

ETHAN ALLEN INTERIORS INC

Form 10-K

August 08, 2016

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended June 30, 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 number 1-11692

Ethan Allen Interiors Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

06-1275288

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

Ethan Allen Drive, Danbury, CT

(Address of principal executive offices)

06811

(Zip Code)

Registrant's telephone number, including area code (203) 743-8000

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class

Common Stock, \$.01 par value

Name of Each Exchange On Which Registered

New York Stock Exchange, Inc.

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Securities registered pursuant to Section 12(g) of the Act:

None

(Title of Class)

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>

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

The aggregate market value of the Registrant's common stock, par value \$.01 per share, held by non-affiliates (based upon the closing sale price on the New York Stock Exchange) on December 31, 2015, (the last day of the Registrant's most recently completed second fiscal quarter) was approximately \$703,752,000. As of July 31, 2016, there were 27,747,128 shares of the Registrant's common stock, par value \$.01 per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE: Certain information contained in the Registrant's definitive Proxy Statement for the 2016 Annual Meeting of stockholders, which will be filed with the Securities and Exchange Commission pursuant to Regulation 14A of the Securities Exchange Act of 1934, is incorporated by reference into Part III hereof.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

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ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

PART I

Item 1. Business

The Company

Incorporated in Delaware in 1989, Ethan Allen Interiors Inc., through its wholly-owned subsidiary, Ethan Allen Global, Inc., and Ethan Allen Global, Inc.'s subsidiaries (collectively, "We," "Us," "Our," "Ethan Allen" or the "Company"), is a leading interior design company and manufacturer and retailer of quality home furnishings. Founded over 80 years ago, today we are a leading international home fashion brand doing business in North America, Europe, Asia and the Middle East. We are vertically integrated from design through delivery, affording our clientele a value equation of style, quality and price that is unique to the industry. We offer complimentary interior design service to our clients and sell a full range of furniture products and decorative accents through ethanallen.com and a network of approximately 300 design centers in the United States and abroad. The design centers represent a mix of independent licensees and our own Company operated retail segment. We own and operate nine manufacturing facilities including six manufacturing plants and one sawmill in the United States and one manufacturing plant each in Mexico and Honduras.

Available Information

We make available, free of charge via our website, all Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and other information filed with, or furnished to, the Securities and Exchange Commission (the "SEC" or the "Commission"), including exhibits and amendments to such reports. Information contained on our website is not part of this Annual Report. This information is available at www.ethanallen.com/investors as soon as reasonably practicable after it is electronically filed with, or furnished to, the SEC. In addition, our SEC filings, including exhibits filed therewith, are also available on the SEC's website at www.sec.gov. You may obtain and copy any document we furnish or file with the SEC at the SEC's public reference room at 100 F Street, NE, Room 1580, Washington, D.C. 20549. You may obtain information on the operation of the SEC's public reference facilities by calling the SEC at 1-800-SEC-0330. You may request copies of these documents, upon payment of a duplicating fee, by writing to the SEC at its principal office at 100 F Street, NE, Room 1580, Washington, D.C..

In addition, charters of all committees of our Board of Directors, as well as our Corporate Governance guidelines, are available on our website at www.ethanallen.com/governance or, upon written request, in printed hardcopy form. Written requests should be sent to Office of the Secretary, Ethan Allen Interiors Inc., Ethan Allen Drive, Danbury, Connecticut 06811.

Mission Statement

Our primary business objective is to provide our customers with a convenient, full-service, one-stop shopping solution for their home decorating needs by offering complementary interior design services and stylish, high-quality products at good value. In order to meet our stated objective, we have developed and adhere to a focused and comprehensive business strategy. The elements of this strategy, each of which is integral to our solutions-based philosophy, include (i) our vertically integrated operating structure, (ii) our stylish products and related marketing initiatives, (iii) our retail design center network, (iv) our people, and (v) our focus on providing interior design solutions.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Operating Segments

Our products are sold through a dedicated global network of approximately 300 retail design centers. As of June 30, 2016, the Company operated 143 design centers (our retail segment) and our independent retailers operated 153 design centers (as compared to 144 and 155, respectively, at the end of the prior fiscal year). Our wholesale segment net sales include sales to our retail segment (which are eliminated in consolidation), and sales to our independent retailers. Our retail segment net sales accounted for 79% of our consolidated net sales in fiscal 2016. Our wholesale segment net sales to independent retailers accounted for 21%, including approximately 10.5% of our net sales in fiscal 2016 to the ten largest independent retailers, who operate 102 design centers. Our independent retailer in China operated 83 of these locations at the end of fiscal 2016.

Our wholesale and retail operating segments represent strategic business areas of our vertically integrated business that operate separately and provide their own distinctive services (further outlined below). This vertical structure enables us to offer our complete line of home furnishings and accents more effectively while controlling quality and cost. For certain financial information regarding our operating segments, see Note 15 to the Consolidated Financial Statements included under Item 8 of this Annual Report and incorporated herein by reference.

Our home furnishings and accents are marketed and sold in a similar manner in our wholesale and retail segments, although the type of customer (wholesale versus retail) and the specific services that each operating segment provides are different. Within the wholesale segment, we maintain revenue information according to each respective product line (i.e. case goods, upholstery, or home accents and other). Case goods include items such as beds, dressers, armoires, tables, chairs, buffets, entertainment units, home office furniture, and wooden accents. Upholstery items include sleepers, recliners and other motion furniture, chairs, ottomans, custom pillows, sofas, loveseats, cut fabrics and leather. Skilled artisans cut, sew and upholster custom-designed upholstery items which are available in a variety of frame, fabric and trim options. Home accent and other items include window treatments and drapery hardware, wall decor, florals, lighting, clocks, mattresses, bedspreads, throws, pillows, decorative accents, area rugs, wall coverings and home and garden furnishings.

We evaluate performance of the respective segments based upon revenues and operating income. Inter-segment transactions result, primarily, from the wholesale sale of inventory to the retail segment, including the related profit margin.

Wholesale Segment Overview:

Wholesale net sales for each of the last three fiscal years are summarized below (in millions):

	Fiscal Year Ended June 30,		
	2016	2015	2014
Wholesale net sales	\$491.5	\$469.4	\$453.6

Wholesale net sales for each of the last three fiscal years, allocated by product line, were as follows:

	Fiscal Year Ended June 30,		
	2016	2015	2014
Case Goods	32 %	34 %	36 %
Upholstered Products	51 %	48 %	48 %
Home Accents and Other	17 %	18 %	16 %
	100 %	100 %	100 %

The wholesale segment, principally involved in the development of the Ethan Allen brand, encompasses all aspects of design, manufacture, sourcing, sale, and distribution of our broad range of home furnishings and accents. Wholesale revenue is generated upon the wholesale sale and shipment of our products to our network of independently operated design centers and Company operated design centers (see Company operated retail comments below) through its national distribution center and one other smaller fulfillment center.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

During the past year, independent retailers opened 15 new design centers and closed 16, two of which were relocations. We continue to promote the growth and expansion of our independent retailers through ongoing support in the areas of market analysis, site selection, and business development. As in the past, our independent retailers are required to enter into license agreements with us, which (i) authorize the use of certain Ethan Allen trademarks and (ii) require adherence to certain standards of operation, including a requirement to fulfill related warranty service agreements. We are not subject to any territorial or exclusive retailer agreements in North America. The wholesale segment also develops and implements related marketing and brand awareness programs.

Wholesale profitability includes (i) the wholesale gross margin, which represents the difference between the wholesale net sales price and the cost associated with manufacturing and/or sourcing the related product, and (ii) other operating costs associated with wholesale segment activities.

Approximately 75% of the products sold by the Company are manufactured in its North American plants. During fiscal 2016, the Company's case goods manufacturing footprint increased 59,000 square feet, further increasing throughput in our Honduras facility. In our upholstery plants in Maiden, North Carolina we expanded production capacity and built a new R&D facility. A 300,000 square foot expansion is underway at our upholstery plant in Mexico which we anticipate completing during fiscal 2017. We operate four case good plants (two in Vermont including one sawmill, one in North Carolina, and one in Honduras), four upholstery plants (three at our North Carolina campus, and one in Mexico) and one home accent plant in New Jersey. We also source selected case goods, upholstery, and home accent items from third-party suppliers domestically and abroad.

As of June 30, 2016, our wholesale backlog was \$40.3 million (as compared to \$63.7 million as of June 30, 2015) which is anticipated to be serviced in the first quarter of fiscal 2017. This backlog fluctuates based on the timing of net orders booked, manufacturing schedules and efficiency, the timing of sourced product receipts, the timing and volume of wholesale shipments, and the timing of various promotional events. Because orders may be rescheduled and/or canceled and the sourcing timing may change, the measure of backlog at a point in time is not necessarily indicative of future sales performance.

For the twelve months ended June 30, 2016, net orders booked at the wholesale level, which includes orders generated by independently operated and Company operated design centers, totaled \$470.7 million as compared to \$487.4 million for the twelve months ended June 30, 2015. In any given period, net orders booked may be impacted by the timing of floor sample orders received in connection with new product introductions. New product offerings may be made available to the retail network at any time during the year, including in connection with our periodic retailer conferences.

Retail Segment Overview:

Retail net sales for each of the last three fiscal years are summarized below (in millions):

	Fiscal Year Ended June		
	30,		
	2016	2015	2014
Retail net sales	\$626.5	\$579.7	\$580.7

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Retail net sales for each of the last three fiscal years, allocated by product line, were as follows:

	Fiscal Year Ended		
	June 30,		
	2016	2015	2014
Case Goods	30 %	32 %	33 %
Upholstered Products	48 %	45 %	45 %
Home Accents and Other	22 %	23 %	22 %
	100 %	100 %	100 %

The retail segment sells home furnishings and accents to consumers through a network of Company operated design centers. The Company also offers access to its products to qualified independent interior designers through our interior design affiliate (“IDA”) program. Retail revenue is generated upon the retail sale and delivery of our products to our retail customers through our network of service centers. Retail profitability reflects (i) the retail gross margin, which represents the difference between the retail net sales price and the cost of goods, purchased primarily from the wholesale segment, and (ii) other operating costs associated with retail segment activities.

We measure the performance of our design centers based on net sales and written orders booked on a comparable period basis. Comparable design centers are those which have been operating for at least 15 months. During the first three months of operations of newly opened (including relocated) design centers, written orders are booked but minimal net sales are achieved through the delivery of products. Design centers we acquire from independent retailers are included in comparable design center sales in their 13th full month of Ethan Allen-owned operations. The frequency of our promotional events as well as the timing of the end of those events can also affect the comparability of orders booked during a given period.

We pursue further expansion of the Company operated retail business by adding interior design professionals and expanding the IDA program, opening new design centers, relocating existing design centers and, when appropriate, acquiring design centers from independent retailers. During fiscal 2016 our reach was expanded further through our launch of our gift registry, and through establishing licensing arrangements with Disney Consumer Products, an affiliate program with the Army and Air Force Exchange Service and marketing agreements with several leading national real estate brokerages. During fiscal 2016, we opened ten new design centers, six of which were relocations. The geographic distribution of retail design center locations is included under Item 2 of Part I of this Annual Report.

Products

Our strategy has been to position Ethan Allen as a preferred brand offering complimentary design service together with products of superior style, quality and value to provide consumers with a comprehensive, one-stop shopping solution for their home furnishing and interior design needs. In carrying out our strategy, we continue to expand our reach to a broader consumer base through a diverse selection of attractively priced products, designed to complement one another, reflecting current fashion trends in home decorating. During fiscal 2016, the Company continued to strengthen its product offerings by introducing new products to retail consumers in case goods, upholstery, and home accents, by introducing a very large collection of new products and existing products in new finishes under the umbrella of “Romantic Classics”, “Casual Classics”, and the expansion of our custom quick-ship program. Much of our furniture is built by hand, one piece at a time, in our North American workshops. Most frames are hand-assembled and stitching is guided by hand. We select international partners who are as committed to quality as we are. All case good frames are made with premium lumber and veneers. We use best-in-class construction techniques, including mortise and tenon joinery and four-corner glued dovetail joinery on drawers. We combine technology with personal service and maintain an up-to-date broad range of styles and custom options in keeping with today’s home decorating trends. These factors continue to define Ethan Allen, positioning us as a leader in home fashion.

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The interior of our design centers, which were substantially refreshed during the past two fiscal years, are organized to facilitate display of our product offerings, both in room settings that project the category lifestyle and by product grouping to facilitate comparisons of the styles and tastes of our clients. To further enhance the experience, technology is used to expand the range of products viewed by including content from our website in applications used on large touch-screen flat panel displays.

We continuously monitor changes in home fashion trends through attendance at international industry events and fashion shows, internal market research, and regular communication with our retailers and design center design consultants who provide valuable input on consumer trends. We believe that the observations and input gathered enable us to incorporate appropriate style details into our products to react quickly to changing consumer tastes.

Product Development and Sourcing Activities

Using a combination of on staff and outsourced product designers, we design the majority of the products we sell; all of which are branded Ethan Allen. This important facet of our vertically integrated business enables us to control the design specifications and establish consistent levels of quality across the products in our own North American plants. To capitalize on this vertical integration, between the fall of 2014 and the spring of 2016, the Company undertook a significant redesign of products. Much of the product design took advantage of the Company's custom manufacturing capabilities in its North American plants, where we manufacture and / or assemble approximately 75% of the products we sell, making us one of the largest manufacturers of home furnishings in the United States. Our main manufacturing facilities are located in the Northeast and Southeast regions of the United States supported by an upholstery plant in Mexico and a case goods plant in Honduras. Our plants are located near sources of raw materials and skilled artisans. We source approximately 25% of the products we sell from third-party suppliers, most of which are located outside the United States, primarily in Asia. We carefully select our sourcing partners and require them to provide products according to our specifications and quality standards. We believe that strategic investments in our manufacturing facilities balanced with outsourcing from foreign and domestic suppliers will accommodate significant future sales growth and allow us to maintain an appropriate degree of control over cost, quality and service to our customers.

We are focused on environmental and social responsibility and incorporating uniform environment, health and safety programs into our manufacturing standards. Our "green" initiatives include but are not limited to the use of responsibly harvested Appalachian woods, water based finishes and measuring our carbon footprint, greenhouse gases and recycled materials from our operations. We have implemented the Enhancing Furniture's Environmental Culture (EFEC) environmental management system sponsored by the American Home Furnishing Alliance (AHFA) at all of our domestic manufacturing, distribution and service center facilities, and have begun to expand these effort to our retail design centers. Our domestic manufacturing, distribution and service centers have also achieved Sustainable by Design (SBD) registration under the EFEC program. Our Silao Mexico facility has also been audited and registered

under the AHFA's EFEC program. SBD provides a framework for home furnishings companies to create and maintain a corporate culture of conservation and environmental stewardship by integrating socio-economic policies and sustainable business practices into their manufacturing operations and sourcing strategies.

Raw Materials and Other Suppliers

The most important raw materials we use in furniture manufacturing are lumber, veneers, plywood, hardware, glue, finishing materials, glass, laminates, fabrics, foam, and filling material. The various types of wood used in our products include cherry, ash, oak, maple, prima vera, African mahogany, birch, rubber wood and poplar.

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Fabrics and other raw materials are purchased both domestically and outside the United States. We have no significant long-term supply contracts, and have sufficient alternate sources of supply to prevent disruption in supplying our operations. We maintain a number of sources for our raw materials, which we believe contribute to our ability to obtain competitive pricing. Lumber prices and availability fluctuate over time based on factors such as weather and demand. The cost of some of our raw materials such as foam and shipping costs are dependent on petroleum cost. Higher material prices, cost of petroleum, and costs of sourced products could have an adverse effect on margins.

Appropriate amounts of lumber and fabric inventory are typically stocked to maintain adequate production levels. We believe that our sources of supply for these materials are sufficient and that we are not dependent on any one supplier.

We enter into standard purchase agreements with certain foreign and domestic suppliers to source selected case goods, upholstery, and home accent items. The terms of these arrangements are customary for the industry and do not contain any long-term contractual obligations on our behalf. We believe we maintain good relationships with our suppliers.

Distribution and Logistics

We distribute our products through three distribution centers, owned by the Company, strategically located in New Jersey, Oklahoma, and Virginia. These distribution centers provide efficient cross-dock operations to receive and ship product from our manufacturing facilities and third-party suppliers to our network of Company and independently operated retail service centers. Retail service centers prepare products for delivery into clients' homes. At June 30, 2016, the Company operated retail design centers were supported by 13 Company operated retail service centers and 14 service centers operated by third parties.

While we manufacture to custom order the majority of our products, we also stock selected case goods, upholstery and home accents to provide for quick delivery of in-stock items and to allow for more efficient production runs. Wholesale shipments utilize our own fleet of trucks and trailers or are subcontracted with independent carriers. Our fleet of trucks are financed under capital lease agreements with remaining terms ranging from less than two to over three years, and all of our trailers are owned.

Our practice has been to sell our products at the same delivered cost to all Company and independently operated design centers in North America, regardless of their shipping point. This policy creates pricing credibility with our wholesale customers while providing our retail network the opportunity to achieve more consistent margins by

removing fluctuations attributable to the cost of shipping. Further, this policy eliminates the need for our independent retailers to carry significant amounts of inventory in their own warehouses. As a result, we obtain more accurate consumer product demand information.

Marketing Programs

Our marketing and advertising strategies are developed to drive traffic into our network of design centers and to ethanallen.com. We believe these strategies give Ethan Allen a strong competitive advantage in the home furnishings industry. We create and coordinate print, digital and television campaigns nationally, as well as assist in international and local marketing and promotional efforts. The Company's network of approximately 300 retail design centers, along with the over 6,000 independent members of the Interior Design Affiliate program, benefit from these marketing efforts, and we believe these efforts position us to consistently fulfill our brand promise as America's Classic Design Brand.

Our team of advertising specialists creates consistent, clear messages that Ethan Allen is a leader in home fashion, designer services and classic style, with everything for the well designed home. We use several forms of media to communicate our message, including social media, digital advertising, television (national and local), direct mail, newspapers and national shelter magazines. These messages are also conveyed on our website at ethanallen.com. A strong email marketing program delivers promotional messages, inspiration, design ideas and product brochures to a growing database of clients.

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Our national television, social media, online and print advertising campaigns are designed to leverage our strong brand equity, finding creative and compelling ways to remind consumers of our tremendous range of products, services, special programs, and custom options. Coordinated local digital, television and print advertising also serve to support our national programs.

The Ethan Allen direct mail magazine, which emphasizes the eclectic mix of our wide breadth of products and services, is a key marketing tool. We publish these magazines and sell them to Company and independently operated design centers that use demographic information collected internally and through independent market research to target potential clients. Given the importance of this advertising medium, direct mail marketing lists are continually refined to target those consumers who are most likely to purchase, and improve the return on direct mail expenditures. Approximately 23 million copies of our direct mail magazine were distributed to consumers during fiscal 2016.

At ethanallen.com we provide our clients and our associates with the tools they need to shop, design and buy. The website features inspiring photography, engaging video content, and all our latest news and promotional information. This year we launched an enhanced user experience and streamlined the path to purchase by updating the designs to our category pages, product types, and checkout.

Ethan Allen also has local websites in various international regions to support our international licensees. These websites, some in local languages, provide a regionalized presentation of the brand while also linking to our main website.

We launched an online specialty store in partnership with the Army and Air Force Exchange Service. The specialty online store accessible through shopmyexchange.com is an Exchange members-only website. The Army and Air Force Exchange Service is dedicated to ensuring active and retired soldiers, airmen, and their families have access to U.S. goods and services, wherever they serve or live.

To enhance the Ethan Allen client experience, our design centers have interactive touchscreens, where users can browse our full product catalog, check out hundreds of fully designed rooms, print product descriptions, learn about promotions, and much more. Our design consultants utilize customized tablets so they can be more productive in our design centers and in our clients' homes.

Our social media platforms offer fans and followers inspirational images, trend information, and design ideas, as well as tips for how to bring distinctive Ethan Allen style to their homes. We have a robust and loyal following on Facebook, Pinterest, Instagram, Twitter, Google+, YouTube, LinkedIn and Houzz. Our products are available to buy on Pinterest where we were one of the first brands to launch with Pinterest's buyable pins program.

Our new mover and marketing program with major realtors brings Ethan Allen into targeted homes at the moment homeowners are most likely in the market for new furnishings. This program educates qualified consumers about our services and product offerings and is an extension of our designers' grassroots marketing efforts.

We also have a robust and informative extranet available to our retailers and design professionals. It is the primary source of communication in and among members of our retail network. It provides information about every aspect of the retail business at Ethan Allen, including advertising materials, prototype floor plan displays, and extensive product details.

Retail Design Center Network

Ethan Allen design centers are typically located in busy retail settings as freestanding destinations or as part of suburban strip malls or shopping malls, depending upon the real estate opportunities in a particular market. Our design centers average approximately 16,000 square feet in size with 75% between 15,000 and 25,000 square feet and 20% less than 15,000 square feet and 5% greater than 25,000 square feet.

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Combining technology with personal service in our design centers has allowed us to reduce the size of our design centers. At June 30, 2016 we operated 19 design centers that have opened in the past three years, and these average 8,700 square feet. These smaller footprint design centers reflect our direction as we move forward in repositioning our retail design center network. These new and relocated design centers also reflect our shift from destination and shopping mall locations to lifestyle centers that better project our brand and offer increased traffic opportunities.

We maintain consistency of presentation throughout the retail design center network through a comprehensive set of standards and display planning assistance. These interior display design standards assist each design center in presenting a high quality image by using focused lifestyle settings and select product category groupings to display our products and information to facilitate design solutions and to educate consumers. We also create a consistent brand projection through our exterior facades and signage. The establishment of these standards has helped position Ethan Allen as a leader in home furnishings retailing.

We continue to strengthen the retail network with many initiatives, including the opening of new and relocating design centers in desirable locations, updating presentations and floor plans, strengthening of the professionalism of our designers through training and certification, and the consolidation of certain design centers and service centers.

People

At June 30, 2016, the Company, through its subsidiaries, had approximately 5,200 employees (“associates”), none of whom are represented by unions. We believe we maintain good relationships with our employees.

The retail network, which includes both Company subsidiaries and independently operated design centers, is staffed with a sales force of interior design consultants and service professionals who provide customers with complimentary home decorating and interior design solutions. Our interior design associates receive specialty training with respect to the distinctive design and quality features inherent in each of our products and programs. This enables them to more effectively communicate the elements of style and value that serve to differentiate us from our competition. As such, we believe our design consultants, and the complimentary service they provide, create a distinct competitive advantage over other home furnishing retailers. We continue to strengthen the level of service, professionalism, interior design competence, efficiency, and effectiveness of retail design center associates. The Company’s interior design affiliate program adds further strength and breadth to our interior design reach. We believe that this program augments the design center design staff to reach more clients and improve market penetration.

We recognize the importance of our retail design center network to our long-term success. Accordingly, we believe we (i) have established a strong management team within Company operated design centers and (ii) continue to work closely with our independent retailers in order to assist them. With this in mind, we make our services available to every design center, whether independently operated or Company operated, in support of their marketing efforts, including coordinated advertising, merchandising and display programs, and by providing extensive training seminars and educational materials. We believe that the development of design consultants, service and delivery personnel, and independent retailers is important for the growth of our business. As a result, we have committed to make available comprehensive retail training programs intended to increase the customer service capabilities of each individual.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Customer Service Offerings

We offer numerous customer service programs, each of which has been developed and introduced to consumers in an effort to make their shopping experience easier and more enjoyable.

Gift Card

This program allows customers to purchase and redeem gift cards through our website or at any participating retail design center, which can be used for any of our products or services.

Ethan Allen Consumer Credit Programs

The Ethan Allen Platinum program offers consumers (clients) a menu of custom financing options. Financing offered through this program is administered by a third-party financial institution and is granted to our customers on a non-recourse basis to the Company. Clients may apply for an Ethan Allen Platinum card at any participating design center or on-line at ethanallen.com.

Competition

The domestic and global home furnishings industry faces numerous challenges, which include an influx of low-priced products from overseas. As a result, there is a high degree of competition in our markets. We differentiate ourselves as a preferred brand by adhering to a business strategy focused on providing (i) high-quality, well designed and often custom, handmade products at good value, (ii) a comprehensive complement of home furnishing design solutions, including our complimentary design service, and (iii) excellence in customer service. We consider our vertical integration a significant competitive advantage in the current environment as it allows us to design, manufacture and source, distribute, market, and sell our products through one of the industry's largest single-source retail networks.

The internet also provides a highly competitive medium for the sale of a significant amount of home furnishings each year, and we believe it is becoming increasingly important. Although much of that product is sold through commodity oriented, low priced and low service retailers, we believe consumers are spending more time window shopping on the internet and are thus better informed when they do visit our brick and mortar facilities. At Ethan Allen, the ultimate goal of our internet strategy is to drive traffic into our network of design centers by combining technology with excellent personal service. At ethanallen.com, customers have the opportunity to buy our products online but we take the process further. With so much of our product offering being custom, we encourage our website customers to get help from our network of interior design professionals. This complimentary interior design support creates a competitive advantage through our excellent personal service. This enhances the online experience and regularly leads to internet customers becoming clients of our network of interior design centers.

Industry globalization has provided us an opportunity to adhere to a blended sourcing strategy, establishing relationships with certain manufacturers, both domestically and outside the United States, to source selected case goods, upholstery, and home accent items. We intend to continue to balance our own North American production with opportunities to source from foreign and domestic manufacturers, as appropriate, in order to maintain our competitive advantage.

We believe the home furnishings industry competes primarily on the basis of product styling and quality, personal service, prompt delivery, product availability and price. We further believe that we effectively compete on the basis of each of these factors and that, more specifically, our direct manufacturing, product presentations, website, and complimentary design service create a distinct competitive advantage, further supporting our mission of providing consumers with a complete home decorating and design solution. We also believe that we differentiate ourselves further with the quality of our design service through our intensive training. Our objective is to continue to develop and strengthen our retail network by (i) expanding the Company operated retail business through the repositioning of and opening of new design centers, and (ii) obtaining and retaining independent retailers, encouraging such retailers to expand their business through the opening or relocation of new design centers with the objective of increasing the volume of their sales (iii) further expanding our sales network through our IDA and realtor referral programs and (iv) further expanding our ecommerce.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Trademarks

We currently hold, or have registration applications pending for, numerous trademarks, service marks and copyrights for the Ethan Allen name, logos and designs in a broad range of classes for both products and services in the United States and in many foreign countries. In addition, we have registered, or have applications pending for certain of our slogans utilized in connection with promoting brand awareness, retail sales and other services and certain collection names. We view such trademarks and service marks as valuable assets and have an ongoing program to diligently monitor and defend, through appropriate action, against their unauthorized use.

Executive Officers of the Registrant

Set forth in the table below is a list of our executive officers, together with certain biographical information, including their ages as of the date of this Report:

M. Farooq Kathwari, age 71

Chairman of the Board, President and Chief Executive Officer since 1988

Daniel M. Grow, age 70

Senior Vice President, Business Development since February 2015

Vice-President, Business Development from 2009 to 2015

Eric D. Koster, age 69

Vice-President, General Counsel and Secretary since April 2013

Private practice prior to joining the Company in April 2013

Tracy Paccione, age 50

Vice-President, Merchandising since June 2009

Clifford Thorn, age 64

Vice-President, Upholstery Manufacturing since May 2001

Corey Whitely, age 56

Executive Vice-President, Administration, Chief Financial Officer and Treasurer since July 2014

Executive Vice-President, Operations from October 2007 through July 2014

Item 1A. Risk Factors

The following information describes certain significant risks and uncertainties inherent in our business that should be carefully considered, along with other information contained elsewhere in this Annual Report and in other filings, when making an investment decision with respect to us. If one or more of these risks actually occurs, the impact on our business, including our financial condition, results of operations, and cash flows could be adverse.

An economic downturn may materially adversely affect our business.

Our business and results of operations are affected by international, national and regional economic conditions. Regional economic conditions in the United States and in other regions of the world where we have a concentration of design centers such as Canada or China may impact the Company greater compared to economic conditions in other parts of the world where we have lesser concentration of design centers. The United States and many other international economies experienced a major recession, which reduced the available market size for our industry from historic peak levels. While we have recalibrated the footprint of our vertically integrated enterprise to be profitable with lower revenues than achieved at our historic peak, an economic downturn of significance or extended duration could adversely affect consumer demand and discretionary spending habits and, as a result, our business performance, profitability, and cash flows.

Access to consumer credit could be interrupted and reduce sales and profitability.

Our ability to continue to access consumer credit for our clients could be negatively affected by conditions outside our control. If capital market conditions were to worsen meaningfully, there is a risk that our business partner that issues our private label credit card program may not be able to fulfill its obligations under that agreement. In addition, further tightening of credit markets may restrict the ability and willingness of customers to make purchases.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

We may be unable to obtain sufficient external funding to finance our operations and growth.

Historically, we have relied upon our cash from operations to fund our debt service, operations and growth. As we operate and expand our business, we may rely on external funding sources, including the proceeds from the issuance of additional debt or use of the \$115 million revolving bank line of credit under our existing \$150 million credit facility. The credit facility bears interest at a floating rate and there is a risk that the rate will increase and as we are not hedging our interest rate for the credit facility, our debt service costs could increase. Any unexpected reduction in cash flow from operations could increase our external funding requirements to levels above those currently available. There can be no assurance that we will not experience unexpected cash flow shortfalls in the future or that any increase in external funding required by such shortfalls will be available on acceptable terms or at all.

Operating losses could reduce our liquidity and impact our dividend policy.

Historically, we have relied on our cash from operations or debt issuances to fund our operations and the payment of cash dividends. If the Company's financial performance were to deteriorate resulting in financial losses we may not be able to fund a shortfall from operations and would require external funding. Some financing instruments used by the Company historically may not be available to the Company in the future. We cannot assure that additional sources of financing would be available to the Company on commercially favorable terms should the Company's capital requirements exceed cash available from operations and existing cash and cash equivalents. In such circumstances, the Company may reduce its quarterly dividends.

Additional impairment charges could reduce our profitability.

We have significant long-lived tangible and intangible assets recorded on our balance sheets. If our operating results decline, we may incur impairment charges in the future, which could have a material impact on our financial results. We evaluate the recoverability of the carrying amount of our long-lived tangible and intangible assets on an ongoing basis. There can be no assurance that the outcome of such future reviews will not result in substantial impairment charges. Impairment assessment inherently involves judgments as to assumptions about expected future cash flows and the impact of market conditions on those assumptions. Future events and changing market conditions may impact our assumptions as to prices, costs or other factors that may result in changes in our estimates of future cash flows. Although we believe the assumptions we use in testing for impairment are reasonable, significant changes in any of our assumptions could produce a significantly different result.

We face changes in global and local economic conditions that may adversely affect consumer demand and spending, our manufacturing operations or sources of merchandise and international operations.

Historically, the home furnishings industry has been subject to cyclical variations in the general economy and to uncertainty regarding future economic prospects. Such uncertainty, as well as other variations in global economic conditions such as rising fuel costs, wage and benefit inflation, currency fluctuations, and increasing interest rates, may continue to cause inconsistent and unpredictable consumer spending habits, while increasing our own input costs. These risks, as well as industrial accidents or work stoppages, could also severely disrupt our manufacturing operations, which could have a material adverse effect on our financial performance.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

We import a portion of our merchandise from foreign countries and operate manufacturing plants in Mexico and Honduras and operate retail design centers in Canada. As a result, our ability to obtain adequate supplies or to control our costs may be adversely affected by events affecting international commerce and businesses located outside the United States, including natural disasters, changes in international trade, central bank actions, changes in the relationship of the U.S. dollar versus other currencies, labor availability and cost, and other governmental policies of the U.S. and the countries from which we import our merchandise or in which we operate facilities. The inability to import products from certain foreign countries or the imposition of significant tariffs could have a material adverse effect on our results of operations.

Competition from overseas manufacturers and domestic retailers may adversely affect our business, operating results or financial condition.

Our wholesale business segment is involved in the development of our brand, which encompasses the design, manufacture, sourcing, sales and distribution of our home furnishings products, and competes with other U.S. and foreign manufacturers. Our retail network sells home furnishings to consumers through a network of Company operated design centers, and competes against a diverse group of retailers ranging from specialty stores to traditional furniture and department stores, any of which may operate locally, regionally and nationally, as well as over the internet. We also compete with these and other retailers for appropriate retail locations as well as for qualified design consultants and management personnel. Such competition could adversely affect our future financial performance.

Industry globalization has led to increased competitive pressures brought about by the increasing volume of imported finished goods and components, particularly for case good products, and the development of manufacturing capabilities in other countries, specifically within Asia. The increase in overseas production capacity has created over-capacity for many manufacturers, including us, which has led to industry-wide plant consolidation. In addition, because many foreign manufacturers are able to maintain substantially lower production costs, including the cost of labor and overhead, imported product may be capable of being sold at a lower price to consumers, which, in turn, could lead to some measure of further industry-wide price deflation.

We cannot provide assurance that we will be able to establish or maintain relationships with sufficient or appropriate manufacturers, whether foreign or domestic, to supply us with selected case goods, upholstery and home accent items to enable us to maintain our competitive advantage. In addition, the emergence of foreign manufacturers has served to broaden the competitive landscape. Some of these competitors produce furniture types not manufactured by us and may have greater financial resources available to them or lower costs of operating. This competition could adversely affect our future financial performance.

Failure to successfully anticipate or respond to changes in consumer tastes and trends in a timely manner could adversely impact our business, operating results and financial condition.

Sales of our products are dependent upon consumer acceptance of our product designs, styles, quality and price. We continuously monitor changes in home design trends through attendance at international industry events and fashion shows, internal marketing research, and regular communication with our retailers and design consultants who provide valuable input on consumer tendencies. However, as with all retailers, our business is susceptible to changes in consumer tastes and trends. Such tastes and trends can change rapidly and any delay or failure to anticipate or respond to changing consumer tastes and trends in a timely manner could adversely impact our business, operating results and financial condition.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Our number of manufacturing and logistics sites may increase our exposure to business disruptions and could result in higher transportation costs.

We have a limited number of manufacturing sites in our case good and upholstery operations, consolidated our distribution network into fewer centers for both wholesale and retail segments, and operate a single home accents plant. Our upholstery operations consist of three upholstery plants at our North Carolina campus and one plant in Mexico. The Company operates three manufacturing plants (North Carolina, Vermont, and Honduras) and one sawmill in support of our case goods operations. Our plants require various raw materials and commodities such as logs and lumber for our case good plants and foam, springs and engineered hardwood board for our upholstery plants. As a result of the consolidation of our manufacturing operations into fewer facilities, if any of our manufacturing or logistics sites experience significant business interruption, our ability to manufacture products or deliver timely would likely be impacted. While we have long-standing relationships with multiple outside suppliers of our raw materials and commodities, there can be no assurance of their ability to fulfill our supply needs on a timely basis. The consolidation to fewer locations has resulted in longer distances for delivery and could result in higher costs to transport products if fuel costs increase significantly.

Our current and former manufacturing and retail operations and products are subject to increasingly stringent environmental, health and safety requirements.

We use and generate hazardous substances in our manufacturing and retail operations. In addition, both the manufacturing properties on which we currently operate and those on which we have ceased operations are and have been used for industrial purposes. Our manufacturing operations and, to a lesser extent, our retail operations involve risk of personal injury or death. We are subject to increasingly stringent environmental, health and safety laws and regulations relating to our products, current and former properties and our current operations. These laws and regulations provide for substantial fines and criminal sanctions for violations and sometimes require product recalls and/or redesign, the installation of costly pollution control or safety equipment, or costly changes in operations to limit pollution or decrease the likelihood of injuries. In addition, we may become subject to potentially material liabilities for the investigation and cleanup of contaminated properties and to claims alleging personal injury or property damage resulting from exposure to or releases of hazardous substances or personal injury because of an unsafe workplace.

In addition, noncompliance with, or stricter enforcement of, existing laws and regulations, adoption of more stringent new laws and regulations, discovery of previously unknown contamination or imposition of new or increased requirements could require us to incur costs or become the basis of new or increased liabilities that could be material.

Fluctuations in the price, availability and quality of raw materials could result in increased costs or cause production delays which might result in a decline in sales, either of which could adversely impact our earnings.

We use various types of wood, foam, fibers, fabrics, leathers, and other raw materials in manufacturing our furniture. Certain of our raw materials, including fabrics, are purchased domestically and outside North America. Fluctuations in the price, availability and quality of raw materials could result in increased costs or a delay in manufacturing our products, which in turn could result in a delay in delivering products to our customers. For example, lumber prices fluctuate over time based on factors such as weather and demand, which in turn, impact availability. Production delays or upward trends in raw material prices could result in lower sales or margins, thereby adversely impacting our earnings.

In addition, certain suppliers may require extensive advance notice of our requirements in order to produce products in the quantities we desire. This long lead time may require us to place orders far in advance of the time when certain products will be offered for sale, thereby exposing us to risks relating to shifts in consumer demand and trends, and any significant downturn in the U.S. economy.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

We depend on key personnel and could be affected by the loss of their services.

The success of our business depends upon the services of certain senior executives, and in particular, the services of M. Farooq Kathwari, Chairman of the Board, President and Chief Executive Officer, who is the only one of our senior executives who operates under a written employment agreement. The loss of any such person or other key personnel could have a material adverse effect on our business and results of operations.

Our business is sensitive to increasing labor costs, competitive labor markets, our continued ability to retain high-quality personnel and risks of work stoppages.

The market for qualified employees and personnel in the retail and manufacturing industries is highly competitive. Our success depends upon our ability to attract, retain and motivate qualified artisans, professional and clerical associates and upon the continued contributions of these individuals. We cannot provide assurance that we will be successful in attracting and retaining qualified personnel. A shortage of qualified personnel may require us to enhance our wage and benefits package in order to compete effectively in the hiring and retention of qualified employees. Our labor and benefit costs may continue to increase and such increases may not be recovered. This could have a material adverse effect on our business, operating results and financial condition.

Our success depends upon our brand, marketing and advertising efforts and pricing strategies. If we are not able to maintain and enhance our brand, or if we are not successful in these other efforts, our business and operating results could be adversely affected.

Maintaining and enhancing our brand is critical to our ability to expand our base of customers and may require us to make substantial investments. Our advertising campaign utilizes television, direct mail, newspapers, magazines and radio to maintain and enhance our existing brand equity. We cannot provide assurance that our marketing, advertising and other efforts to promote and maintain awareness of our brand will not require us to incur substantial costs. If these efforts are unsuccessful or we incur substantial costs in connection with these efforts, our business, operating results and financial condition could be adversely affected.

We may not be able to maintain our current design center locations at current costs. We may also fail to successfully select and secure design center locations.

Our design centers are typically located in busy urban settings as freestanding destinations or as part of suburban strip malls or shopping malls, depending upon the real estate opportunities in a particular market. Our business competes with other retailers and as a result, our success may be affected by our ability to renew current design center leases and to select and secure appropriate retail locations for existing and future design centers.

Our results of operations for any quarter are not necessarily indicative of our results of operations for a full year.

Sales of furniture and other home furnishing products fluctuate from quarter to quarter due to such factors as changes in global and regional economic conditions, changes in competitive conditions, changes in production schedules in response to seasonal changes in energy costs and weather conditions, changes in consumer order patterns, and the timing of various promotional events. From time to time, we have experienced, and may continue to experience, volatility with respect to demand for our home furnishing products. Accordingly, results of operations for any quarter are not necessarily indicative of the results of operations for a full year.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Failure to protect our intellectual property could adversely affect us.

We believe that our copyrights, trademarks, service marks, trade secrets, and all of our other intellectual property are important to our success. We rely on patent, trademark, copyright and trade secret laws, and confidentiality and restricted use agreements, to protect our intellectual property and may seek licenses to intellectual property of others. Some of our intellectual property is not covered by any patent, trademark, or copyright or any applications for the same. We cannot provide assurance that agreements designed to protect our intellectual property will not be breached, that we will have adequate remedies for any such breach, or that the efforts we take to protect our proprietary rights will be sufficient or effective. Any significant impairment of our intellectual property rights or failure to obtain licenses of intellectual property from third parties could harm our business or our ability to compete. Moreover, we cannot provide assurance that the use of our technology or proprietary know-how or information does not infringe the intellectual property rights of others. If we have to litigate to protect or defend any of our rights, such litigation could result in significant expense.

The Company relies heavily on information and technology to operate its business, and any disruption to its technology infrastructure (including cyber attacks) or the internet could harm the Company's operations.

We operate many aspects of our business including financial reporting, and customer relationship management through server and web-based technologies, and store various types of data on such servers or with third-parties who in turn store it on servers and in the “cloud”. Any disruption to the internet or to the Company's or its service providers' global technology infrastructure, including malware, insecure coding, “Acts of God,” attempts to penetrate networks, data theft or loss and human error, could have adverse affects on the Company's operations. A cyber attack of our systems or networks that impairs our information technology systems could disrupt our business operations and result in loss of service to customers. We have a comprehensive cybersecurity program designed to protect and preserve the integrity of our information technology systems. We have experienced and expect to continue to experience actual or attempted cyber attacks of our IT systems or networks; however, none of these actual or attempted cyber attacks has had a material impact on our operations or financial condition. Additionally, we have access to sensitive customer information in the ordinary course of business. If a significant data breach occurred, our reputation may be adversely affected, customer confidence may be diminished, or we may be subject to legal claims, any of which may contribute to the loss of customers and have a material adverse impact on our business. While we have invested and continue to invest in information technology risk management, cybersecurity and disaster recovery plans, these measures cannot fully insulate the Company from technology disruptions or data theft or loss and the resulting adverse effect on the Company's operations and financial results.

We could incur substantial costs due to compliance with conflict mineral regulations, which may materially adversely affect our business, operating results, and financial condition.

The SEC has adopted rules regarding disclosure of the use of tantalum, tin, tungsten, and gold (commonly referred to as conflict minerals), which are mined from the Democratic Republic of the Congo and surrounding countries. This requirement could affect the sourcing of materials used in some of our products as well as the companies we use to manufacture our products. If our products are found to contain conflict minerals sourced from the Democratic Republic of the Congo or surrounding countries, the Company would take actions such as changing materials or designs to reduce the possibility that the purchase of conflict minerals may fund armed groups in the region. These actions could add engineering and other costs to the manufacture of our products.

We expect to incur costs to continue to upgrade our process to discover the origin of the tantalum, tin, tungsten, and gold used in our products, and to audit our conflict minerals disclosures. Our reputation and consequently our financial condition may also suffer if we have included conflict minerals originating in the Democratic Republic of the Congo or surrounding countries in our products, and those conflict minerals funded armed groups in the region.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Our 144,000 sq. ft. corporate headquarters, located in Danbury, Connecticut, and adjacent Ethan Allen Hotel and Conference Center, containing approximately 200 guestrooms, are owned by the Company. The hotel is used primarily for functions and accommodations for the general public as well as in connection with Ethan Allen functions and training programs.

We operate nine manufacturing facilities located in the U.S., Mexico and Honduras. All of these facilities are owned by the Company and include four case good plants (including one sawmill) totaling 1,789,000 square feet, four upholstery furniture plants totaling 947,000 square feet, and one home accent plant of 177,000 square feet. Our wholesale division also owns and operates three national distribution and fulfillment centers, one of which shares a facility with our manufacturing, which are a combined 1,001,000 square feet. Two of our case goods manufacturing facilities are located in Vermont, one is in North Carolina and one is in Honduras. We have three upholstery manufacturing facilities at our North Carolina campus, and one in Mexico. Our home accents plant is located in New Jersey, and our distribution facilities are located in New Jersey, Oklahoma, and Virginia .

We own three and lease ten retail service centers, totaling 732,000 square feet. Our retail service centers are located throughout the United States and Canada and serve to support our various retail sales districts.

The location activity and geographic distribution of our retail design center network as of June 30, 2016 is as follows:

	Year-to-date Fiscal 2016	Year-to-date Fiscal 2015
	Company-	Company-
	Independent	Independent
	retailer	retailer
	operated	operated
	Total	Total
Retail Design Center location activity:		

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Balance at beginning of period	155	144	299	152	143	295
New locations	15	10	25	22	4	26
Closures	(16)	(12)	(28)	(17)	(5)	(22)
Transfers	(1)	1	-	(2)	2	-
Balance at end of period	153	143	296	155	144	299
Relocations (in new and closures)	2	6	8	7	2	9

Retail Design Center geographic locations:

United States	50	137	187	58	137	195
Canada	-	6	6	2	6	8
Asia	94	-	94	87	-	87
Europe	2	-	2	1	1	2
Middle East	7	-	7	7	-	7
Total	153	143	296	155	144	299

Of the 143 Company operated retail design centers, 66 of the properties are owned and 77 of the properties are leased from independent third parties. Of the 66 owned design centers, 17 are subject to land leases. We own six additional retail properties, two of which are leased to independent Ethan Allen retailers, and four of which are leased to unaffiliated third parties. See Note 7 to the Consolidated Financial Statements included under Item 8 of this Annual Report for more information with respect to our operating lease obligations.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

We believe that all of our properties are well maintained and in good condition. We estimate that our manufacturing plants are currently operating at approximately 66% of capacity based on their current shifts and staffing. We believe we have additional capacity at selected facilities, which we could utilize with minimal additional capital expenditures.

Item 3. Legal Proceedings

In the ordinary course of our business, we are party to various legal proceedings and claims which we believe are incidental to the operation of our business. Other than as described under Note 13 to our consolidated financial statements included in Part II, Item 8 of this Annual Report on Form 10-K, we believe the ultimate outcome of these proceedings to which we are currently a party will not have a material adverse effect on our business, financial position, results of operations or cash flows.

Regulations issued under the Clean Air Act Amendments of 1990 required the industry to reformulate certain furniture finishes or institute process changes to reduce emissions of volatile organic compounds. Compliance with many of these requirements has been facilitated through the introduction of high solids coating technology and alternative formulations. In addition, we have instituted a variety of technical and procedural controls, including reformulation of finishing materials to reduce toxicity, implementation of high velocity low pressure spray systems, development of storm water protection plans and controls, and further development of related inspection/audit teams, all of which have served to reduce emissions per unit of production. We remain committed to implementing new waste minimization programs and/or enhancing existing programs with the objective of (i) reducing the total volume of waste, (ii) limiting the liability associated with waste disposal, and (iii) continuously improving environmental and job safety programs on the factory floor which serve to minimize emissions and safety risks for employees. In order to reduce the use of hazardous materials in the manufacturing process, we will continue to evaluate the most appropriate, cost-effective control technologies for finishing operations and production methods. We believe that our facilities are in material compliance with all such applicable laws and regulations. Our currently anticipated capital expenditures for environmental control facility matters are not material.

Item 4. Mine Safety Disclosures

Not applicable

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

Our common stock is traded on the New York Stock Exchange ("NYSE") under ticker symbol "ETH". The following table sets forth, for each quarterly period during the past two fiscal years, (i) the intraday high and low sales prices of our common stock as reported on the NYSE and (ii) the dividends per share declared by us:

	Market Price		Dividends
	High	Low	Per Share
<u>Fiscal 2016</u>			
First Quarter	\$31.87	\$25.76	0.14
Second Quarter	29.65	25.30	0.14
Third Quarter	32.10	22.46	0.17
Fourth Quarter	35.31	29.39	0.17
<u>Fiscal 2015</u>			
First Quarter	\$26.84	\$22.06	\$ 0.12
Second Quarter	31.24	22.58	0.12
Third Quarter	32.63	25.31	0.12
Fourth Quarter	28.25	23.33	0.14

Mr. Kathwari, Chief Executive Officer and President, has certified to the NYSE, pursuant to Section 303A.12 of the NYSE's Listing Company Manual, that he is unaware of any violation by the Company of the NYSE's corporate governance listing standards.

As of July 31, 2016, there were 238 shareholders of record of our common stock. Management estimates there are approximately 10,000 beneficial shareholders of the Company's common stock. The Company's policy is to issue quarterly dividends, and we expect to continue to declare quarterly dividends for the foreseeable future, business conditions permitting.

Equity Compensation Plan Information

The Equity Compensation Plan Information required by this Item will appear in the Ethan Allen Interiors Inc. proxy statement for the Annual Meeting of Shareholders scheduled to be held on November 16, 2016 and is incorporated herein by reference in the introductory paragraph of Part III of this Annual Report.

Issuer Purchases of Equity Securities

On November 21, 2002, our Board of Directors approved a share repurchase program authorizing us to repurchase up to 2,000,000 shares of our common stock, from time to time, either directly or through agents, in the open market at prices and on terms satisfactory to us. Subsequent to that date, the Board of Directors increased the aggregate authorization under the repurchase program on several separate occasions, the last of which was on April 13, 2015 when the Board of Directors increased the aggregate authorization to approximately 3,000,000 shares. There is no expiration date on the repurchase authorization and the amount and timing of future share repurchases, if any, will be determined as market and business conditions warrant. There were no purchases made by or on behalf of us or any affiliated purchaser (as defined in Rule 10b-18(a)(3) under the Exchange Act) of our common stock during the three months ended June 30, 2016.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Comparative Company Performance

The following line graph compares the cumulative total stockholder return for the Company with the S&P 500 Index, and the S&P Retail Select Industry Index (SPSIRE), assuming \$100 was invested on June 30, 2011.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**Item 6. Selected Financial Data**

The following table presents selected financial data for the fiscal years ended June 30, 2016, 2015, 2014, 2013 and 2012 that has been derived from our consolidated financial statements (dollar amounts in thousands except per share data). The information set forth below should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations included under Item 7 of this Annual Report and our Consolidated Financial Statements (including the notes thereto) included under Item 8 of this Annual Report.

	Fiscal Year Ended June 30,				
	2016	2015	2014	2013	2012
<u>Consolidated Operations Data</u>					
Net Sales	\$794,202	\$754,600	\$746,659	\$729,083	\$729,373
Cost of Sales	351,966	343,437	340,163	330,734	339,085
Selling, general and administrative expenses	353,057	345,229	336,860	337,912	340,591
Operating income	89,179	65,934	69,636	60,437	49,697
Interest and other expense, net	1,223	9,251	7,234	10,263	8,458
Income before income tax expense	87,956	56,683	62,402	50,174	41,239
Income tax expense (benefit)	31,319	19,541	19,471	17,696	(8,455)
Net income	\$56,637	\$37,142	\$42,931	\$32,478	\$49,694
<u>Per Share Data</u>					
Net income per basic share	\$2.02	\$1.29	\$1.48	\$1.13	\$1.72
Basic weighted average shares outstanding	28,072	28,874	28,918	28,864	28,824
Net income per diluted share	\$2.00	\$1.27	\$1.47	\$1.11	\$1.71
Diluted weighted average shares outstanding	28,324	29,182	29,276	29,239	29,109
Cash dividends per share	\$0.62	\$0.50	\$0.40	\$0.77	\$0.30
<u>Other Information</u>					
Depreciation and amortization	\$19,353	\$19,142	\$17,930	\$18,008	\$18,581
Capital expenditures and acquisitions	\$23,132	\$21,778	\$19,305	\$19,775	\$23,404
Working capital	\$124,857	\$130,012	\$169,582	\$127,631	\$131,715
Current ratio	2.01 to 1	1.92 to 1	2.25 to 1	1.96 to 1	1.87 to 1
Effective tax rate	35.6 %	34.5 %	31.2 %	35.3 %	-20.5 %
<u>Balance Sheet Data (at end of period)</u>					
Total assets	\$577,409	\$605,977	\$654,434	\$617,285	\$644,788
Total debt, including capital lease obligations	41,838	76,237	130,912	131,289	154,500
Shareholders' equity	\$392,202	\$370,535	\$367,467	\$334,357	\$321,868
Debt as a percentage of equity	10.7 %	20.6 %	35.6 %	39.3 %	48.0 %

Debt as a percentage of capital	9.6	%	17.1	%	26.3	%	28.2	%	32.4	%
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ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation

The following discussion of financial condition and results of operations is based upon, and should be read in conjunction with, our Consolidated Financial Statements (including the notes thereto) included under Item 8 of this Annual Report.

Forward-Looking Statements

Management's discussion and analysis of financial condition and results of operations and other sections of this Annual Report on Form 10-K contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which represent management's beliefs and assumptions concerning future events based on information currently available to us relating to our future results. Such forward-looking statements are identified in this Annual Report on Form 10-K and in documents incorporated herein by reference by use of forward-looking words such as "anticipate", "believe", "plan", "estimate", "expect", "intend", "will", "may", "continue", "project", "target", "outlook", "forecast", "guidance", and similar expressions and the neg such forward-looking words. These forward-looking statements are subject to management decisions and various assumptions about future events, and are not guarantees of future performance. A number of risks and uncertainties could cause actual results to differ materially from those anticipated in the forward-looking statements, including, but not limited to: changes in global or regional political or economic conditions, including changes in governmental and central bank policies; our ability to secure debt or other forms of financing; the effect of operating losses on our ability to pay cash dividends; changes in business conditions in the furniture industry, including changes in consumer spending patterns, tastes and demand for home furnishings; competition from overseas manufacturers and domestic retailers and competitive factors such as changes in products or marketing efforts of others; effects of our brand awareness and marketing programs, including changes in demand for our existing and new products; our ability to locate new design center sites and/or negotiate favorable lease terms for additional design centers or for the expansion of existing design centers; fluctuations in interest rates and the cost, availability and quality of raw materials; pricing pressures; the effects of labor strikes; weather conditions that may affect sales; volatility in fuel, utility, transportation and security costs; the potential effects of natural disasters affecting our suppliers or trading partners; the effects of terrorist attacks or conflicts or wars involving the United States or its allies or trading partners; and those matters discussed in Items 1A and 7A of this Annual Report on Form 10-K and in our other SEC filings. Accordingly, actual circumstances and results could differ materially from those contemplated by the forward-looking statements.

Given the risks and uncertainties surrounding forward-looking statements, you should not place undue reliance on these statements. Many of these factors are beyond our ability to control or predict. Our forward-looking statements speak only as of the date of this Annual Report on Form 10-K. Other than as required by law, we undertake no

obligation to update or revise forward-looking statements, whether as a result of new information, future events, or otherwise.

Critical Accounting Policies

Our consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles that require, in some cases, that certain estimates and assumptions be made that affect the amounts and disclosures reported in those financial statements and the related accompanying notes. Estimates are based on currently known facts and circumstances, prior experience and other reasonable assumptions. We use our best judgment in valuing these estimates and may, as warranted, solicit external advice. Actual results could differ from these estimates, assumptions and judgments, and these differences could be material. The following critical accounting policies, some of which are impacted significantly by estimates, assumptions and judgments, affect our consolidated financial statements.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Inventories – Inventories (finished goods, work in process and raw materials) are stated at the lower of cost, determined on a first-in, first-out basis, or market. Cost is determined based solely on those charges incurred in the acquisition and production of the related inventory (i.e. material, labor and manufacturing overhead costs). We estimate an inventory reserve for excess quantities and obsolete items based on specific identification and historical write-downs, taking into account future demand and market conditions. If actual demand or market conditions in the future are less favorable than those estimated, additional inventory write-downs may be required.

Revenue Recognition – Revenue is recognized when all of the following have occurred: persuasive evidence of a sales arrangement exists (e.g. a wholesale purchase order or retail sales invoice); the sales arrangement specifies a fixed or determinable sales price; title and risk of ownership has passed to the customer; no specific performance obligations remain; product is shipped or services are provided to the customer; collectability is reasonably assured. As such, revenue recognition generally occurs upon the shipment of goods to independent retailers or, in the case of Ethan Allen operated retail design centers, upon delivery to the customer. If a shipping charge is billed to customers, this is included in revenue. Recorded sales provide for estimated returns and allowances. We permit our customers to return defective products and incorrect shipments, and terms we offer are standard for the industry.

Allowance for Doubtful Accounts – We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. The allowance for doubtful accounts is based on a review of specifically identified accounts in addition to an overall aging analysis. Judgments are made with respect to the collectability of accounts receivable based on historical experience and current economic trends. Actual losses could differ from those estimates.

Retail Design Center Acquisitions – We account for the acquisition of retail design centers and related assets with the purchase method. Accounting for these transactions as purchase business combinations requires the allocation of purchase price paid to the assets acquired and liabilities assumed based on their fair values as of the date of the acquisition. The amount paid in excess of the fair value of net assets acquired is accounted for as goodwill.

Impairment of Long-Lived Assets and Goodwill – Goodwill and other indefinite-lived intangible assets are evaluated for impairment on an annual basis during the fourth quarter of each fiscal year, and between annual tests whenever events or circumstances indicate that the carrying value of the goodwill or other intangible asset may exceed its fair value. When testing goodwill for impairment, we may assess qualitative factors for some or all of our reporting units to determine whether it is more likely than not (that is, a likelihood of more than 50 percent) that the fair value of a reporting unit is less than its carrying amount, including goodwill. Alternatively, we may bypass this qualitative assessment for some or all of our reporting units and determine whether the carrying value exceeds the fair value using a quantitative assessment as described below.

The recoverability of long-lived assets are evaluated for impairment by determining whether the carrying value will be recovered through the expected undiscounted future cash flows resulting from the use of the asset. In the event the sum of the expected undiscounted future cash flows is less than the carrying value of the asset, an impairment loss equal to the excess of the asset's carrying value over its fair value is recorded. The long-term nature of these assets requires the estimation of cash inflows and outflows several years into the future and only takes into consideration technological advances known at the time of the impairment test.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

To evaluate goodwill using a quantitative assessment, the Company determines the current fair value of the reporting units using a combination of “Market” and “Income” approaches. In the Market approach, the “Guideline Company” method is used, which focuses on comparing the Company’s risk profile and growth prospects to reasonably similar publicly traded companies. Key assumptions used for the Guideline Company method are total invested capital (“TIC”) multiples for revenues and operating cash flows, as well as consideration of control premiums. The TIC multiples are determined based on public furniture companies within our peer group, and if appropriate, recent comparable transactions are considered. Control premiums are determined using recent comparable transactions in the open market. Under the Income approach, a discounted cash flow method is used, which includes a terminal value, and is based on external analyst financial projection estimates, as well as internal financial projection estimates prepared by management. The long-term terminal growth rate assumptions reflect our current long-term view of the market in which we compete. Discount rates use the weighted average cost of capital for companies within our peer group, adjusted for specific company risk premium factors.

The fair value of our trade name, which is the Company’s only indefinite-lived intangible asset other than goodwill, is valued using the relief-from-royalty method. Significant factors used in trade name valuation are rates for royalties, future growth, and a discount factor. Royalty rates are determined using an average of recent comparable values. Future growth rates are based on the Company’s perception of the long-term values in the market in which we compete, and the discount rate is determined using the weighted average cost of capital for companies within our peer group, adjusted for specific company risk premium factors.

In the fourth quarter of fiscal years 2016, 2015 and 2014, the Company performed qualitative assessments of the fair value of the wholesale reporting unit and concluded that the fair value of its goodwill exceeded its carrying value. The fair value of the trade name exceeded its carrying value by a substantial margin in fiscal years 2016, 2015, and 2014. To calculate fair value of these assets, management relies on estimates and assumptions which by their nature have varying degrees of uncertainty. Wherever possible, management therefore looks for third party transactions to provide the best possible support for the assumptions incorporated. Management considers several factors to be significant when estimating fair value including expected financial outlook of the business, changes in the Company’s stock price, the impact of changing market conditions on financial performance and expected future cash flows, and other factors. Deterioration in any of these factors may result in a lower fair value assessment, which could lead to impairment of the long-lived assets and goodwill of the Company.

Income Taxes – Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Additional factors that we consider when making judgments about the deferred tax valuation include tax law changes,

a recent history of cumulative losses, and variances in future projected profitability.

The Company evaluates, on a quarterly basis, uncertain tax positions taken or expected to be taken on tax returns for recognition, measurement, presentation, and disclosure in its financial statements. If an income tax position exceeds a 50% probability of success upon tax audit, based solely on the technical merits of the position, the Company recognizes an income tax benefit in its financial statements. The tax benefits recognized are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The liability associated with an unrecognized tax benefit is classified as a long-term liability except for the amount for which a cash payment is expected to be made or tax positions settled within one year. We recognize interest and penalties related to income tax matters as a component of income tax expense.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Business Insurance Reserves – We have insurance programs in place to cover workers’ compensation and property/casualty claims. The insurance programs, which are funded through self-insured retention, are subject to various stop-loss limitations. We accrue estimated losses using actuarial models and assumptions based on historical loss experience. Although we believe that the insurance reserves are adequate, the reserve estimates are based on historical experience, which may not be indicative of current and future losses. In addition, the actuarial calculations used to estimate insurance reserves are based on numerous assumptions, some of which are subjective. We adjust insurance reserves, as needed, in the event that future loss experience differs from historical loss patterns.

Other Loss Reserves – We have a number of other potential loss exposures incurred in the ordinary course of business such as environmental claims, product liability, litigation, tax liabilities, restructuring charges, and the recoverability of deferred income tax benefits. Establishing loss reserves for these matters requires the use of estimates and judgment with regard to maximum risk exposure and ultimate liability or realization. As a result, these estimates are often developed with our counsel, or other appropriate advisors, and are based on our current understanding of the underlying facts and circumstances. Because of uncertainties related to the ultimate outcome of these issues or the possibilities of changes in the underlying facts and circumstances, additional charges related to these issues could be required in the future.

Results of Operations

A summary of our consolidated operations for the past three fiscal years are presented in the following table (\$ in millions).

	Fiscal years ended June 30,					
	2016	%	2015	%	2014	%
Net sales	\$794.2	100.0%	\$754.6	100.0%	\$746.7	100.0%
Gross profit	\$442.2	55.7 %	\$411.2	54.5 %	\$406.5	54.4 %
SG&A	\$353.1	44.5 %	\$345.2	45.7 %	\$336.9	45.1 %
Operating income	89.2	11.2 %	65.9	8.7 %	69.6	9.3 %
Net income	56.6	7.1 %	37.1	4.9 %	42.9	5.7 %
Earnings per diluted share	\$2.00		\$1.27		\$1.47	
Net cash provided by operating activities	\$58.4		\$55.1		\$59.9	

A summary of changes from the preceeding fiscal year are presented in the following table.

	Fiscal years ended June		
	30,		
	2016	2015	2014
Net sales	5.2 %	1.1 %	2.4 %
Operating income	35.3 %	-5.3 %	15.2 %
Net income	52.5 %	-13.5 %	32.2 %
Earnings per diluted share	57.5 %	-13.6 %	32.4 %
Net cash provided by operating activities	5.9 %	-8.0 %	-2.3 %

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Beginning in the fall of 2014, we began a major transformation of our product offerings with several phases. We introduced Casual Classics during the first phase in the fall of 2014, focusing on several design projections with relaxed finishes and comfort. In the spring and summer of 2015, we launched the second phase, Romantic Classics, with design projections featuring unique, stand-alone timeless pieces with new finishes and forms, designed specifically for manufacturing primarily at our North American workshops to obtain maximum benefit from our vertical integration. We launched the third phase in the fall of 2015, during which we further developed Romantic Classics, inspired by European designs, taking inspiration from the classics and modernizing them for today's living, with continued focus on North American manufacturing. In our current phase, we continue to differentiate our brand by further expanding our Casual Classics, with three new design projections; Buckhead, featuring designs infused with European inspiration and Southern charm, introduced in June 2016; Santa Monica, a blend of breezy beach house and vintage farmhouse flair, introduced in July 2016; and Brooklyn, a sophisticated industrial design, expected to be introduced in August 2016. These new product offerings will be followed by the introduction of our Ethan Allen | Disney home line in the fall of 2016. While we implement major product introductions, such as the anticipated introductions described above, our wholesale segment experiences some disruptions in manufacturing as we change tooling and methods, build prototypes and then ramp up production. In our retail segment, some disruption also occurs in our design centers as we update floor displays, and sell the remainder of our older products on clearance to make space for the new product. Our continuous product transformation in measured steps helps us minimize these disruptions and preserve our reputation for offering high-quality and fashionable products.

For the year ended June 30, 2016, our net sales increased from the prior fiscal year at a higher rate than in the previous two fiscal years, as our new introductions and marketing efforts gain traction with consumers. Operating expenses during fiscal 2016 decreased as a percentage of sales in fiscal 2016 compared to fiscal 2015, further contributing to a fiscal 2016 net income increase of 52.5% over the prior fiscal year and earnings per diluted share of \$2.00. Net cash provided by operating activities along with operating cash enabled us to repurchase \$19.3 million of our common stock under our share repurchase program, pay down \$31.5 million of our debt earlier than scheduled, and return \$16.6 million in cash dividends to our shareholders. At June 30, 2016 we had total cash and securities of \$60.5 million, and working capital of \$124.9 million.

The components of consolidated revenues and operating income (loss) by business segment are as follows (in millions):

	Fiscal Year Ended June 30,		
	2016	2015	2014
Revenue:			
Wholesale segment	\$491.5	\$469.4	\$453.6
Retail segment	626.5	579.7	580.7
Elimination of inter-segment sales	(323.8)	(294.5)	(287.6)
Consolidated revenue	\$794.2	\$754.6	\$746.7

Operating income :

Wholesale segment	\$74.4	\$67.0	\$57.8
Retail segment	16.5	1.7	10.5
Adjustment for inter-company profit (1)	(1.7)	(2.8)	1.3
Consolidated operating income	\$89.2	\$65.9	\$69.6

(1) Represents the change in wholesale profit contained in Ethan Allen operated design center inventory existing at the end of the period.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

A summary by business segment of annual percentage changes from the preceeding fiscal years are presented in the following tables.

	Fiscal Year Ended June 30,		
	2016	2015	2014
Wholesale segment			
Revenue	4.7 %	3.5 %	4.4 %
Operating Income	11.1 %	15.9 %	13.7 %
Backlog	-36.8 %	41.8 %	-6.5 %

	Fiscal Year Ended June 30,		
	2016	2015	2014
Retail segment			
Revenue	8.1 %	-0.2 %	0.4 %
Comparable design center revenue	8.5 %	0.7 %	3.0 %
Total written orders	1.7 %	3.9 %	1.0 %
Comparable design center written orders	1.8 %	4.4 %	3.0 %
Operating Income	853.1 %	-83.6 %	31.2 %
Backlog	-13.1 %	18.6 %	-4.7 %

The fiscal 2016 decreases in backlogs of 36.8% for wholesale and 13.1% for retail followed backlog increases at the end of fiscal 2015. In June 2015 a price increase effective July 1, 2015 was announced which created a spike in June 2015 orders for both wholesale and retail, in advance of the price increase, increasing the fiscal 2015 ending backlogs. There was no corresponding price increase announced at the end of fiscal 2016.

Operating income in the retail segment in fiscal 2016 increased 853.1% compared to fiscal 2015 primarily due to a \$46.8 million increase in revenue in fiscal 2016, and net gains on the sale of real estate in fiscal 2016 compared to net losses in fiscal 2015.

We continue to make investments to strengthen the level of service, professionalism, interior design competence, efficiency, and effectiveness of the retail network design center personnel. We believe that over time, we will continue to benefit from (i) continuous repositioning and opening of new design centers in our retail network, (ii) frequent new product introductions, (iii) new and innovative marketing promotions and effective use of targeted advertising media, and (iv) continued use of the latest technology coupled with personal service from our interior design professionals.

We believe our network of professionally trained interior design professionals differentiates us significantly from others in our industry.

Our manufacturing operations gained efficiency by increasing throughput in our Honduras facility, and expanding capacity and building a new R&D facility in North Carolina. We estimate our manufacturing facilities are currently operating at approximately 66% of capacity based on their current shifts and staffing. We believe we have sufficient scalable capacity that can support strong sales growth while maintaining control over cost, quality and service to our customers.

Business Results:

Our revenues are comprised of (i) wholesale sales to independently operated and Company operated retail design centers and (ii) retail sales of Company operated design centers. See Note 15 to our Consolidated Financial Statements for the year ended June 30, 2016 included under Item 8 of this Annual Report.

Fiscal 2016 Compared to Fiscal 2015

Consolidated revenue for the fiscal year ended June 30, 2016 was \$794.2 million compared to \$754.6 million for fiscal 2015. There was year-over-year sales growth in both the wholesale and retail segments.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Wholesale revenue for fiscal 2016 increased by \$22.1 million, or 4.7%, to \$491.5 million from \$469.4 million in the prior fiscal year. The year-over-year increase was attributable to increased sales to our Company operated design centers and domestic independent retailers, partly offset by a decrease to our international independent design centers, primarily in China. There were 296 design centers globally as of June 30, 2016, a decrease by three from June 30, 2015. There was a net decrease of two independently operated retail network locations, which included a decrease of eight legacy locations in the U.S., bringing the total U.S. independent total to 50, and a net increase of eight new locations in China, bringing the China total to 83. Our international net sales to independent retailers was 5.4% of our consolidated net sales for the fiscal year ended June 30, 2016 compared to 7.5% the previous fiscal year.

Retail revenue from Ethan Allen operated design centers for the twelve months ended June 30, 2016 increased by \$46.8 million, or 8.1%, to \$626.5 million from \$579.7 million for the twelve months ended June 30, 2015. Comparable store revenue increased 8.5%. Year-over-year, written orders for the Company operated design centers increased 1.7% and comparable design centers written orders increased 1.8%. A higher increase in net sales relative to written orders is reflected in the 13.1% decrease in ending backlog at June 30 2016.

Gross profit for fiscal 2016 increased to \$442.2 million from \$411.2 million in fiscal 2015. The \$31.1 million increase in gross profit was attributable to increases in both our retail and wholesale segment net sales, as well as a higher mix of retail net sales to consolidated net sales in fiscal 2016 of 78.9% compared to the 76.8% in the prior fiscal year.

Operating expenses increased \$7.8 million or 2.3% to \$353.1 million or 44.5% of net sales in fiscal 2016 from \$345.2 million or 45.7% of net sales in fiscal 2015. The increase in fiscal year 2016 expenses in absolute dollars is primarily due to increased variable costs associated with our increased sales in both business segments. As a percentage of net sales, expenses decreased during fiscal 2016 as compared to fiscal 2015 primarily due to gains associated with the disposal of real estate in fiscal 2016 compared to expenses in the prior fiscal year.

Operating income for the fiscal year ended June 30, 2016 totaled \$89.2 million, or 11.2% of net sales, compared to \$65.9 million, or 8.7% of net sales, in the prior fiscal year. Wholesale operating income for fiscal 2016 totaled \$74.4 million, or 15.1% of net sales, as compared to \$67.0 million, or 14.3% of net sales, in the prior year. Retail operating income was \$16.5 million, or 2.6% of sales, for fiscal 2016, compared to \$1.7 million, or 0.3% of sales, for fiscal 2015, an increase of \$14.7 million. The increase in consolidated operating income was primarily attributable to increased net sales, and the net impact of real estate dispositions on both fiscal years as previously discussed.

Interest and other income, net was \$0.4 million in fiscal 2016 compared to an expense of \$3.3 million in fiscal 2015. The prior fiscal year included a loss on the early extinguishment of our Senior Notes in the quarter ended March 31, 2015 of \$3.7 million, which consisted of a \$3.5 million “make whole” payment, and the write-off of unamortized balances of original issue discount, deferred financing fees and derivative instruments.

Interest and other related financing costs decreased \$4.3 million to \$1.6 million from \$5.9 million in the prior fiscal year. The decrease is primarily due to lower interest expense throughout fiscal 2016 due to early extinguishment of our Senior Notes in the quarter ended March 31, 2015, as well as further debt repayments during fiscal 2016.

Income tax expense was \$31.3 million for fiscal 2016 and \$19.5 million for fiscal 2015. Our effective tax rate for fiscal 2016 was 35.6% compared to 34.5% in fiscal 2015. The effective tax rate for both fiscal years primarily includes tax expense on that fiscal year’s net income, and tax and interest expense on uncertain tax positions, partially offset by the reversal and recognition of some uncertain tax positions.

Net income for fiscal 2016 was \$56.6 million as compared to \$37.1 million in fiscal 2015. Net income per diluted share totaled \$2.00 in fiscal 2016 compared to \$1.27 per diluted share in the prior fiscal year.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Fiscal 2015 Compared to Fiscal 2014

Consolidated revenue for the fiscal year ended June 30, 2015 was \$754.6 million compared to \$746.7 million for fiscal 2014. There was year-over-year sales growth in the wholesale segment and a slight decline in the retail segment. The increase in the wholesale segment in fiscal 2015 was primarily due to higher shipments internationally and to our retail segment.

Wholesale revenue for fiscal 2015 increased by \$15.8 million, or 3.5%, to \$469.4 million from \$453.6 million in fiscal 2014. The year-over-year increase was attributable to increased sales to both our Company operated design centers and independent retailers worldwide. Orders similarly increased 7.7% during the same period. The number of total design centers globally as of June 30, 2015 was 299, which increased by four from June 30, 2014. The independently operated retail network, net of relocations, increased by three design centers to 155 at June 30, 2015 including a net increase of five locations to 75 in China. Our international net sales to independent retailers was 7.5% of our consolidated net sales for the fiscal year ended June 30, 2015 compared to 6.5% the for the year ended June 30, 2014.

Retail revenue from Ethan Allen operated design centers for the twelve months ended June 30, 2015 decreased by \$1.0 million, or 0.2%, to \$579.7 million from \$580.7 million for the twelve months ended June 30, 2014. Year-over-year, written orders for the Company operated design centers increased 3.9% and comparable design centers written business increased 4.4%. Net sales were impacted by the increased level of clearance sales during fiscal 2015 as compared to fiscal 2014. The strengthening of the U.S. dollar to the Canadian dollar and euro resulted in an average decrease in sales of 0.5% due to the seven to eight design centers we operated in Canada and Europe throughout the fiscal year. The increase in written orders is reflected in the 18.6% increase in ending backlog at June 30 2015.

Gross profit for fiscal 2015 increased to \$411.2 million from \$406.5 million in fiscal 2014. The \$4.7 million increase in gross profit was primarily attributable to increases in our wholesale segment of both manufacturing efficiency and net sales. This was partly offset by a lower mix of retail net sales to consolidated net sales in fiscal 2015 of 76.8% compared to the 77.8% in fiscal 2014, and a net increase in cost of goods sold due to the elimination of intercompany profit in ending inventory.

Operating expenses increased \$8.4 million or 2.5% to \$345.2 million or 45.7% of net sales in fiscal 2015 from \$336.9 million or 45.1% of net sales in fiscal 2014. The increase in fiscal 2015 expenses is primarily due to costs associated with strengthening our management team in the retail segment, increased maintenance and repair costs and

depreciation expense associated with our retail design center refurbishing efforts undertaken during fiscal 2015 and increased expense associated with the disposal of real estate, due to our continual repositioning of the retail network.

Operating income for the fiscal year ended June 30, 2015 totaled \$65.9 million, or 8.7% of net sales, compared to \$69.6 million, or 9.3% of net sales, in fiscal 2014. Wholesale operating income for fiscal 2015 totaled \$67.0 million, or 14.3% of net sales, as compared to \$57.8 million, or 12.7% of net sales, in fiscal 2014. Retail operating income was \$1.7 million, or 0.3% of sales, for fiscal 2015, compared to \$10.5 million, or 1.8% of sales, for fiscal 2014, a decrease of \$8.8 million. The reduction in consolidated operating income was primarily attributable to increased operating expenses in our retail segment and increased clearance sales as previously discussed, and an increase in the intercompany profit in ending inventory, partly offset by increases in our wholesale segment due to efficiency and volume.

Interest and other income, net was an expense of \$3.3 million in fiscal 2015 compared to income of \$0.3 million in fiscal 2014. Fiscal 2015 included a loss on the early extinguishment of our Senior Notes in the quarter ended March 31, 2015 of \$3.7 million, which consisted of a \$3.5 million “make whole” payment, and the write-off of unamortized balances of original issue discount, deferred financing fees and derivative instruments.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Interest and other related financing costs decreased \$1.6 million to \$5.9 million from \$7.5 million in fiscal 2014. The decrease is primarily due to lower interest expense throughout fiscal 2015, from lower debt due to the Senior Note repurchases during fiscal 2014 and the early extinguishment of our Senior Notes in the quarter ended March 31, 2015.

Income tax expense was \$19.5 million for both fiscal 2015 and fiscal 2014. Our effective tax rate for fiscal 2015 was 34.5% compared to 31.2% in fiscal 2014. The fiscal 2015 effective tax rate includes tax expense on income, and the recognition of certain previously unrecognized tax benefits, partly offset by recording tax and interest expense on additional uncertain tax positions. The fiscal 2014 effective tax rate includes tax expense on income, the benefit from the reversal of valuation allowances against certain deferred tax assets in the retail segment, and the recognition of certain previously unrecognized tax benefits, partially offset by tax and interest expense on additional uncertain tax positions.

Net income for fiscal 2015 was \$37.1 million as compared to \$42.9 million in fiscal 2014. Net income per diluted share totaled \$1.27 in fiscal 2015 compared to \$1.47 per diluted share in fiscal 2014.

Liquidity and Capital Resources

At June 30, 2016, we held unrestricted cash and equivalents of \$52.7 million and restricted cash and investments of \$7.8 million. At June 30, 2015, we held unrestricted cash and cash equivalents of \$76.2 million, marketable securities of \$2.2 million, and restricted cash and investments of \$8.0 million. During fiscal 2016 we used cash to pay down a portion of our debt and for common share repurchases. Our principal sources of liquidity include cash and cash equivalents, marketable securities, cash flow from operations, amounts available under our credit facility, and other borrowings.

In September 2005, we issued \$200 million in ten-year senior unsecured notes due October 1, 2015 (the "Senior Notes"). The Company entered into a five year, \$150 million senior secured revolving credit and term loan facility on October 21, 2014, as amended (the "Facility"). The Facility, which expires on October 21, 2019, provides a term loan of up to \$35 million and a revolving credit line of up to \$115 million, subject to borrowing base availability. During March 2015, we utilized \$35 million of the term loan and \$40 million of the revolving credit line, along with our available cash to fully redeem our Senior Notes. We incurred financing costs of \$1.5 million under the Facility, which are being amortized by the interest method, over the remaining life of the Facility.

At the Company's option, revolving loans under the Facility bear interest, based on the average availability, at an annual rate of either (a) the London Interbank Offered rate ("LIBOR") plus 1.5% to 1.75%, or (b) the higher of (i) the prime rate, (ii) the federal funds effective rate plus 0.50%, or (iii) LIBOR plus 1.0% plus in each case 0.5% to 0.75%. At June 30, 2016 the annual interest rate in effect on the revolving loan was 2.0%.

At the Company's option, term loans under the Facility bear interest, based on the Company's rent adjusted leverage ratio, at an annual rate of either (a) LIBOR plus 1.75% to 2.25%, or (b) the higher of (i) the prime rate, (ii) the federal funds effective rate plus 0.50%, or (iii) LIBOR plus 1.0% plus in each case 0.75% to 1.25%. At June 30, 2016 the annual interest rate in effect on the term loan was 2.25%.

The Company pays a commitment fee of 0.15% to 0.25% per annum on the unused portion of the Facility, and fees on issued letters of credit at an annual rate of 1.5% to 1.75% based on the average availability. Certain payments are restricted if the availability under the revolving credit line falls below 20% of the total revolving credit line, and the Company is subject to pro forma compliance with the fixed charge coverage ratio if applicable.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Quarterly installments of principal on the term loan are payable based on a straight line 15-year amortization period, with the balance due at maturity. The Company does not expect to repay the revolving credit line portion of the Facility within the next year.

The Facility is secured by all property owned, leased or operated by the Company in the United States and includes certain real property owned by the Company and contains customary covenants which may limit the Company's ability to incur debt; engage in mergers and consolidations; make restricted payments (including dividends and share repurchases); sell certain assets; and make investments.

The Company must maintain a minimum fixed charge coverage ratio of 1.1 to 1.0 at all times. If the outstanding term loans are less than \$17.5 million and the fixed charge coverage ratio equals or exceeds 1.25 to 1.0, the fixed charge coverage ratio ceases to apply and thereafter is only triggered if average monthly availability is less than 15% of the amount of the revolving credit line. During November 2015, we made a \$16.5 million prepayment on the term loan, bringing the outstanding term loan to \$17.3 million, and the fixed charge coverage ratio ceased to apply. Our subsequent average availability exceeded 65%, such that the fixed charge coverage ratio did not apply.

The Company intends to use the Facility for working capital and general corporate purposes, including dividend payments and share repurchases, in addition to the refinancing of our Senior Notes which occurred in March 2015. At both June 30, 2016 and June 30, 2015, there was \$0.2 million of standby letters of credit outstanding under the Facility. Total availability under the Facility was \$89.8 million at June 30, 2016 and \$74.8 million at June 30, 2015. The increase in availability was due to \$15.0 million payments we made on the revolving loan during fiscal 2016.

At both June 30, 2016 and June 30, 2015, we were in compliance with all covenants of the Senior Notes and the credit facilities.

A summary of net cash provided by (used in) operating, investing, and financing activities for each of the last three fiscal years is provided below (in millions):

	Fiscal Years Ended June		
	30,		
	2016	2015	2014
<u>Cash provided by (used in) operating activities</u>			

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Net income plus depreciation and amortization	\$76.0	\$56.3	\$60.9
Working capital items	(19.3)	(15.2)	(2.1)
Other operating activities	1.7	14.0	1.1
Total provided by operating activities	\$58.4	\$55.1	\$59.9

Cash provided by (used in) investing activities

Capital expenditures & acquisitions	\$(23.1)	\$(21.8)	\$(19.3)
Net sales (purchases) of marketable securities	2.2	15.4	(3.4)
Other investing activities	8.4	9.8	10.6
Total provided (used) in investing activities	\$(12.5)	\$3.4	\$(12.1)

Cash provided by (used in) financing activities

Payments of long-term debt and capital lease obligations	\$(34.8)	\$(133.7)	\$(0.5)
Borrowings from revolving credit and term loan facilities	\$-	\$75.0	\$-
Purchases and retirements of company stock	(19.3)	(17.6)	-
Payment of cash dividends	(16.6)	(13.3)	(11.3)
Other financing activities	1.6	(1.4)	0.5
Total used in financing activities	\$(69.1)	\$(91.0)	\$(11.3)

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Cash Provided By (Used in) Operating Activities

In fiscal 2016 cash of \$58.4 million was provided by operating activities, an increase of \$3.3 million from \$55.1 million in the prior year comparable period. This was largely due to an increase in net income in fiscal 2016. This was partly offset by net decreases in other operating activities of \$12.3 million and cash used for working capital in the ordinary course of business of \$4.1 million (defined below). Net income plus depreciation and amortization in the prior fiscal year includes a \$3.7 million expense for the early redemption of our Senior Notes. Of this amount, \$3.5 million is offset as a positive in other operating activities, as this is considered a financing activity and not an operating activity. Other operating activities changed primarily due to net gains on the sale of real estate in the current year compared to net losses in the prior year. These are deducted from net income to arrive at cash from operating activities. Working capital items consist of current assets (accounts receivable, inventories, prepaid and other current assets) less current liabilities (customer deposits, payables, and accrued expenses and other current liabilities).

Cash Provided By (Used in) Investing Activities

In fiscal 2016, cash of \$12.5 million was used in investing activities, an increase in cash used of \$16.0 million from \$3.4 million which was provided by during the prior year comparable period. More cash was used during fiscal 2016 primarily due to decreases in net sales of marketable securities in the current fiscal year. There were also less proceeds from the sale of real estate in fiscal 2016 than in the prior fiscal year, although the gains on sale were greater in fiscal 2016 than in the prior fiscal year, and increased current fiscal year capital expenditures. We anticipate that cash from operations will be sufficient to fund future capital expenditures.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES***Cash Provided By (Used in) Financing Activities***

In fiscal 2016, \$69.1 million was used in financing activities, a decrease of \$21.8 million from \$91.0 million in the prior year comparable period. This was primarily due to the early redemption of our Senior Notes in March 2015. The Senior Notes had a face value of \$129.4 million, which we redeemed by paying \$54.4 million with available cash, and \$75 million with borrowings under the Facility. We also paid a \$3.5 million prepayment premium to bondholders as stipulated in the original bond indenture. During fiscal 2016 we made a \$16.5 million prepayment on the term loan, a \$15 million payment on our revolver, \$3.3 million in scheduled payments on debt and capital leases, and utilized \$19.3 million to repurchase 697,799 shares at a weighted average cost of \$27.72 per share. At June 30, 2016 we have remaining Board authorization to repurchase 1.8 million shares. Cash dividends paid per share increased from \$0.10 to \$0.12 in October 2014, \$0.14 in July 2015, and \$0.17 in April 2016, resulting in an increase in payments during fiscal 2016 of 24.7%. We expect to continue to declare quarterly dividends for the foreseeable future, business conditions permitting.

Our total debt obligations at June 30, 2016 consist of the following (in millions):

Revolving Credit Facility due 10/21/2019	\$25.0
Term Loan due 10/21/2019	\$16.2
Capital leases	\$1.5
Unamortized debt issuance costs	\$(0.9)
Total debt	\$41.8
Less current maturities	\$3.0
Total long-term	\$38.8

The following table summarizes, as of June 30, 2016, the timing of cash payments related to our outstanding contractual obligations (in millions):

	Total	Less than 1 Year	1-3 Years	4-5 Years	More than 5 Years
Long-term debt obligations:					
Debt maturities	\$41.8	\$3.0	\$4.7	\$34.1	\$-
Contractual interest	2.7	0.9	1.6	0.2	-
Operating lease obligations	215.4	33.9	60.7	46.5	74.3

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Letters of credit	0.2	0.2	-	-	-
Purchase obligations (1)	-	-	-	-	-
Other long-term liabilities	0.2	-	-	0.0	0.2
Total contractual obligations	\$260.3	\$37.9	\$67.0	\$80.9	\$74.5

(1) For purposes of this table, purchase obligations are defined as agreements that are enforceable and legally binding and that specify all significant terms, including fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. While we are not a party to any significant long-term supply contracts or purchase commitments, we do, in the normal course of business, regularly initiate purchase orders for the procurement of (i) selected finished goods sourced from third-party suppliers, (ii) lumber, fabric, leather and other raw materials used in production, and (iii) certain outsourced services. All purchase orders are based on current needs and are fulfilled by suppliers within short time periods. At June 30, 2016, our open purchase orders with respect to such goods and services totaled approximately \$31 million.

Further discussion of our contractual obligations associated with outstanding debt and lease arrangements can be found in Notes 6 and 7, respectively, to the Consolidated Financial Statements included under Item 8 of this Annual Report.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

We believe that our cash flow from operations, together with our other available sources of liquidity, will be adequate to make all required payments of principal and interest on our debt, to permit anticipated capital expenditures, and to fund working capital and other cash requirements. As of June 30, 2016, we had working capital of \$124.9 million compared to \$130.0 million at June 30, 2015, a decrease of \$5.2 million and a current ratio of 2.0 to 1 at June 30, 2016 and 1.9 to 1 at June 30, 2015. In addition to using available cash to fund changes in working capital, necessary capital expenditures, acquisition activity, the repayment of debt, and the payment of dividends, the Company has been authorized by our board of directors to repurchase our common stock, from time to time, either directly or through agents, in the open market at prices and on terms satisfactory to us.

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

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

We may, from time to time in the ordinary course of business, provide guarantees on behalf of selected affiliated entities or become contractually obligated to perform in accordance with the terms and conditions of certain business agreements. The nature and extent of these guarantees and obligations may vary based on our underlying relationship with the benefiting party and the business purpose for which the guarantee or obligation is being provided. The only such program in place at both June 30, 2016 and June 30, 2015 was for our consumer credit program described below.

Ethan Allen Consumer Credit Program

The terms and conditions of our consumer credit program, which is financed and administered by a third-party financial institution on a non-recourse basis to Ethan Allen, are set forth in an agreement between the Company and that financial service provider (the "Program Agreement") which was last amended effective January 2014. Any independent retailer choosing to participate in the consumer credit program is required to enter into a separate agreement with that same third-party financial institution which sets forth the terms and conditions under which the retailer is to perform in connection with its offering of consumer credit to its customers (the "Retailer Agreement"). We have obligated ourselves on behalf of any independent retailer choosing to participate in our consumer credit program by agreeing, in the event of default, breach, or failure of the independent retailer to perform under such Retailer Agreement, to take on certain responsibilities of the independent retailer, including, but not limited to, delivery of goods and reimbursement of customer deposits. Customer receivables originated by independent retailers remain

non-recourse to Ethan Allen. The Program Agreement will terminate on July 31, 2019, but includes a provision for automatic one-year renewals unless either party gives notice of termination. While the maximum potential amount of future payments (undiscounted) that we could be required to make under this obligation is indeterminable, recourse provisions exist that would enable us to recover, from the independent retailer, any amount paid or incurred by us related to our performance. Based on the underlying creditworthiness of our independent retailers, including their historical ability to satisfactorily perform in connection with the terms of our consumer credit program, we believe this obligation will expire without requiring funding by us. To ensure funding for delivery of products sold, the terms of the Program Agreement also contain a right for the financial services provider to demand from the Company collateral at a variable rate based on the volume of program sales if the Company does not meet certain covenants. At June 30 of 2016 and 2015, no collateral was required under the Program Agreement.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Product Warranties

Our products, including our case goods, upholstery and home accents, generally carry explicit product warranties that extend from three to seven years and are provided based on terms that are generally accepted in the industry. All of our domestic independent retailers are required to enter into, and perform in accordance with the terms and conditions of, a warranty service agreement. We record provisions for estimated warranty and other related costs at time of sale based on historical warranty loss experience and make periodic adjustments to those provisions to reflect actual experience. On rare occasion, certain warranty and other related claims involve matters of dispute that ultimately are resolved by negotiation, arbitration or litigation. In certain cases, a material warranty issue may arise which is beyond the scope of our historical experience. We provide for such warranty issues as they become known and are deemed to be both probable and estimable. It is reasonably possible that, from time to time, additional warranty and other related claims could arise from disputes or other matters beyond the scope of our historical experience. As of June 30, 2016 and 2015, the Company's product warranty liability totaled \$1.2 million and \$1.0 million, respectively.

Impact of Inflation

We believe inflation had an impact on our business the last three fiscal years but we have generally been able to create operational efficiencies, seek lower cost alternatives, or raise selling prices in order to offset increases in product and operating costs. It is possible in the future that we will not be successful in our efforts to offset the impacts from inflation.

Business Outlook

We continue to strengthen our vertically integrated structure from concept of idea, to engineering, to manufacturing, to retail and logistics. On the manufacturing side, our objective is to maintain strong manufacturing capabilities in North America, which we believe is a long-term competitive advantage that will allow us to advance our objectives of maintaining short order times, exceptional quality and improving capacity to ship custom made to order items more quickly, which in turn will allow us to grow our business. In September 2015, the Company announced the planned doubling of its upholstery manufacturing facility in Mexico. The expansion has begun and is expected to be completed within the next two years.

Beginning in fiscal 2014, we have been undergoing a major transformation of our product offerings, which is intended to refresh over 70% of our products with the completion of the most current phase during the summer through fall of 2016. We believe that we are well positioned to leverage all the actions we have taken.

We expect the home furnishings industry to remain extremely competitive with respect to both the sourcing of products and the wholesale and retail sale of those products for the foreseeable future. Domestic manufacturers continue to face pricing pressures because of the lower manufacturing costs in some other countries, particularly within Asia. While we also utilize overseas sourcing for approximately one quarter of our products, we choose to differentiate ourselves by maintaining a substantial North American manufacturing base, where we can leverage our vertically integrated structure to our advantage. We continue to believe that a balanced approach to product sourcing, which includes our own North American manufacturing of about 75% of our product offerings coupled with the import of other selected products, provides the greatest degree of flexibility and is the most effective approach to ensuring that acceptable levels of quality, service and value are attained.

We therefore remain cautiously optimistic about our performance due to the many strong programs already in place and others we currently plan to introduce in the coming months. Our retail strategy involves (i) a continued focus on providing new product introductions, a wide array of product solutions, and superior interior design solutions through our large staff of interior design professionals, (ii) continuing strong advertising and marketing campaigns to get our message across and to continue broadening our customer base, (iii) the opening of new or relocated design centers in more prominent locations, and encouraging independent retailers to do the same, (iv) leveraging the use of technology and personal service within our retail network and online through www.ethanallen.com, and (v) further expansion internationally. We believe this strategy provides an opportunity to grow our business. Further discussion of the home furnishings industry has been included under Item 1 of this Annual Report.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Where You Can Find Other Information

Our website is *www.ethanallen.com*. Information contained on our website is not part of this Annual Report on Form 10-K. Information that we furnish or file with the SEC, including our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to, or exhibits included in, these reports are available for download, free of charge, on our website soon after such reports are filed with or furnished to the SEC. Our SEC filings, including exhibits filed therewith, are also available on the SEC's website at *www.sec.gov*. You may obtain and copy any document we furnish or file with the SEC at the SEC's public reference room at 100 F Street, NE, Room 1580, Washington, D.C. 20549. You may obtain information on the operation of the SEC's public reference facilities by calling the SEC at 1-800-SEC-0330. You may request copies of these documents, upon payment of a duplicating fee, by writing to the SEC at its principal office at 100 F Street, NE, Room 1580, Washington, D.C. 20549.

Recent Accounting Pronouncements

See Note 1 to our consolidated financial statements included in Part II, Item 8 of this Annual Report on Form 10-K.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to market risks relating to fluctuations in interest rates and foreign currency exchange rates.

Interest rate risk exists primarily through our borrowing activities. We utilize United States dollar denominated borrowings to fund substantially all our working capital and investment needs. Short-term debt, if required, is used to meet working capital requirements and long-term debt is generally used to finance long-term investments. There is inherent rollover risk for borrowings as they mature and are renewed at current market rates. The extent of this risk is not quantifiable or predictable because of the variability of future interest rates and our future financing requirements.

For floating-rate obligations, interest rate changes do not affect the fair value of the underlying financial instrument but would impact future earnings and cash flows, assuming other factors are held constant. Conversely, for fixed-rate obligations, interest rate changes affect the fair value of the underlying financial instrument but would not impact

earnings or cash flows. At June 30, 2016, we had \$41.2 million of floating-rate debt obligations outstanding under our Facility. We currently do not engage in any interest rate hedging activity and we have no intention of doing so in the foreseeable future. Based on the average interest rate of the loans under the Facility during the quarter ended June 30, 2016, and to the extent that borrowings were outstanding, a 10% change in the interest rate would not have a material effect on our consolidated results of operations and financial condition.

Foreign currency exchange risk is primarily limited to our operation of Ethan Allen operated retail design centers located in Canada, one distribution center in Belgium, and our plants in Mexico and Honduras, as substantially all purchases of imported parts and finished goods are denominated in United States dollars. As such, gains or losses resulting from market changes in the value of foreign currencies have not had, nor are they expected to have, a material effect on our consolidated results of operations. A decrease in the value of foreign currencies (in particular Asian) relative to the United States dollar may affect the profitability of our vendors but as we employ a balanced sourcing strategy, we believe any impact would be moderate relative to peers in the industry.

Item 8. Financial Statements and Supplementary Data

Our Consolidated Financial Statements and Supplementary Data are listed in Item 15 of this Annual Report.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders

Ethan Allen Interiors Inc.:

We have audited the accompanying consolidated balance sheets of Ethan Allen Interiors Inc. and subsidiaries (the Company) as of June 30, 2016 and 2015, and the related consolidated statements of comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended June 30, 2016. We also have audited the Company's internal control over financial reporting as of June 30, 2016, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally

accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Ethan Allen Interiors Inc. and subsidiaries as of June 30, 2016 and 2015, and the results of its operations and its cash flows for each of the years in the three-year period ended June 30, 2016, in conformity with U.S. generally accepted accounting principles. Also in our opinion, Ethan Allen Interiors Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of June 30, 2016, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) .

/s/ KPMG LLP

August 8, 2016

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**Consolidated Balance Sheets****June 30, 2016 and 2015****(In thousands, except share data)**

	2016	2015
ASSETS		
Current assets:		
Cash and cash equivalents	\$52,659	\$76,182
Marketable securities	-	2,198
Accounts receivable, less allowance for doubtful accounts of \$1,639 at June 30, 2016 and \$1,386 at June 30, 2015	9,467	12,547
Inventories	162,323	151,916
Prepaid expenses and other current assets	23,755	27,831
Total current assets	248,204	270,674
Property, plant and equipment, net	273,615	277,035
Goodwill and other intangible assets	45,128	45,128
Restricted cash and investments	7,820	8,010
Other assets	2,642	5,130
Total assets	\$577,409	\$605,977
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current maturities of long-term debt	\$3,001	\$3,034
Customer deposits	60,958	67,970
Accounts payable	15,437	18,946
Accrued compensation and benefits	22,067	26,896
Accrued expenses and other current liabilities	21,884	23,816
Total current liabilities	123,347	140,662
Long-term debt	38,837	73,203
Other long-term liabilities	23,023	21,577
Total liabilities	185,207	235,442
Shareholders' equity:		
Class A common stock, par value \$0.01; 150,000,000 shares authorized; 48,921,544 shares issued at June 30, 2016 and 48,884,5866 shares issued at June 30, 2015	489	489
Class B common stock, par value \$0.01; 600,000 shares authorized; none issued	-	-
Additional paid-in-capital	374,972	370,914
Less: Treasury stock (at cost), 21,175,416 shares at June 30, 2016 and 20,477,617 shares at June 30, 2015	(624,932)	(605,586)
Retained earnings	646,315	607,079
Accumulated other comprehensive income	(4,846)	(2,638)
Total Ethan Allen Interiors Inc. shareholders' equity	391,998	370,258
Noncontrolling interests	204	277
Total shareholders' equity	392,202	370,535
Total liabilities and shareholders' equity	\$577,409	\$605,977

See accompanying notes to consolidated financial statements.

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ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**Consolidated Statements of Comprehensive Income
For Years Ended June 30, 2016, 2015, and 2014
(In thousands, except share data)**

	2016	2015	2014
Net sales	\$794,202	\$754,600	\$746,659
Cost of sales	351,966	343,437	340,163
Gross profit	442,236	411,163	406,496
Selling, general and administrative expenses	353,057	345,229	336,860
Operating income	89,179	65,934	69,636
Interest and other income (expense)	395	(3,333)	276
Interest and other related financing costs	1,618	5,918	7,510
Income before income taxes	87,956	56,683	62,402
Income tax expense	31,319	19,541	19,471
Net income	\$56,637	\$37,142	\$42,931
<u>Per share data:</u>			
Net income per basic share	\$2.02	\$1.29	\$1.48
Basic weighted average common shares	28,072	28,874	28,918
Net income per diluted share	\$2.00	\$1.27	\$1.47
Diluted weighted average common shares	28,324	29,182	29,276
Dividends declared per common share	\$0.62	\$0.50	\$0.40
Comprehensive income:			
Net income	\$56,637	\$37,142	\$42,931
Other comprehensive income			
Currency translation adjustment	(2,208)	(3,308)	(77)
Other	27	78	105
Other comprehensive income (loss) net of tax	(2,181)	(3,230)	28
Comprehensive income	\$54,456	\$33,912	\$42,959

See accompanying notes to consolidated financial statements.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows
For Years Ended June 30, 2016, 2015, and 2014
(In thousands)

	2016	2015	2014
Operating activities:			
Net income	\$56,637	\$37,142	\$42,931
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	19,353	19,142	17,930
Compensation expense related to share-based payment awards	2,356	1,236	1,325
Provision (benefit) for deferred income taxes	671	3,923	(3,032)
Restructuring and impairment charge	-	784	-
Loss (gain) on disposal of property, plant and equipment	(2,267)	4,180	2,093
Other	(1,295)	3,606	415
Change in operating assets and liabilities, net of effects of acquired businesses:			
Accounts receivable	2,926	(559)	(149)
Inventories	(9,982)	(5,036)	(9,019)
Prepaid and other current assets	5,113	(9,628)	4,269
Customer deposits	(7,275)	7,517	586
Accounts payable	(3,509)	(5,349)	1,300
Accrued expenses and other current liabilities	(6,550)	(2,113)	969
Other assets and liabilities	2,191	261	271
Net cash provided by operating activities	58,369	55,106	59,889
Investing activities:			
Proceeds from the disposal of property, plant & equipment	8,073	9,103	3,381
Change in restricted cash and investments	190	497	6,926
Capital expenditures	(22,967)	(19,787)	(19,305)
Acquisitions	(165)	(1,991)	-
Purchases of marketable securities	-	-	(18,268)
Sales of marketable securities	2,150	15,430	14,883
Other investing activities	193	176	325
Net cash provided by (used in) investing activities	(12,526)	3,428	(12,058)
Financing activities:			
Borrowings from revolving credit and term loan facilities	-	75,000	-
Payments on long-term debt and capital lease obligations	(34,840)	(133,710)	(480)
Purchases and retirements of company stock	(19,346)	(17,552)	-
Payment of cash dividends	(16,646)	(13,348)	(11,297)
Other financing activities	1,718	(1,353)	525
Net cash used in financing activities	(69,114)	(90,963)	(11,252)
Effect of exchange rate changes on cash	(252)	(565)	(4)

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Net increase (decrease) in cash & cash equivalents	(23,523)	(32,994)	36,575
Cash & cash equivalents - beginning of year	76,182	109,176	72,601
Cash & cash equivalents - end of year	\$52,659	\$76,182	\$109,176

Supplemental cash flow information:

Income taxes paid	\$29,003	\$18,250	\$20,928
Interest paid	\$1,352	\$7,181	\$7,085
Non-cash capital lease obligations incurred	\$-	\$1,700	\$-

See accompanying notes to consolidated financial statements.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Consolidated Statements of Shareholders' Equity
For Years Ended June 30, 2016, 2015, and 2014
(In thousands, except share data)

	Common Stock	Additional Paid-in Capital	Treasury Stock	Accumulated Other Comprehensive Income	Retained Earnings	Non- Controlling Interests	Total
Balance at June 30, 2013	486	363,938	(584,041)	684	553,083	207	334,357
Stock issued on share-based awards	-	357	-	-	-	-	357
Compensation expense associated with share-based awards	-	1,325	-	-	-	-	1,325
Tax benefit associated with exercise of share based awards	-	113	-	-	-	-	113
Dividends declared on common stock	-	-	-	-	(11,619)	-	(11,619)
Capital distribution	-	-	-	-	-	(25)	(25)
Comprehensive income (loss)	-	-	-	(42)	42,931	70	42,959
Balance at June 30, 2014	486	365,733	(584,041)	642	584,395	252	367,467
Stock issued on share-based awards	3	4,117	-	-	-	-	4,120
Compensation expense associated with share-based awards	-	1,236	-	-	-	-	1,236
Tax benefit associated with exercise of share based awards	-	(172)	-	-	-	-	(172)
Purchase/retirement of company stock	-	-	(21,545)	-	-	-	(21,545)
Dividends declared on common stock	-	-	-	-	(14,458)	-	(14,458)
Capital distribution	-	-	-	-	-	(25)	(25)
Comprehensive income (loss)	-	-	-	(3,280)	37,142	50	33,912
Balance at June 30, 2015	489	370,914	(605,586)	(2,638)	607,079	277	370,535
Stock issued on share-based awards	-	734	-	-	-	-	734
Compensation expense associated with share-based awards	-	2,356	-	-	-	-	2,356
Tax benefit associated with exercise of share based awards	-	968	-	-	-	-	968

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Purchase/retirement of company stock	-	-	(19,346)	-	-	-	(19,346)
Dividends declared on common stock	-	-	-	-	(17,401)	-	(17,401)
Capital distribution	-	-	-	-	-	(100)	(100)
Comprehensive income (loss)	-	-	-	(2,208)	56,637	27	54,456
Balance at June 30, 2016	\$ 489	\$374,972	\$(624,932)	\$ (4,846)	\$646,315	\$ 204	\$392,202

See accompanying notes to consolidated financial statements.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

June 30, 2016, 2015 and 2014

(1) Summary of Significant Accounting Policies

Basis of Presentation

The following is a summary of significant accounting policies of Ethan Allen Interiors Inc., and its wholly-owned subsidiaries (collectively "We," "Us," "Our," "Ethan Allen" or the "Company"). All significant intercompany accounts and transactions have been eliminated in the consolidated financial statements. Our consolidated financial statements also include the accounts of an entity in which we are a majority shareholder with the power to direct the activities that most significantly impact the entity's performance. Noncontrolling interest amounts in the entity are immaterial and included in the Consolidated Statement of Comprehensive Income within interest and other income, net.

On April 7, 2015 the FASB issued ASU 2015-03, Simplifying the Presentation of Debt Issuance Costs. The new standard classifies debt issuance costs as a deduction from the debt liability, consistent with debt discounts. Prior to the issuance of ASU 2015-03, these costs were classified as assets. We adopted the provisions of ASU 2015-03 beginning in July 2015 and prior period amounts have been reclassified to conform to the current period presentation. As of June 30, 2015, \$0.3 million of debt issuance costs were reclassified in the consolidated balance sheet from other noncurrent assets to current portion of long-term debt and \$1.0 million was reclassified from other noncurrent assets to long-term debt, less current portion. The adoption of ASU 2015-03 did not impact our consolidated statements of comprehensive income, or our consolidated statements of cash flows.

Nature of Operations

We are a leading manufacturer and retailer of quality home furnishings and accents, offering complimentary interior design service to our clients and sell a full range of furniture products and decorative accents. We sell our products through one of the country's largest home furnishing retail networks and at June 30, 2016 there were a total of 296 retail design centers, of which 143 are Company operated and 153 are independently operated. Nearly all of our

Company operated retail design centers are located in the United States, with the remaining Company operated design centers located in Canada. The majority of the independently operated design centers are in Asia, with the remaining independently operated design centers located throughout the United States, the Middle East and Europe. We have nine manufacturing facilities, one of which includes a separate sawmill operation, located throughout the United States, and one plant each in Mexico and Honduras.

Use of Estimates

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

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Reclassifications

Certain reclassifications have been made to prior years' financial statements in order to conform to the current year's presentation. These changes were made for disclosure purposes only and did not have any impact on previously reported results.

Cash Equivalents

Cash and short-term, highly liquid investments with original maturities of three months or less are considered cash and cash equivalents. We invest excess cash in money market accounts, short-term commercial paper, and U.S. Treasury Bills.

Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market. Cost is determined based solely on those charges incurred in the acquisition and production of the related inventory (i.e. material, labor and manufacturing overhead costs).

Marketable Securities

The Company's investments are classified at the time of purchase as either available-for-sale or held-to-maturity, and reassessed as of each balance sheet date. Our marketable securities consist of available-for-sale securities, and are marked-to-market based on prices provided by our investment advisors, with unrealized gains and temporary unrealized losses reported as a component of other comprehensive income net of tax, until realized. When realized, the Company recognizes gains and losses on the sales of the securities on a specific identification method and includes the realized gains or losses in other income, net, in the consolidated statements of operations. The Company includes interest, dividends, and amortization of premium or discount on securities classified as available-for-sale in other income, net in the consolidated statements of operations. We also evaluate our available-for-sale securities to determine whether a decline in fair value of a security below the amortized cost basis is other than temporary. Should the decline be considered other than temporary, we write down the cost of the security and include the loss in

earnings. In making this determination we consider such factors as the reason for and significance of the decline, current economic conditions, the length of time for which there has been an unrealized loss, the time to maturity, and other relevant information. Available-for-sale securities are classified as either short-term or long-term based on management's intention of when to sell the securities.

Property, Plant and Equipment

Property, plant and equipment are stated at cost, net of accumulated depreciation and amortization. Depreciation of plant and equipment is provided over the estimated useful lives of the respective assets on a straight-line basis. Estimated useful lives of the respective assets typically range from twenty to forty years for buildings and improvements and from three to twenty years for machinery and equipment. Leasehold improvements are amortized based on the underlying lease term, or the asset's estimated useful life, whichever is shorter.

Operating Leases

We record expense for operating leases by recognizing the minimum lease payments on a straight-line basis, beginning on the date that the lessee takes possession or control of the property. A number of our operating lease agreements contain provisions for tenant improvement allowances, rent holidays, rent concessions, and/or rent escalations.

Incentive payments received from landlords are recorded as deferred lease incentives and are amortized over the underlying lease term on a straight-line basis as a reduction of rent expense. When the terms of an operating lease provide for periods of free rent, rent concessions, and/or rent escalations, we establish a deferred rent liability for the difference between the scheduled rent payment and the straight-line rent expense recognized. This deferred rent liability is also amortized over the underlying lease term on a straight-line basis as a reduction of rent expense.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Retail Design Center Acquisitions

We account for the acquisition of retail design centers and related assets with the purchase method. Accounting for these transactions as purchase business combinations requires the allocation of purchase price paid to the assets acquired and liabilities assumed based on their fair values as of the date of the acquisition. The amount paid in excess of the fair value of net assets acquired is accounted for as goodwill.

Goodwill and Other Intangible Assets

Our intangible assets are comprised primarily of goodwill, which represents the excess of cost over the fair value of net assets acquired, and trademarks. We determined these assets have indefinite useful lives, and are therefore not amortized.

Impairment of Long-Lived Assets and Goodwill

Goodwill and other indefinite-lived intangible assets are evaluated for impairment on an annual basis during the fourth quarter of each fiscal year, and between annual tests whenever events or circumstances indicate that the carrying value of the goodwill or other intangible asset may exceed its fair value. When testing goodwill for impairment, we may assess qualitative factors for some or all of our reporting units to determine whether it is more likely than not (that is, a likelihood of more than 50 percent) that the fair value of a reporting unit is less than its carrying amount, including goodwill. Alternatively, we may bypass this qualitative assessment for some or all of our reporting units and determine whether the carrying value exceeds the fair value using a quantitative assessment as described below.

The recoverability of long-lived assets are evaluated for impairment by determining whether the carrying value will be recovered through the expected undiscounted future cash flows resulting from the use of the asset. In the event the sum of the expected undiscounted future cash flows is less than the carrying value of the asset, an impairment loss equal to the excess of the asset's carrying value over its fair value is recorded. The long-term nature of these assets requires the estimation of cash inflows and outflows several years into the future and only takes into consideration technological advances known at the time of the impairment test.

To evaluate goodwill using a quantitative assessment, the Company determines the current fair value of the reporting units using a combination of “Market” and “Income” approaches. In the Market approach, the “Guideline Company” method is used, which focuses on comparing the Company’s risk profile and growth prospects to reasonably similar publicly traded companies. Key assumptions used for the Guideline Company method are total invested capital (“TIC”) multiples for revenues and operating cash flows, as well as consideration of control premiums. The TIC multiples are determined based on public furniture companies within our peer group, and if appropriate, recent comparable transactions are considered. Control premiums are determined using recent comparable transactions in the open market. Under the Income approach, a discounted cash flow method is used, which includes a terminal value, and is based on external analyst financial projection estimates, as well as internal financial projection estimates prepared by management. The long-term terminal growth rate assumptions reflect our current long-term view of the market in which we compete. Discount rates use the weighted average cost of capital for companies within our peer group, adjusted for specific company risk premium factors.

The fair value of our trade name, which is the Company’s only indefinite-lived intangible asset other than goodwill, is valued using the relief-from-royalty method. Significant factors used in trade name valuation are rates for royalties, future growth, and a discount factor. Royalty rates are determined using an average of recent comparable values. Future growth rates are based on the Company’s perception of the long-term values in the market in which we compete, and the discount rate is determined using the weighted average cost of capital for companies within our peer group, adjusted for specific company risk premium factors.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Financial Instruments

Because of their short-term nature, the carrying value of our cash and cash equivalents, receivables and payables, short-term debt and customer deposit liabilities approximates fair value. Substantially all of our long-term debt at both June 30, 2016 and 2015 consists of our term loan and revolving credit facility. The estimated fair value is equal to the carrying value on those dates.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards.

Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance must be established for deferred tax assets when it is more likely than not that the assets will not be realized.

We recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. Most of the unrecognized tax benefits, if recognized, would be recorded as a benefit to income tax expense.

The liability associated with an unrecognized tax benefit is classified as a long-term liability except for the amount for which a cash payment is expected to be made or tax positions settled within one year. We recognize interest and penalties related to income tax matters as a component of income tax expense.

Revenue Recognition

Revenue is recognized when all of the following have occurred: persuasive evidence of a sales arrangement exists (e.g. a wholesale purchase order or retail sales invoice); the sales arrangement specifies a fixed or determinable sales price; title and risk of ownership has passed to the customer; no specific performance obligations remain; product is shipped or services are provided to the customer; collectability is reasonably assured. As such, revenue recognition generally occurs upon the shipment of goods to independent retailers or, in the case of Ethan Allen operated retail design centers, upon delivery to the customer. If shipping is billed to customers, this is included in revenue. Recorded sales provide for estimated returns and allowances. We permit our customers to return defective products and incorrect shipments, and terms we offer are standard for the industry.

Shipping and Handling Costs

Our practice has been to sell our products at the same delivered cost to all retailers nationwide, regardless of shipping point. Costs incurred by the Company to deliver finished goods are expensed and recorded in selling, general and administrative expenses. Shipping and handling costs amounted to \$71.7 million in fiscal year 2016, \$67.3 million for fiscal 2015 and \$67.1 million in fiscal 2014.

Advertising Costs

Advertising costs are expensed when first aired or distributed. Our total advertising costs were \$31.5 million in fiscal year 2016, \$30.2 million in fiscal year 2015 and \$29.5 million in fiscal year 2014. These amounts include advertising media expenses, outside and inside agency expenses, certain website related fees and photo and video production net of proceeds received by us under our agreement with the third-party financial institution responsible for administering our consumer finance programs. Prepaid advertising costs at June 30, 2016 totaled \$2.0 million compared to \$1.8 million at June 30, 2015.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Earnings Per Share

We compute basic earnings per share by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated similarly, except that the weighted average outstanding shares are adjusted to include the effects of converting all potentially dilutive share-based awards issued under our employee stock plans (see Notes 9 and 10). Certain unvested share-based payment awards are participating securities because they contain rights to receive non-forfeitable dividends (if paid). The earnings available to participating securities under the two-class method of computing earnings per share is insignificant.

Share-Based Compensation

We estimate, as of the date of grant, the fair value of stock options awarded using the Black-Scholes option pricing model. Use of a valuation model requires management to make certain assumptions with respect to selected model inputs, including anticipated changes in the underlying stock price (i.e. expected volatility) and option exercise activity (i.e. expected life). Expected volatility is based on the historical volatility of our stock and other contributing factors. The expected life of options granted, which represents the period of time that the options are expected to be outstanding, is based, primarily, on historical data. We estimate, as of the date of grant, the fair value of restricted stock units awarded using a discounted cash flow model which requires management to make certain assumptions with respect to model inputs including anticipated future dividends not paid during the restriction period, and a discount for lack of marketability for a one-year holding period after vesting.

Share-based compensation expense is included in the Consolidated Statements of Operations within selling, general and administrative expenses. Tax benefits associated with our share-based compensation arrangements are included in the Consolidated Statements of Operations within income tax expense.

All shares of our common stock received in connection with the exercise of share-based awards have been recorded as treasury stock and result in a reduction in shareholders' equity.

Foreign Currency Translation

The functional currency of each Company operated foreign location is the respective local currency. Assets and liabilities are translated into United States dollars using the current period-end exchange rate and income and expense amounts are translated using the average exchange rate for the period in which the transaction occurred. Resulting translation adjustments are reported as a component of accumulated other comprehensive income within shareholders' equity.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (the "FASB") issued ASU 2014-09, *Revenue from Contracts with Customers*. This ASU provides a framework for revenue recognition that replaces most existing GAAP revenue recognition guidance when it becomes effective. We have an option to use either a retrospective approach or a cumulative effect adjustment approach to implement the guidance. The new standard is effective for us on July 1, 2018, with early adoption permitted in 2017. We are currently evaluating the impact of this guidance on our financial statements and the timing of adoption, and have not yet selected a transition approach.

In April 2015 the FASB issued ASU 2015-03, *Simplifying the Presentation of Debt Issuance Costs*. The new standard classifies debt issuance costs as a deduction from the debt liability, consistent with debt discounts. Prior to the issuance of ASU 2015-03, these costs were classified as assets. We adopted the provisions of ASU 2015-03 beginning in July 2015 and prior period amounts have been reclassified to conform to the current period presentation. As of June 30, 2015, \$0.3 million of debt issuance costs were reclassified in the consolidated balance sheets from other noncurrent assets to current portion of long-term debt and \$1.0 million was reclassified from other noncurrent assets to long-term debt, less current portion. The adoption of ASU 2015-03 did not impact our consolidated statements of comprehensive income, or our consolidated statements of cash flows.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

In November 2015, the FASB issued ASU 2015-17, *Balance Sheet Classification of Deferred Taxes*, which requires the Company to present all deferred tax assets and liabilities as noncurrent. This pronouncement is effective for the Company on July 1, 2017, and early adoption is permitted. The Company is currently evaluating the impact on our consolidated financial statements and the timing of adoption.

In February 2016, the FASB issued ASU 2016-02, *Leases*, which is intended to improve financial reporting about leasing transactions. The ASU will require lessees that lease assets with lease terms of more than twelve months to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. Lessors will remain largely unchanged from current GAAP. In addition, the ASU will require disclosures to help investors and other financial statement users better understand the amount, timing and uncertainty of cash flows arising from leases. This pronouncement is effective for the Company on July 1, 2019, and early adoption is permitted. The Company is currently evaluating the impact on our consolidated financial statements and the timing of adoption.

In March 2016, the FASB issued Accounting Standards 2016-09, *Improvements to Employee Share-Based Payment Accounting*, which amends ASC Topic 718, Stock Compensation. The objective of this amendment is part of the FASB's Simplification Initiative as it applies to several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This pronouncement is effective for the Company on July 1, 2017, and allows for prospective, retrospective or modified retrospective adoption, depending on the area covered in the update, with early adoption permitted. The Company is currently evaluating the impact on our consolidated financial statements and the timing of adoption.

In July 2015, the FASB issued ASU No. 2015-11, "Inventory (Topic 330): Simplifying the Measurement of Inventory," which states that inventory should be measured at the lower of cost and net realizable value. Net realizable value is defined as estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. The new guidance is effective for the Company on July 1, 2017. The new guidance should be applied prospectively with earlier application permitted as of the beginning of an interim or annual reporting period. The Company is currently evaluating the impact on our consolidated financial statements and the timing of adoption.

(2) Business Acquisitions

From time to time the Company acquires design centers from its independent retailers in arms length transactions. There were no material acquisitions completed during the three fiscal years ended June 30, 2016, 2015 and 2014

respectively.

(3) Inventories

Inventories at June 30 are summarized as follows (in thousands):

	2016	2015
Finished goods	\$129,627	\$118,537
Work in process	9,497	10,537
Raw materials	27,554	25,943
Valuation allowance	(4,355)	(3,101)
Inventories	\$162,323	\$151,916

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**(4) Property, Plant and Equipment**

Property, plant and equipment at June 30 are summarized as follows (in thousands):

	2016	2015
Land and improvements	\$80,002	\$82,806
Building and improvements	392,196	385,439
Machinery and equipment	126,066	126,667
Property, plant and equipment, gross	598,264	594,912
Less: accumulated depreciation and amortization	(324,649)	(317,877)
Property, plant and equipment, net	\$273,615	\$277,035

(5) Goodwill and Other Intangible Assets

At both June 30, 2016 and 2015, we had \$25.4 million of goodwill, and \$19.7 million of other indefinite-lived intangible assets consisting of Ethan Allen trade names, all of which is in our wholesale segment.

In the fourth quarter of fiscal years 2016, 2015, and 2014, the Company performed qualitative assessments of the fair value of the wholesale reporting unit and concluded that the fair value of its goodwill exceeded its carrying value. In fiscal year 2011 the Company performed a quantitative assessment and determined the fair value of its wholesale reporting unit exceeded its carrying value by a substantial margin. The fair value of the trade name exceeded its carrying value by a substantial margin in fiscal years 2016, 2015 and 2014. To calculate fair value of these assets, management relies on estimates and assumptions which by their nature have varying degrees of uncertainty. Management therefore looks for third party transactions to provide the best possible support for the assumptions incorporated. Management considers several factors to be significant when estimating fair value including expected financial outlook of the business, changes in the Company's stock price, the impact of changing market conditions on financial performance and expected future cash flows, and other factors. Deterioration in any of these factors may result in a lower fair value assessment, which could lead to impairment of the long-lived assets and goodwill of the Company.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**(6) Borrowings**

Total debt obligations at June 30 consist of the following (in thousands):

	2016	2015
Term loan	\$16,167	\$35,000
Revolver	25,000	40,000
Capital leases and other	671	1,237
Total debt	41,838	76,237
Less current maturities	3,001	3,034
Total long-term debt	\$38,837	\$73,203

In September 2005, we issued \$200 million in ten-year senior unsecured notes due October 1, 2015 (the "Senior Notes"). The Company entered into a five year, \$150 million senior secured revolving credit and term loan facility on October 21, 2014, as amended (the "Facility"). The Facility, which expires on October 21, 2019, provides a term loan of up to \$35 million and a revolving credit line of up to \$115 million, subject to borrowing base availability. During March 2015, we utilized \$35 million of the term loan and \$40 million of the revolving credit line, along with our available cash to fully redeem our Senior Notes. We incurred financing costs of \$1.5 million under the Facility, which are being amortized by the interest method, over the remaining life of the Facility.

At the Company's option, revolving loans under the Facility bear interest, based on the average availability, at an annual rate of either (a) the London Interbank Offered rate ("LIBOR") plus 1.5% to 1.75%, or (b) the higher of (i) the prime rate, (ii) the federal funds effective rate plus 0.50%, or (iii) LIBOR plus 1.0% plus in each case 0.5% to 0.75%. At June 30, 2016 the annual interest rate in effect on the revolving loan was 2.0%.

At the Company's option, term loans under the Facility bear interest, based on the Company's rent adjusted leverage ratio, at an annual rate of either (a) LIBOR plus 1.75% to 2.25%, or (b) the higher of (i) the prime rate, (ii) the federal funds effective rate plus 0.50%, or (iii) LIBOR plus 1.0% plus in each case 0.75% to 1.25%. At June 30, 2016 the annual interest rate in effect on the term loan was 2.25%.

The Company pays a commitment fee of 0.15% to 0.25% per annum on the unused portion of the Facility, and fees on issued letters of credit at an annual rate of 1.5% to 1.75% based on the average availability. Certain payments are

restricted if the availability under the revolving credit line falls below 20% of the total revolving credit line, and the Company is subject to pro forma compliance with the fixed charge coverage ratio if applicable.

Quarterly installments of principal on the term loan are payable based on a straight line 15-year amortization period, with the balance due at maturity. The Company does not expect to repay the revolving credit line portion of the Facility within the next year.

The Facility is secured by all property owned, leased or operated by the Company in the United States and includes certain real property owned by the Company and contains customary covenants which may limit the Company's ability to incur debt; engage in mergers and consolidations; make restricted payments (including dividends and share repurchases); sell certain assets; and make investments.

The Company must maintain a minimum fixed charge coverage ratio of 1.1 to 1.0 at all times. If the outstanding term loans are less than \$17.5 million and the fixed charge coverage ratio equals or exceeds 1.25 to 1.0, the fixed charge coverage ratio ceases to apply and thereafter is only triggered if average monthly availability is less than 15% of the amount of the revolving credit line. During November 2015, we made a \$16.5 million prepayment on the term loan, bringing the outstanding term loan to \$17.3 million, and the fixed charge coverage ratio ceased to apply. Our subsequent average availability exceeded 65.0%, such that the fixed charge coverage ratio did not apply.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

The Company intends to use the Facility for working capital and general corporate purposes, including dividend payments and share repurchases, in addition to the refinancing of our Senior Notes which occurred in March 2015. At both June 30, 2016 and June 30, 2015, there was \$0.2 million of standby letters of credit outstanding under the Facility. Total availability under the Facility was \$89.8 million at June 30, 2016 and \$74.8 million at June 30, 2015. The increase was due to \$15.0 million payments we made on the revolving loan during fiscal 2016.

At both June 30, 2016 and June 30, 2015, we were in compliance with all covenants of the Senior Notes and the credit facilities.

The weighted-average interest rate applicable under our outstanding debt obligations for each of the last three fiscal years were as follows:

	Fiscal Year Ended		
	June 30,		
	2016	2015	2014
Weighted-average interest rate	2.0%	4.8 %	5.5 %

Aggregate scheduled maturities of our debt obligations for each of the five fiscal years subsequent to June 30, 2016, and thereafter are as follows (in thousands):

<u>Fiscal Year Ended June 30</u>	
2017	3,303
2018	2,815
2019	2,396
2020	34,213
2021	-
Subsequent to 2021	-
Total scheduled debt payments	\$42,727

(7) Leases

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We lease real property and equipment under various operating lease agreements expiring at various times through 2039. Leases covering retail design center locations and equipment may require, in addition to stated minimums, contingent rentals based on retail sales or equipment usage. Generally, the leases provide for renewal for various periods at stipulated rates. Future minimum lease payments under non-cancelable operating leases for each of the five fiscal years subsequent to June 30, 2016, and thereafter are shown in the table following. Also shown are minimum future rentals from subleases, which will partially offset lease payments in the aggregate (in thousands):

Fiscal Year Ended June 30

	Minimum Future Lease Payments	Minimum Future Sublease Rentals
2017	\$ 33,895	\$ 1,990
2018	32,197	2,009
2019	28,517	1,460
2020	24,439	956
2021	22,081	767
Subsequent to 2021	74,291	766
Total	\$ 215,420	\$ 7,948

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Total rent expense for each of the past three fiscal years ended June 30 was as follows (in thousands):

	2016	2015	2014
Basic rentals under operating leases	\$31,692	\$31,220	\$31,168
Contingent rentals under operating leases	180	160	215
Basic and contingent rentals	31,872	31,380	31,383
Less: sublease rent	(1,964)	(3,062)	(2,494)
Total rent expense	\$29,908	\$28,318	\$28,889

Deferred rent credits and deferred lease incentives are reflected in the Consolidated Balance Sheets and are amortized over the respective underlying lease terms on a straight-line basis as a reduction of rent expense. The amounts for the past two fiscal years are as follows:

	2016	2015
Deferred rent credits	\$13,003	\$12,362
Deferred lease incentives	\$4,538	\$3,762

(8) Shareholders' Equity

Our authorized capital stock consists of (a) 150,000,000 shares of Class A Common Stock, par value \$.01 per share, (b) 600,000 shares of Class B Common Stock, par value \$.01 per share, and (c) 1,055,000 shares of Preferred Stock, par value \$.01 per share, of which (i) 30,000 shares have been designated Series A Redeemable Convertible Preferred Stock, (ii) 30,000 shares have been designated Series B Redeemable Convertible Preferred Stock, (iii) 155,010 shares have been designated as Series C Junior Participating Preferred Stock, and (iv) the remaining 839,990 shares may be designated by the Board of Directors with such rights and preferences as they determine (all such preferred stock, collectively, the "Preferred Stock"). Shares of Class B Common Stock are convertible to shares of our Common Stock upon the occurrence of certain events or other specified conditions being met. As of June 30, 2016 and 2015, there were no shares of Preferred Stock or Class B Common Stock issued or outstanding.

Share Repurchase Program

On November 21, 2002, our Board of Directors approved a share repurchase program authorizing us to repurchase up to 2,000,000 shares of our common stock, from time to time, either directly or through agents, in the open market at

prices and on terms satisfactory to us. Subsequent to that date, the Board of Directors increased the aggregate authorization under the repurchase program on several separate occasions, the last of which was on April 13, 2015 when the Board of Directors increased the aggregate authorization to approximately 3,000,000 shares. There is no expiration date on the repurchase authorization and the amount and timing of future share repurchases, if any, will be determined as market and business conditions warrant. As of June 30, 2016 we had a remaining Board authorization to repurchase 1.8 million shares.

During the past three fiscal years, we repurchased the following shares of our common stock (trade date basis):

	2016	2015	2014
Common shares repurchased	697,799	645,831	-
Cost to repurchase common shares	\$19,346,104	\$16,469,725	\$ -
Average price per share	\$27.72	\$25.50	\$ -

For the fiscal years presented above, we funded our purchases of treasury stock with existing cash on hand and cash generated through current period operations. All of our common stock repurchases are recorded as treasury stock and result in a reduction of shareholders' equity.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**(9) Earnings per Share**

The following table sets forth the calculation of weighted average shares for the fiscal years ended June 30 (in thousands):

	2016	2015	2014
Weighted average shares of common stock outstanding for basic calculation	28,072	28,874	28,918
Effect of dilutive stock options and other share-based awards	252	308	358
Weighted average shares of common stock outstanding adjusted for dilution calculation	28,324	29,182	29,276

Certain restricted stock awards and the potential exercise of certain stock options were excluded from the respective diluted earnings per share calculation because their impact is anti-dilutive. In 2016, 2015 and 2014, stock options and share based awards of 460,155, 591,058 and 724,292, respectively, have been excluded.

(10) Share-Based Compensation

For the twelve months ended June 30, 2016, 2015, and 2014, share-based compensation expense totaled \$2.4 million, \$1.2 million, and \$1.3 million respectively. These amounts have been included in the Consolidated Statements of Comprehensive Income within selling, general and administrative expenses. During the twelve months ended June 30, 2016, 2015, and 2014, we recognized related tax benefits associated with our share-based compensation arrangements totaling \$0.8 million, \$0.5 million and \$0.5 million, respectively (before valuation allowances). Such amounts have been included in the Consolidated Statements of Comprehensive Income within income tax expense.

At June 30, 2016, we had 1,341,207 shares of common stock available for future issuance pursuant to the 1992 Stock Option Plan (the "Plan"). The maximum number of shares of common stock reserved for issuance under the Plan is 6,487,867 shares. The Plan provides for the grant of non-compensatory stock options to eligible employees and non-employee directors. Stock options under the Plan are non-qualified under section 422 of the Internal Revenue Code and allow for the purchase of shares of our common stock. The Plan also provides for the issuance of stock appreciation rights ("SARs") on issued options, however no SARs have been issued to date. The awarding of such options is determined by the Compensation Committee of the Board of Directors after consideration of recommendations proposed by the Chief Executive Officer. Options are generally granted with an exercise price equal

to the market price of our common stock at the date of grant, vest ratably over a specified service period, and have a contractual term of 10 years. Equity awards can also include performance vesting conditions. Company policy further requires an additional one year holding period beyond the service vest date for certain executives. Beginning January 31, 2014, grants to employees included both company performance and service vesting conditions (as further described below). Grants to independent directors had a 3 year service vest condition. Following is a description of grants made under the Plan.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIESStock Option Awards

We estimate, as of the date of grant, the fair value of stock options awarded using the Black-Scholes option pricing model. Use of a valuation model requires management to make certain assumptions with respect to selected model inputs, including anticipated changes in the underlying stock price (i.e. expected volatility) and option exercise activity (i.e. expected life). Expected volatility is based on the historical volatility of our stock. The risk-free rate of return is based on the U.S. Treasury bill rate extrapolated to the term matching the expected life of the grant. The dividend yield is based on the annualized dividend rate at the grant date relative to the grant date stock price. The expected life of options granted, which represents the period of time that the options are expected to be outstanding, is based, primarily, on historical data. The weighted average assumptions used for fiscal years ended June 30 are noted in the following table:

	2016	2015	2014
Volatility	48.1%	52.9%	56.3%
Risk-free rate of return	1.93%	2.03%	1.52%
Dividend yield	1.95%	2.09%	1.55%
Expected average life (years)	6.3	6.7	5.2

Options granted to employees beginning January 1, 2014 vest provided certain performance and service conditions are met (“Performance Options”). The performance conditions allow the potential vesting in three equal tranches, provided attainment of a minimum annual 5% growth in operating income (as defined in the agreement) for each of the ensuing three fiscal years. If the minimum annual growth is not achieved in any fiscal year, that tranche is forfeited, except that if a cumulative compound growth rate of 5% is achieved at the end of the three fiscal years, performance conditions for all three tranches will have been met. Service conditions require an additional period after performance conditions are met. Consequently, assuming both performance and service conditions are met, shares become exercisable between 3 and 5 years from grant date. At June 30, 2016, 196,000 Performance Options achieved the performance conditions, and consequently will vest ratably in three equal tranches on the grant date anniversary in years three, four and five provided service conditions are also met. The Company considers the remaining 130,000 Performance Options to be probable of achieving the respective performance conditions so they are being amortized to expense over their respective service periods. The Performance Options are reflected in the options tables presented below. All options were issued at the closing stock price on each grant date, and have a contractual term of 10 years. A summary of stock option activity occurring during the fiscal year ended June 30, 2016 is presented below.

Weighted

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<u>Options</u>	Shares	Weighted Average Exercise Price	Average Remaining Contractual Term (yrs)	Aggregate Intrinsic Value
Outstanding - June 30, 2015	994,888	\$ 24.33		
Granted	24,367	28.73		
Exercised	(36,958)	19.87		
Canceled (forfeited/expired)	(75,224)	30.85		
Outstanding - June 30, 2016	907,073	24.08	5.1	\$8,308,141
Exercisable - June 30, 2016	553,371	\$ 22.93	3.1	\$5,778,995

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

All options granted during fiscal 2016 were to non-employee independent directors of the Company as compensation for their services. The weighted average grant-date fair value of options granted during fiscal 2016, 2015 and 2014 was \$11.53, \$11.30 and \$11.42 respectively. The total intrinsic value of options exercised during 2016, 2015 and 2014 was \$0.3 million, \$4.5 million, and \$0.2 million, respectively. As of June 30, 2016, there was \$2.0 million of total unrecognized compensation cost related to nonvested options granted under the Plan. That cost is expected to be recognized over a weighted average period of 2.6 years. A summary of the nonvested shares as of June 30, 2016 and changes during the year then ended is presented below.

<u>Options</u>	Shares	Weighted Average Grant Date Fair Value
Nonvested June 30, 2015	454,574	\$ 10.49
Granted	24,367	11.53
Vested	(96,191)	7.59
Canceled (forfeited/expired)	(29,048)	11.33
Nonvested at June 30, 2016	353,702	\$ 11.28

Restricted Stock Awards

No new restricted stock awards were granted during fiscal 2016. A summary of nonvested restricted share activity occurring during the fiscal year ended June 30, 2016 is presented below.

<u>Restricted Awards</u>	Shares	Average Grant Date Fair Value
Nonvested - June 30, 2015	21,000	\$ 13.61
Granted	-	
Vested	(21,000)	\$ 13.61
Canceled (forfeited/expired)	-	
Nonvested - June 30, 2016	-	\$ -

As of June 30, 2016, there was no unrecognized compensation cost related to restricted shares granted under the Plan. The total fair value of restricted shares vested during the fiscal years ending June 30, 2016 and 2015 was \$0.7 million and \$0.8 million respectively.

Stock Unit Awards

We account for stock unit awards as equity-based awards because upon vesting, they will be settled in common shares. These awards, which contain time and other vesting conditions, may also contain performance conditions providing recipients a contingent right to receive shares of the Company's common stock ("Performance Units"), conditioned upon the Company's achievement of certain performance targets and goals, and subject to the terms of the agreements. For Performance Units, we expense as compensation cost the fair value of the shares as of the grant date, and amortize expense ratably over the total performance and time vest period, taking into account the probability that we will satisfy the performance goals. We estimate, as of the date of grant, the fair value of Performance Units with a discounted cash flow model, using as model inputs the risk-free rate of return as the discount rate, dividend yield for dividends not paid during the restriction period, and a discount for lack of marketability for a one-year post-vest holding period. The lack of marketability discount used is the present value of a future put option using Monte-Carlo and Black-Scholes pricing models. The weighted average assumptions used for the fiscal year ended June 30 is noted in the table following. No Performance based restricted stock unit awards were granted under the Plan prior to December 1, 2015.

	2016
Volatility	33.3%
Risk-free rate of return	0.77%
Dividend yield	1.99%
Expected average life (years)	1.75

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

For each grant of Performance Units, the amount of the grant that will be earned and paid will be determined by reference to the achievement of certain performance goals for each of two initial fiscal years (on a cumulative basis) and the three fiscal years (on a cumulative basis) applicable to such grant.

A summary of stock unit activity occurring during the fiscal year ended June 30, 2016 is presented below.

	Units	Weighted Average Grant Date Fair Value
Non-vested units at June 30, 2015	126,000	\$ 24.67
Granted	92,050	24.34
Vested	-	-
Canceled (forfeited/expired)	-	-
Non-vested units at June 30, 2016	218,050	24.53

As of June 30, 2016, there was \$1.4 million of total unrecognized compensation cost related to nonvested units granted under the Plan based on our probability estimates. That cost is expected to be recognized over a weighted average period of 1.3 years.

(11) Income Taxes

Income tax expense (benefit) attributable to income from operations consists of the following for the fiscal years ended June 30 (in thousands):

	2016	2015	2014
Current:			
Federal	\$27,660	\$15,064	\$20,693
State	2,898	489	1,900
Foreign	88	55	60

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Total current	30,646	15,608	22,653
Deferred:			
Federal	(237)	2,979	(941)
State	207	759	(1,921)
Foreign	703	195	(320)
Total deferred	673	3,933	(3,182)
Income Tax Expense (Benefit)	\$31,319	\$19,541	\$19,471

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

The following is a reconciliation of expected income tax expense (benefit) (computed by applying the federal statutory income tax rate to income before taxes) to actual income tax expense (benefit) (in thousands):

	2016		2015		2014	
Expected Income Tax Expense	\$30,785	35.0%	\$19,839	35.0%	\$21,841	35.0%
State income taxes, net of federal income tax	2,514	2.9 %	1,597	2.8 %	2,209	3.5 %
Valuation allowance	339	0.4 %	409	0.7 %	(1,540)	-2.5 %
Section 199 Qualified Production Activities deduction	(1,513)	-1.7 %	(998)	-1.8 %	(1,342)	-2.2 %
Unrecognized tax expense (benefit)	(479)	-0.5 %	(641)	-1.1 %	(904)	-1.4 %
Other, net	(327)	-0.4 %	(665)	-1.2 %	(793)	-1.3 %
Actual income tax expense (benefit)	\$31,319	35.6%	\$19,541	34.5%	\$19,471	31.2%

The deferred income tax asset and liability balances at June 30 (in thousands) include:

	2016	2015
Deferred tax assets:		
Employee compensation accruals	4,343	4,555
Stock based compensation	2,665	2,639
Deferred rent credits	6,705	5,943
Net operating loss carryforwards	3,375	4,059
Goodwill	1,729	2,748
Other, net	2,659	3,241
Total deferred tax assets	21,476	23,185
Less: Valuation allowance	(2,155)	(1,816)
Net deferred tax assets	\$19,321	\$21,369
	2016	2015
Deferred tax liabilities:		
Property, plant and equipment	654	1,358
Intangible assets other than goodwill	14,260	14,261
Commissions	3,478	3,999
Other, net	-	149
Total deferred tax liability	18,392	19,767
Total net deferred tax asset	\$929	\$1,602

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The deferred tax balances are classified in the Consolidated Balance Sheets as follows at June 30 (in thousands):

	2016	2015
Current assets	\$3,174	\$2,301
Non-current assets	3,001	3,932
Current liabilities	-	-
Non-current liabilities	5,246	4,631
Total net deferred tax asset	\$929	\$1,602

Current deferred tax assets and liabilities and non-current deferred tax assets and liabilities have been presented net in the Consolidated Balance Sheets.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

We evaluate our deferred taxes to determine if the “more likely than not” standard of evidence has not been met thereby supporting the need for a valuation allowance. A valuation allowance must be established for deferred tax assets when it is less than 50% likely that assets will be realized. At June 30 of 2016 and 2015, such an allowance was in place against the Belgian foreign tax assets, and at June 30, 2016 this valuation allowance was approximately \$2.2 million.

The Company’s deferred income tax assets at June 30, 2016 with respect to the net operating losses expire as follows (in thousands):

	Deferred Income Tax Assets	Net Operating Loss Carryforwards
United States (State), expiring between 2017 and 2032	\$ 1,086	\$ 24,130
Foreign, Expiring in 2034	2,289	6,809

Deferred U.S. federal income taxes are not provided for unremitted foreign earnings of our foreign subsidiaries because we expect those earnings will be permanently reinvested.

Uncertain Tax Positions

We recognize interest and penalties related to income tax matters as a component of income tax expense. If the \$2.2 million of unrecognized tax benefits and related interest and penalties as of June 30, 2016 were recognized, approximately \$1.4 million would be recorded as a benefit to income tax expense. A reconciliation of the beginning and ending amount of unrecognized tax benefits including related interest and penalties as of June 30, 2016 and 2015 is as follows (in thousands):

	2016	2015
Beginning balance	\$3,117	\$4,699
Additions for tax positions taken	776	568
Reductions for tax positions taken in prior years	(1,530)	(1,555)
Settlements	(193)	(596)
Ending balance	\$2,170	\$3,117

It is reasonably possible that various issues relating to approximately \$0.4 million of the total gross unrecognized tax benefits as of June 30, 2016 will be resolved within the next twelve months as exams are completed or statutes expire. If recognized, approximately \$0.3 million of unrecognized tax benefits would reduce our tax expense in the period realized. However, actual results could differ from those currently anticipated.

The Company conducts business globally and, as a result, the Company or one or more of its subsidiaries files income tax returns in the U.S., various state, and foreign jurisdictions. In the normal course of business, the Company is subject to examination by the taxing authorities in such major jurisdictions as the U.S. Canada, Mexico, Belgium and Honduras. As of June 30, 2016, the Company and certain subsidiaries are currently under audit from 2010 through 2015 in the U.S. While the amount of uncertain tax benefits with respect to the entities and years under audit may change within the next twelve months, it is not anticipated that any of the changes will be significant.

(12) Employee Retirement Programs

The Ethan Allen Retirement Savings Plan

The Ethan Allen Retirement Savings Plan (the "Savings Plan") is a defined contribution plan, which is offered to substantially all of our employees who have completed three consecutive months of service regardless of hours worked. We may, at our discretion, make a matching contribution to the 401(k) portion of the Savings Plan on behalf of each participant. Total 401(k) Company match expense amounted to \$3.4 million in 2016, \$3.3 million in 2015, and \$2.8 million in 2014. The contribution was made entirely in cash in 2016, 2015 and 2014.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Other Retirement Plans and Benefits

Ethan Allen provides additional benefits to selected members of senior and middle management in the form of previously entered deferred compensation arrangements and a management cash bonus and other incentive programs. The total cost of these benefits was \$3.6 million, \$3.7 million, and \$3.5 million in 2016, 2015 and 2014, respectively.

(13) Litigation

We are routinely party to various legal proceedings, including investigations or as a defendant in litigation, in the ordinary course of business. We are also subject to various federal, state and local environmental protection laws and regulations and are involved, from time to time, in investigations and proceedings regarding environmental matters. Such investigations and proceedings typically concern air emissions, water discharges, and/or management of solid and hazardous wastes. Under these laws, we and/or our subsidiaries are, or may be, required to remove or mitigate the effects on the environment of the disposal or release of certain hazardous materials.

Regulations issued under the Clean Air Act Amendments of 1990 required the industry to reformulate certain furniture finishes or institute process changes to reduce emissions of volatile organic compounds. Compliance with many of these requirements has been facilitated through the introduction of high solids coating technology and alternative formulations. In addition, we have instituted a variety of technical and procedural controls, including reformulation of finishing materials to reduce toxicity, implementation of high velocity low pressure spray systems, development of storm water protection plans and controls, and further development of related inspection/audit teams, all of which have served to reduce emissions per unit of production. We remain committed to implementing new waste minimization programs and/or enhancing existing programs with the objective of (i) reducing the total volume of waste, (ii) limiting the liability associated with waste disposal, and (iii) continuously improving environmental and job safety programs on the factory floor which serve to minimize emissions and safety risks for employees. In order to reduce the use of hazardous materials in the manufacturing process, we will continue to evaluate the most appropriate, cost-effective control technologies for finishing operations and production methods. We believe that our facilities are in material compliance with all such applicable laws and regulations. Our currently anticipated capital expenditures for environmental control facility matters are not material.

On a quarterly basis, we review our litigation activities and determine if an unfavorable outcome to us is considered “remote”, “reasonably possible” or “probable” as defined by U.S. GAAP. Where we determine an unfavorable outcome is probable and is reasonably estimable, we accrue for potential litigation losses. The liability we may ultimately incur with respect to such litigation matters, in the event of a negative outcome, may be in excess of amounts currently

accrued, if any; however, we do not expect that the reasonably possible outcome of these litigation matters would, individually or in the aggregate, have a material adverse effect on our financial condition, results of operations or cash flows. Where we determine an unfavorable outcome is not probable or reasonably estimable, we do not accrue for any potential litigation loss.

Although the outcome of the various claims and proceedings against us cannot be predicted with certainty, management believes that the likelihood is remote that any existing claims or proceedings, individually or in the aggregate, will have a material adverse effect on our financial position, results of operations or cash flows.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**(14) Accumulated Other Comprehensive Income**

The following table sets forth the activity in accumulated other comprehensive income for the fiscal year ended June 30, 2016 (in thousands):

	Foreign currency translation adjustments
Balance June 30, 2015	\$ (2,638)
Changes before reclassifications	(2,208)
Amounts reclassified from accumulated other comprehensive income	-
Current period other comprehensive income	(2,208)
Balance June 30, 2016	\$ (4,846)

Foreign currency translation adjustments are the result of changes in foreign currency exchange rates related to our operations in Canada, Belgium, Honduras and Mexico, and exclude income taxes given that the earnings of non-U.S. subsidiaries are deemed to be reinvested for an indefinite period of time.

(15) Segment Information

Our operations are classified into two operating segments: wholesale and retail. These operating segments represent strategic business areas which, although they operate separately and provide their own distinctive services, enable us to more effectively offer our complete line of home furnishings and accents.

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

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

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

We evaluate performance of the respective segments based upon revenues and operating income. While the manner in which our home furnishings and accents are marketed and sold is consistent, the nature of the underlying recorded sales (i.e. wholesale versus retail) and the specific services that each operating segment provides (i.e. wholesale manufacturing, sourcing, and distribution versus retail selling) are different. Within each segment, we maintain revenue information according to each respective product line (i.e. case goods, upholstery, or home accents and other). A breakdown of wholesale sales by product line for each of the last three fiscal years ended June 30 is provided below:

	Fiscal Year Ended		
	June 30,		
	2016	2015	2014
Case Goods	32 %	34 %	36 %
Upholstered Products	51 %	48 %	48 %
Home Accessories and Other	17 %	18 %	16 %
	100 %	100 %	100 %

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

A breakdown of retail sales by product line for each of the last three fiscal years ended June 30 is provided below:

	Fiscal Year Ended		
	June 30,		
	2016	2015	2014
Case Goods	30 %	32 %	33 %
Upholstered Products	48 %	45 %	45 %
Home Accents and Other	22 %	23 %	22 %
	100 %	100 %	100 %

Information for each of the last three fiscal years ended June 30 is provided below (in thousands):

	2016	2015	2014
<u>Net sales:</u>			
Wholesale segment	\$491,467	\$469,384	\$453,607
Retail segment	626,511	579,713	580,739
Elimination of inter-company sales	(323,776)	(294,497)	(287,687)
Consolidated Total	\$794,202	\$754,600	\$746,659
<u>Operating income (loss):</u>			
Wholesale segment	\$74,412	\$66,988	\$57,816
Retail segment	16,450	1,726	10,515
Adjustment of inter-company profit (1)	(1,683)	(2,780)	1,305
Consolidated Total	\$89,179	\$65,934	\$69,636
<u>Depreciation & Amortization:</u>			
Wholesale segment	\$7,587	\$8,044	\$7,887
Retail segment	11,766	11,098	10,043
Consolidated Total	\$19,353	\$19,142	\$17,930
<u>Capital expenditures:</u>			
Wholesale segment	\$12,446	\$9,427	\$11,013
Retail segment	10,521	10,360	8,292
Acquisitions	165	1,991	-
Consolidated Total	\$23,132	\$21,778	\$19,305

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

	June 30 2016	June 30 2015	June 30 2014
<u>Total Assets:</u>			
Wholesale segment	\$271,116	\$295,949	\$339,271
Retail segment	339,942	341,886	344,025
Inventory profit elimination (2)	(33,649)	(31,858)	(28,862)
Consolidated Total	\$577,409	\$605,977	\$654,434

- (1) Represents the change in wholesale profit contained in Ethan Allen design center inventory at the end of the period.
- (2) The wholesale profit contained in the retail segment inventory that has not yet been realized. These profits are realized when the related inventory is sold.

Our international net sales are comprised of our wholesale segment sales to independent retailers and our retail segment sales to consumers through the Company operated design centers. The number of international design centers, and the related net sales as a percent of our consolidated net sales is shown in the following table.

	Fiscal Year Ended June 30,		
	2016	2015	2014
Independent design centers	103	97	91
Company operated design centers	6	7	8
Total international design centers	109	104	99
Percentage of consolidated net sales	9.2 %	11.6%	10.6%

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**(16) Selected Quarterly Financial Data (Unaudited)**

Tabulated below is selected financial data for each quarter of the fiscal years ended June 30, 2016, 2015, and 2014 (in thousands, except per share data):

	Quarter Ended			
	September 30	December 31	March 31	June 30
<u>Fiscal 2016:</u>				
Net Sales	\$ 190,391	\$ 207,535	\$ 190,583	\$ 205,693
Gross profit	104,673	116,058	105,717	115,788
Net income	13,147	16,534	10,178	16,778
Earnings per basic share	0.46	0.58	0.37	0.60
Earnings per diluted share	0.46	0.58	0.36	0.60
Dividends declared per common share	0.14	0.14	0.17	0.17
<u>Fiscal 2015:</u>				
Net Sales	\$ 190,706	\$ 197,067	\$ 173,259	\$ 193,568
Gross profit	104,803	106,074	94,110	106,176
Net income	11,879	10,038	2,536	12,689
Earnings per basic share	0.41	0.35	0.09	0.44
Earnings per diluted share	0.41	0.34	0.09	0.44
Dividends declared per common share	0.12	0.12	0.12	0.14
<u>Fiscal 2014:</u>				
Net Sales	\$ 181,659	\$ 193,104	\$ 173,061	\$ 198,835
Gross profit	98,743	105,999	93,130	108,624
Net income	9,034	11,555	5,258	17,084
Earnings per basic share	0.31	0.40	0.18	0.59
Earnings per diluted share	0.31	0.39	0.18	0.58
Dividends declared per common share	0.10	0.10	0.10	0.10

(17) Financial Instruments

We determine fair value as the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date and in the principal or most advantageous market for that asset or liability. The fair value should be calculated based on assumptions that market participants would use in pricing the asset or liability, not on assumptions specific to the Company. In addition, the fair value of liabilities includes consideration of non-performance risk including our own credit risk. Each fair value measurement

is reported in one of the three levels, determined by the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

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

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

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

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

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

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table presents our assets and liabilities measured at fair value on a recurring basis at June 30, 2016 and June 30, 2015

(in thousands):

June 30, 2016

	Level 1	Level 2	Level 3	Balance
Cash equivalents	\$60,479	\$ -	\$ -	\$60,479
Available-for-sale securities	-	-	-	-
Total	\$60,479	\$ -	\$ -	\$60,479

June 30, 2015

	Level 1	Level 2	Level 3	Balance
Cash equivalents	\$84,192	\$-	\$ -	\$84,192
Available-for-sale securities	-	2,198	-	2,198
Total	\$84,192	\$2,198	\$ -	\$86,390

Cash equivalents consist of money market accounts, and mutual funds in U.S. government and agency fixed income securities. We use quoted prices in active markets for identical assets or liabilities to determine fair value. There were no transfers between level 1 and level 2 during fiscal years 2016 or 2015. At June 30, 2016 and 2015, \$7.8 million and \$8.0 million, respectively, of cash equivalents were restricted and classified as a long-term asset.

We did not hold any available-for-sale securities at June 30, 2016 as all municipal bonds matured and the proceeds were transferred to our operating cash accounts. As of June 30, 2015, available for sale securities consisted of \$2.2 million in U.S. municipal bonds, with maturities of less than two years, and were rated A/A2 or better by

S&P/Moody's respectively. There were no material gross unrealized gains or losses on available-for-sale securities at June 30, 2016 or June 30, 2015.

The contractual maturities of our available-for-sale investments as of June 30, 2015 were as follows (in thousands):

June 30, 2015

	Cost	Amortized Cost	Estimated Fair Value
Due in one year or less	\$2,296	\$ 2,155	\$ 2,198
Due after one year through five years	\$-		\$ -

There were no proceeds from sales of investments available for sale in fiscal 2016 and \$15.4 million during fiscal 2015, resulting in no material gain or loss in either period. There were no investments that have been in a continuous loss position for more than one year, and there have been no other-than-temporary impairments recognized.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

We measure certain assets, including our cost and equity method investments, at fair value on a nonrecurring basis. These assets are recognized at fair value when they are deemed to be other-than-temporarily impaired. During the year ended June 30, 2015, we determined that certain long-lived assets of our retail design centers in Belgium were impaired, and an impairment charge of \$0.8 million was recorded at that time.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**(18) Restricted Cash and Investments**

At June 30, 2016 and 2015 we held \$7.8 million and \$8.0 million, respectively, of cash and investments in lieu of providing letters of credit for the benefit of the provider of our workmen's compensation and other insurance liabilities. These restricted funds, which can be invested by us in money market mutual funds, and U.S. Treasuries and U.S. Government agency fixed income instruments with maturities of two years or less, cannot be withdrawn from our account without the prior written consent of the secured parties. These restricted funds are classified as long-term assets because they are not expected to be used within one year to fund operations. See also Note 17, "Financial Instruments".

(19) Subsequent Events

None.

(20) Valuation and Qualifying Accounts

The following table provides information regarding the Company's sales discounts, sales returns and allowance for doubtful accounts (in thousands):

	Balance at	Additions (Reductions)	Adjustments	Balance at
	Beginning of Period	Charged to Income	and/or Deductions	End of Period
Accounts Receivable:				
Sales discounts, sales returns and allowance for doubtful accounts:				
June 30, 2016	\$ 1,386	\$ 253	\$ -	