>January 30, 2016           | 21,000                                     | \$ 25.11                          | 21,000  | \$16,321  |
| January 31 -<br>February 27,<br>2016      | 6,000                                      | \$ 27.70                          | 6,000   | \$16,155  |
| .   |  |                                   |   |   |

(1) The Company is authorized to repurchase Company stock under a plan which was originally announced in 1998.

On October 9, 2014, the Board of Directors increased the remaining limit of the repurchase plan to \$20,000. At February 27, 2016, \$16,155 remains available for stock repurchases under the plan.

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

None.

### **Item 6. Exhibits**

a. Exhibits:

Exhibit 3a – Articles of Incorporation as amended are incorporated herein by reference to the Exhibit to Form 10-Q for the fiscal quarter ended February 28, 1994.

Exhibit 3b – By-laws as amended to date are incorporated herein by reference to Exhibit 3b to Form 10-Q for the fiscal quarter ended August 25, 2012, filed October 4, 2012.

Exhibit 4 – Fifth Amended and Restated Credit Agreement with BB&T dated December 5, 2015. Registrant hereby agrees to furnish the SEC, upon request, other instruments defining the rights of holders of long-term debt of the Registrant.

Exhibit 31a – Chief Executive Officer’s certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 31b – Chief Accounting Officer’s certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 32a – Chief Executive Officer’s certification pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Exhibit 32b – Chief Accounting Officer’s certification pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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PART II - OTHER INFORMATION-CONTINUED

BASSETT FURNITURE INDUSTRIES INCORPORATED AND SUBSIDIARIES

FEBRUARY 28, 2015

(Dollars in thousands except share and per share data)

Exhibit 101 – The following financial statements from the Company's Quarterly Report on Form 10-Q for the quarter ended February 27, 2016 formatted in Extensible Business Reporting Language (“XBRL”): (i) condensed consolidated balance sheets, (ii) condensed consolidated statements of operations and retained earnings, (iii) condensed consolidated statements of cash flows, and (iv) the notes to the condensed consolidated financial statements, tagged as blocks of text.

Exhibit 101.INS XBRL Instance

Exhibit 101.SCH XBRL Taxonomy Extension Schema

Exhibit 101.CAL XBRL Taxonomy Extension Calculation

Exhibit 101.DEF XBRL Taxonomy Extension Definition

Exhibit 101.LAB XBRL Taxonomy Extension Labels

Exhibit 101.PRE XBRL Taxonomy Extension Presentation

SIGNATURES

Pursuant to the requirements 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.

BASSETT FURNITURE INDUSTRIES, INCORPORATED

/s/ Robert H. Spilman, Jr.

Robert H. Spilman, Jr., President and Chief Executive Officer

March 31, 2016

/s/ J. Michael Daniel

J. Michael Daniel, Senior Vice President and Chief Financial Officer

March 31, 2016

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