

Lumber Liquidators Holdings, Inc.
Form 10-K
March 18, 2019
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10 K

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

For the fiscal year ended December 31, 2018

OR

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

For the transition period from _____ to _____

Commission file number: 001 33767

Lumber Liquidators Holdings, Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware 27 1310817
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

3000 John Deere Road, Toano, Virginia 23168
(Address of principal executive offices) (Zip Code)

(757) 259 4280

(Registrant's telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
Common Stock, par value \$0.001 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit 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, a smaller reporting company or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	Accelerated filer	Non-accelerated filer	Smaller reporting company	Emerging growth company
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If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of June 30, 2018, the last business day of the registrant's most recent second quarter, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was \$686.4 million based on the closing sale price as reported on the New York Stock Exchange.

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of March 1, 2019:

Title of Class	Number of Shares
Common Stock, \$0.001 par value	28,640,264

DOCUMENTS INCORPORATED BY REFERENCE

Part III incorporates certain information by reference from the registrant's proxy statement for the 2019 annual meeting of stockholders, which will be filed no later than 120 days after the close of the registrant's fiscal year ended December 31, 2018.

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LUMBER LIQUIDATORS HOLDINGS, INC.

ANNUAL REPORT ON FORM 10 K

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENT

This report includes statements of the Company's expectations, intentions, plans and beliefs that constitute "forward-looking statements" within the meanings of the Private Securities Litigation Reform Act of 1995. These statements, which may be identified by words such as "may," "will," "should," "expects," "intends," "plans," "anticipates," "believes," "thinks," "estimates," "seeks," "predicts," "could," "projects," "potential" and other similar terms and phrases, are based on the beliefs of the Company's management, as well as assumptions made by, and information currently available to, the Company's management as of the date of such statements. These statements are subject to risks and uncertainties, all of which are difficult to predict and many of which are beyond the Company's control. These risks include, without limitation, the impact on us of any of the following:

- the outcomes of government investigations and legal proceedings, and the related impact on liquidity;
- reputational harm;
- obligations related to and impacts of new laws and regulations, including pertaining to tariffs;
- obtaining products from abroad, including the effects of tariffs, as well as the effects of antidumping and countervailing duties;
- obligations under various settlement agreements and other compliance matters;
- disruptions related to our corporate headquarters relocation;
- impact of the Tax Cuts and Jobs Act (the "Tax Act");
- the inability to open new stores and fund other capital expenditures needs;
- managing growth;
- increased transportation costs;
 - damage to our assets;
- disruption in our ability to distribute our products;
- operating stores in Canada and an office in China;
- managing third-party installers and product delivery companies, including the quality of service;
- renewing store or warehouse leases;
- having sufficient suppliers;
- our, and our suppliers', compliance with complex and evolving rules, regulations, and laws at the federal, state, and local level;
- disruption in our ability to obtain products from our suppliers;
- product liability claims;
- availability of suitable hardwood, including due to disruptions from the impacts of severe weather;
- changes in economic conditions, both domestic and abroad;
- sufficient insurance coverage;
- access to capital;
- disruption due to cybersecurity threats;
- the handling of confidential customer information, including the impacts from the California Consumer Privacy Act;
- management information systems disruptions;
- alternative e-commerce offerings;
- our advertising strategy;
- anticipating consumer trends;
- competition;
- impact of changes in accounting guidance, including implementation guidelines and interpretations;
 - maintenance of valuation allowances on deferred tax assets and the impacts thereof;
- internal controls;

- stock price volatility; and
- anti-takeover provisions.

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The Company specifically disclaims any obligation to update these statements, which speak only as of the dates on which such statements are made, except as may be required under the federal securities laws. These risks and other factors include those listed in this Item 1A. “Risk Factors” and elsewhere in this report.

References to “we,” “our,” “us,” “the Company” and “Lumber Liquidators” generally refers to Lumber Liquidators Holdings, Inc. and its consolidated subsidiaries collectively and, where applicable, individually.

PART I

Item 1. Business.

Overview

Lumber Liquidators is one of the leading specialty retailers of hard-surface flooring in North America, offering a complete purchasing solution across an extensive assortment of domestic and exotic hardwood species, engineered hardwood, laminate, resilient vinyl, waterproof vinyl plank and porcelain tile. We also feature the renewable flooring products, bamboo and cork, and provide a wide selection of flooring enhancements and accessories, including moldings, noise-reducing underlayment, adhesives and flooring tools. We offer installation and delivery services through third-party independent contractors for customers who purchase our floors. We operate as a single business segment, with our call center, website and customer service network supporting our retail store operations.

We believe we have achieved a reputation for offering great value, superior service and a broad selection of high-quality hard-surface flooring products. With a balance of selection, quality, availability, service and price, we believe our value proposition is the most complete within a highly fragmented hard-surface flooring market. The foundation for our value proposition is strengthened by our unique store model, the industry expertise of our people, and our singular focus on hard-surface flooring.

Lumber Liquidators is a Delaware corporation with its headquarters in Toano, Virginia. We were founded in 1994 and our initial public offering was in November 2007. Our common stock trades on the New York Stock Exchange under the symbol “LL.” We operate in a holding company structure with Lumber Liquidators Holdings, Inc. serving as our parent company and certain direct and indirect subsidiaries, including Lumber Liquidators, Inc., Lumber Liquidators Services, LLC, Lumber Liquidators Production, LLC, and Lumber Liquidators Canada, ULC, conducting our operations.

Our Business

Market

According to the July 2018 Issue of Floor Covering Weekly, U.S. installed floor covering product sales in 2017 were \$40.8 billion, not including labor. Within this market, U.S. hardwood, laminate and vinyl flooring sales accounted for 38.7% of the total. Flooring sales are driven by a number of factors including discretionary income and the housing market. Including installation, the overall flooring industry has grown at a compound annual growth rate of 5.4% from 2012 through 2017. Over the same period, hardwood, laminate and vinyl flooring sales, including the cost of installation grew at a compound annual growth rate of 8.3%. We believe improvements in the quality and construction of certain products, increasing resiliency and water-tolerance of products, ease of installation, availability in a broad range of retail price points, and movement away from soft surfaces will drive continued hard-surface flooring share gain versus soft surface flooring in the future.

Competition

We compete for customers in a highly fragmented marketplace, where we believe no one retailer has captured more than a 17% share of the consumer market for hard-surface flooring. Although the market includes the national home improvement warehouse chains, warehouse clubs and online retailers, we believe nearly half of the industry

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consists of local one-store flooring retailers, small chains of stores that may specialize in one or two flooring categories, and a limited number of regional chains.

Customers

We target several distinct customer groups who each have varied needs with respect to their flooring purchases, including do-it-yourself (“DIY”) customers, do-it-for-me (“DIFM”) customers, and commercial customers. We believe that each of the customer groups we serve is passionate about their flooring purchase and value our wide assortment of flooring products, availability, and the quality of those products. While our offering to each of these groups begins with the same broad assortment, convenient stores, and knowledgeable store associates, each of these customer groups require unique service components based on the ability of our associates to share detailed product knowledge and preferred installation methods. We offer DIFM customers installation services, while our DIY and commercial customers receive more personal attention when completing their purchase, including dedicated call center resources. All customer groups are offered delivery services.

Products and Services

Product Selection

We offer an extensive assortment of hard-surface flooring under more than 15 proprietary brand names, led by our flagship, Bellawood®. We have invested significant resources developing these national brand names, as well as the Lumber Liquidators name. Our hard-surface flooring products are available in various widths and lengths and are generally differentiated in terms of quality and price based on wood versus manufactured materials, the species, wood grade and durability of finish. Prefinished floors are the dominant choice for residential customers over unfinished wood planks that have a finish applied after installation. We also offer an assortment of flooring enhancements, installation services and accessories, including moldings, underlays and tools.

Direct Sourcing

We source directly from mills and other vendors which enables us to offer a broad assortment of high-quality, proprietary products to our customers at a consistently competitive cost. We seek to establish strong, long-term relationships with our vendor partners around the world. In doing so, we look for vendors that have demonstrated an ability to meet our demanding specifications, our rigorous compliance standards and the capability to provide sustainable and growing supplies of high-quality innovative, trend-right products. We source from both domestic and international vendors, and in 2018, approximately 47% of our product was sourced from Asia, 7% was sourced from Europe and Australia, and 5% was sourced from South America.

Supply Chain

Our supply chain is wholly focused on delivering a complete assortment of products to our customers in an efficient manner. We operate a 500,000 square foot leased distribution center in Pomona, California as the primary distribution center for our western stores. We own a one million square foot distribution center on approximately 100 acres of land in Henrico County, Virginia, which serves the East Coast stores. A number of our vendors maintain certain inventory levels for shipment directly to our stores or our customers. Our product is generally transported boxed and palletized, and the weight of our product is a key driver of our supply chain costs.

Compliance and Quality Control

Our compliance programs are designed to ensure the products we sell are safe and responsibly sourced, and meet all regulatory and statutory requirements, including without limitation requirements associated with the Lacey Act, Environment Protection Agency ("EPA") and the California Air Resources Board ("CARB"). We utilize a variety of due diligence processes and controls, including supplier audits, periodic on-site visits, and product testing. We utilize a risk-based approach to implement and operate the various aspects of our compliance program. Our compliance program considers, among other things, product risk, the level of vertical integration at our suppliers' mills, legality concerns

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noted by both private and government parties, and the results of on-site audits that we perform. Our evaluation of sourcing risk is a key component in our allocation of resources to ensure we meet our standards for product compliance and safety. Compliance and Quality Control teams located in the United States and in China are supplemented with external resources that provide independent analyses, which are incorporated into our review processes and monitor our sourcing efforts across all areas from which we source product. Compliance programs are continually under review, updated and enhanced as appropriate to stay current with statutory and regulatory requirements. Our compliance and regulatory affairs committee of the board of directors provides oversight of our compliance programs.

Additionally, we maintain and operate a 1,500 square foot lab within our East Coast distribution center. The lab features two temperature and humidity controlled conditioning rooms and two emission chambers correlated to a CARB-approved Third-Party Certifier standard. We believe this equipment mirrors the capabilities of CARB and other state-of-the-art emission testing facilities. This lab, along with our third-party providers, supports our process to ensure compliance with CARB and EPA requirements.

Installation

Approximately one in 10 of our customers purchase professional installation services through us to measure and install flooring at competitive prices. We offer these services at all of our stores. As of December 31, 2018, we utilized a network of associates to perform certain customer-facing, consultative services and coordinate the installation of our flooring products by third-party independent contractors in our stores. Service revenue for installation transactions we control along with freight is included in net services sales, with the corresponding costs in cost of services sold. We believe our greater interaction with the customer and better relationships with the third-party independent contractors on services provided will ultimately result in a better customer experience and higher utilization by the customer.

Store Model

As of December 31, 2018, we operated 413 retail stores, with 405 located in 47 states in the United States and eight in Ontario, Canada. We opened 21 new stores and closed one store in 2018. We historically had sought locations with lower rent than retailers requiring high traffic or impulse purchases and are able to adapt a range of existing buildings to our format, from freestanding buildings to strip centers to small shopping centers. Our stores are typically 6,500 to 7,500 square feet. We enter into short leases, generally for a base term of five to seven years with renewal options, to maximize our real estate flexibility.

We routinely evaluate our store site selection criteria and are currently targeting retail corridors within a market over the more industrial locations we historically sought. We consistently monitor performance of current stores as well as the market opportunity for new locations, adjusting as needed to optimize the profitability and growth potential of our network. We have recently opened a larger store format in a single-test location. This format includes a showroom that is four times the size of our traditional store, and includes more items in stock and other amenities.

Sales Approach

We strive to have an integrated multi-channel sales model that enables our stores, call center, website and catalogs to work together in a coordinated manner. We believe that due to the average size of the sale and the general infrequency of a flooring purchase, many of our customers conduct extensive research using multiple channels before making a purchase decision. Though our customers utilize a range of these channels in the decision-making process, the final sale is most often completed in the store, working with our flooring experts. Our customers typically plan well in advance for the inconvenience of removing old flooring and installing new flooring. In larger, more complex projects,

greater lead time and preparation is often required. Our research indicates that the length of a hardwood flooring purchase can vary significantly from initial interest to final sale.

Our objective is to help the customer through the entire purchase cycle from inspiration to installation, whether in our store or in their home. Our goal is to provide our customers with everything needed to complete their flooring project – to remove the existing floor, install the new floor with complementary moldings and accessories, and finally, maintain the floor for its lifetime.

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Our sales strategy emphasizes customer service by providing superior, convenient, educational tools for our customers to learn about our products and the installation process. We invest heavily in training our store associates on all of our products and install techniques. Flooring samples of most of the products we offer are available in our stores, or can be ordered through our call center and website. Once an order is placed, customers may choose to either have their purchases delivered or pick them up at a nearby store location.

We are committed to responding to our potential and existing customers in a timely manner. Our call center is staffed by flooring experts cross-trained in sales, customer service and product support. In addition to receiving telephone calls, our call center associates chat online with visitors to our website, respond to emails from our customers and engage in telemarketing activities. Customers can contact our call center to place an order, to make an inquiry or to order a catalog.

Knowledgeable Salespeople

We believe a large segment of residential homeowners are in need of a trusted expert, whether as a guide through a range of flooring alternatives and services or as a resource to both DIY and DIFM customers. We train and position our store management and associates to establish these individual customer relationships, which often last beyond the current purchase to subsequent purchases of additional flooring.

We place an emphasis on identifying, hiring and empowering employees who share a passion for our business philosophy. Many of our store managers have previous experience with the home improvement, retail flooring or flooring installation industries. We provide continuous training focused on selling techniques and in-depth product knowledge for our store associates, who, we believe, are a key driver in a customer's purchasing decision.

Digital / Omni-Channel

Our website contains a broad range of information on our products and services, including a comprehensive knowledge base on all things related to flooring. We also offer extensive product reviews, before and after photos from previous customers, product information and how-to installation videos. A customer also has the ability to chat live with a flooring expert, either online or over the phone, regarding questions about a flooring purchase or installation. We continue to develop new features and functionality to assist customers, and to ensure they have robust tools at their disposal that are effective at helping them make the ideal flooring choice as they move between online and offline channels. We also have an active presence on Facebook, Instagram, Pinterest, YouTube and Twitter.

Advertising and Financing

Advertising: We utilize a mix of traditional and online media, ecommerce, direct mail, social media, and financing offers to emphasize product credibility, value, brand awareness, customer education and direct selling. We increase brand awareness in a variety of ways, including through sports, celebrity endorsements and product placement opportunities. Overall, we actively manage the mix of our media to efficiently drive sales while building brand awareness of our value proposition. We are investing in enhanced digital capabilities.

Financing: We offer our residential customers a financing alternative through a proprietary credit card, the Lumber Liquidators credit card, underwritten by a third-party financial institution, generally with no recourse to us. This program serves the dual function of providing financial flexibility to our customers and offering us promotional opportunities featuring deferred interest, which we often combine with product promotions. Our customers may also use their Lumber Liquidators credit card for installation services. We also offer our commercial customers a financing alternative, which is also underwritten by a third-party financial institution, generally at no recourse to us. The commercial credit program provides our professional customers a range of additional services that we believe add

efficiency to their businesses.

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Employees

As of December 31, 2018, we had approximately 2,200 employees, 95% of whom were full-time and none of whom were represented by a union. Of these employees, 72% work in our stores, 18% work in corporate store support infrastructure or similar functions (including our call center employees) and 10% work in one of our distribution centers. We believe that we have good relations with our employees.

Seasonality and Quarterly Results

Our quarterly results of operations can fluctuate depending on the timing of our advertising expenses and the timing of, and income contributed by, our new stores. Our net sales fluctuate slightly as a result of seasonal factors, and we adjust merchandise inventories in anticipation of those factors, causing variations in our build of merchandise inventories. Generally, we experience higher than average net sales in the spring and fall, when more home remodeling activities typically are taking place, and lower than average net sales in the colder winter months and during the hottest summer months.

Intellectual Property and Trademarks

We have a number of marks registered in the United States, including Lumber Liquidators®, Hardwood Floors For Less!®, Bellawood®, 1 800 HARDWOOD®, Quickclic®, Virginia Mill Works Co. Hand Scraped and Distressed Floors®, Morning Star Bamboo Flooring®, Dream Home Laminate Floors®, Builder's Pride®, Schön Engineered Floors®, Casa de Colour Collection®, Avella®, Corelux® and other product line names. We have also registered certain marks in jurisdictions outside the United States, including the European Union, Canada, China, Australia and Japan. We regard our intellectual property as having significant value and these names are an important factor in the marketing of our brands. Accordingly, we take steps intended to protect our intellectual property including, where necessary, the filing of lawsuits and administrative actions to enforce our rights.

Government Regulation

We are subject to extensive and varied federal, provincial, state and local government regulations in the jurisdictions in which we operate, including laws and regulations relating to our relationships with our employees and customers, independent, third-party installers, public health and safety, zoning, accommodations for persons with disabilities, and fire codes. We are also subject to a number of compliance obligations pursuant to various settlement agreements we have entered into over the past few years. We operate each of our stores, offices and distribution centers in accordance with standards and procedures designed to comply with all applicable laws, codes, licensing requirements and regulations. Certain of our operations and properties are also subject to federal, provincial, state and local laws and regulations relating to the use, storage, handling, generation, transportation, treatment, emission, release, discharge and disposal of hazardous materials, substances and wastes and relating to the investigation and cleanup of contaminated properties, including off-site disposal locations. We do not currently incur significant costs complying with the laws and regulations related to hazardous materials. However, we could be subject to material costs, liabilities or claims relating to compliance in the future, especially in the event of changes in existing laws and regulations or in their interpretation, as well as the passage of new laws and regulations.

Our suppliers are subject to the laws and regulations of their home countries, as well as those relative to the import of their products into the United States, including, in particular, laws regulating labor, forestry and the environment. Our suppliers are subject to periodic compliance audits, onsite visits and other reviews, as appropriate, in efforts to ensure that they are in compliance with all laws and regulations. We also support social and environmental responsibility among our supplier community and our suppliers agree to comply with our expectations concerning environmental, labor and health and safety matters. Those expectations include representations and warranties that our suppliers

comply with the laws, rules and regulations of the countries in which they operate.

Products that we import into the United States and Canada are subject to laws and regulations imposed in conjunction with such importation, including those issued and/or enforced by U.S. Customs and Border Protection and the Canadian Border Services Agency. In addition, certain of our products are subject to laws and regulations relating to

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the importation, acquisition or sale of illegally harvested plants and plant products and the emissions of hazardous materials. We work closely with our suppliers to address the applicable laws and regulations in these areas.

Available Information

We maintain a website at www.lumberliquidators.com. The information on or available through our website is not, and should not be considered, a part of this annual report on Form 10-K. You may access our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports, as well as other reports relating to us that are filed with or furnished to the Securities and Exchange Commission ("SEC") free of charge on our website as soon as reasonably practicable after such material is electronically filed with, or furnished to, the SEC. The SEC also maintains an Internet site, www.sec.gov, which contains reports, proxy and information statements, and other information that we file electronically with the SEC.

Item 1A. Risk Factors.

The risks described below could materially and adversely affect our business, results of operations, financial condition and cash flows. These risks are not the only risks that we face. Our business operations could also be affected by additional factors that apply generally to companies operating in the U.S. and globally, as well as other risks that are not presently known to us or that we currently consider to be immaterial.

Risks Related to Our Operations

Unfavorable allegations, government investigations and legal actions surrounding our products or us could harm our reputation and impair our ability to grow or sustain our business.

We have been involved in a number of government investigations and legal actions, many of which have resulted from unfavorable allegations regarding our products and us. Negative publicity surrounding these government investigations and legal actions could continue to harm our reputation and the demand for our products. Additional unfavorable allegations, government investigations and legal actions involving our products and us could also affect our perception in the market and our brands and negatively impact our business and financial condition. For instance, unfavorable allegations surrounding the product quality of our laminates sourced from China has negatively affected and could continue to negatively affect our operations. If this negative impact is significant, our ability to maintain our liquidity and grow or sustain our business could be jeopardized. The cost to defend ourselves and our former employees could be significant.

We are involved in a number of legal proceedings and, while we cannot predict the outcomes of these proceedings and other contingencies with certainty, some of the outcomes of these proceedings could adversely affect our business and financial condition.

We are, or may become, involved in legal proceedings, government and agency investigations, and consumer, employment, tort and other litigation (see discussion of Legal Proceedings in Item 3 of this Annual Report). While we have accrued material liabilities in connection with certain of these proceedings, we cannot predict with certainty the ultimate outcomes. The outcome of some of these legal proceedings could require us to take actions which could be costly to implement or otherwise negatively affect our operations or could require us to pay substantial amounts of money that could have a material adverse effect on our liquidity, financial condition and results of operations and could affect our ability to obtain capital or access our revolving loan and continue as a going concern. Additionally, defending against lawsuits and legal proceedings involves significant expense and diversion of management's attention

and resources.

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Our overall compliance program, including the Lacey Compliance Plan, is complex and costly to maintain. A failure to manage these programs could adversely affect our ability to conduct business, result in significant fines and other penalties, damage our brand and reputation, and, consequently, negatively impact our financial position and results of operations.

As disclosed on October 7, 2015, we reached a settlement with the United States Department of Justice (“DOJ”) regarding our compliance with the Lacey Act. In connection with that settlement, we agreed to implement the Lacey Compliance Plan, and we are subject to a probation period of five years. Our implementation of the Lacey Compliance Plan, together with requirements resulting from other settlement agreements we have entered into over the past few years (including the Deferred Prosecution Agreement (the “DPA”) with the United States Attorney’s Office for the Eastern District of Virginia (the “U.S. Attorney”) and the DOJ entered into on March 12, 2019), is costly and, if the implementation costs are more than we anticipate, could adversely affect our operating results. In the event we fail to fully implement and comply with the Lacey Compliance Plan as required and in accordance with set deadlines, the government may require us to cease the importation of hardwood flooring from China until the DOJ determines that we are in full compliance with the Lacey Compliance Plan. If we have to cease the importation of hardwood flooring, our ability to operate would be substantially harmed and our business, including our results of operations, would be adversely affected. In the event we breach the DPA, there is a risk the U.S. Attorney and the DOJ would seek to impose remedies provided for in the DPA, including criminal prosecution. Further, the failure to properly manage our overall compliance program and fully comply with the obligations imposed upon us by these various settlement agreements or implement any of the compliance requirements arising from these obligations could adversely affect our ability to conduct business, result in significant fines and other penalties, damage our brand and reputation and negatively impact our financial position and results of operations.

Federal, provincial, state or local laws and regulations, including tariffs, or our failure to comply with such laws and regulations, and our obligations under certain settlement agreements related to our products could increase our expenses, restrict our ability to conduct our business and expose us to legal risks.

We are subject to a wide range of general and industry-specific laws and regulations imposed by federal, provincial, state and local authorities in the countries in which we operate, including those related to tariffs, customs, foreign operations (such as the Foreign Corrupt Practices Act), truth-in-advertising, consumer protection, privacy, zoning and occupancy matters as well as the operation of retail stores and warehouse, production and distribution facilities and provision of installation services. In addition, various federal, provincial and state laws govern our relationship with and other matters pertaining to our employees, including wage and hour-related laws. If we fail to comply with these laws and regulations, we could be subject to legal risk, our operations could be impacted negatively and our reputation could be damaged. Likewise, if such laws and regulations should change, our costs of compliance may increase, thereby impacting our results and hurting our profitability.

Certain portions of our operations are subject to laws and regulations governing hazardous materials and wastes, the remediation of contaminated soil and groundwater and the health and safety of employees. If we are unable to comply with, extend or renew a material approval, license or permit required by such laws, or if there is a delay in renewing any material approval, license or permit, our net sales and operating results could deteriorate or otherwise cause harm to our business.

With regard to our products, we spend significant resources in order to comply with applicable advertising, importation, exportation, environmental and health and safety laws and regulations. If we should violate these laws and regulations, we could experience delays in shipments of our goods, be subject to fines, penalties, criminal charges, or other legal risks, be liable for costs and damages, or suffer reputational harm, which could reduce demand for our

merchandise and hurt our business and results of operations. Further, if such laws and regulations should change we may experience increased costs in order to adhere to the new standards. We are also subject to a number of settlement agreements that impose certain obligations on us with respect to the operation of our business. If we fail to comply with these obligations, we may experience additional costs and expenses and could be subject to additional legal risks.

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Our growth strategy depends in part on our ability to open new stores and is subject to many unpredictable factors.

As of December 31, 2018, we had 413 stores throughout the United States and Canada. Assuming the continued success of our store model and satisfaction of our internal criteria, we plan to continue our selective approach to future openings over the next several years. This growth strategy and the investment associated with the development of each new store may cause our operating results to fluctuate and be unpredictable or decrease our profits. Our future results and ability to implement our growth strategy will depend on various factors, including the following:

- as we open more stores, our rate of expansion relative to the size of our store base will decline;
- consumers in new markets may be less familiar with our brands, and we may need to increase brand awareness in those markets through additional investments in advertising;
- new stores may have higher construction, occupancy or operating costs, inventory requirements, or may have lower average store net sales, than stores opened in the past;
- competitive pressures could cause changes to our store model and making necessary changes could prove costly;
- newly opened stores may reach profitability more slowly than we expect in the future, as we enter more mid-sized and smaller markets and add stores to larger markets where we already have a presence; and
- our Canadian stores may require additional investment in advertising due to our limited penetration in the Canadian market.

Failure to manage our growth effectively could harm our business and operating results.

Our plans call for our selective approach in the addition of new stores over the next several years, and increased orders from our website, call center and catalogs. Our existing management information systems, including our store management systems, compliance procedures and financial and reporting controls, may be unable to support our expansion. Managing our growth effectively will require us to continue to enhance these systems, procedures and controls and to hire, train and retain regional and store managers and personnel for our compliance and financial and reporting departments. We may not respond quickly enough to the changing demands that our expansion will impose on us. Any failure to manage our growth effectively could harm our business and operating results.

Increased transportation costs could harm our results of operations.

The efficient transportation of our products through our supply chain is a critical component of our operations. If the cost of fuel or other costs, such as import tariffs, duties and international container rates, rise, it could result in increases in our cost of sales due to additional transportation charges and fees. Additionally, there are a limited number of delivery companies capable of efficiently transporting our products from our suppliers. Consolidation within this industry could result in increased transportation costs. A reduction in the availability of qualified drivers and an increase in driver regulations could continue to increase our costs. We may be unable to increase the price of our products to offset increased transportation charges, which could cause our operating results to deteriorate.

Damage, destruction or disruption of our distribution centers could significantly impact our operations and impede our ability to distribute certain of our products.

We have two distribution centers which house products for the direct shipment of flooring to our stores or to our customers. If either of our distribution centers or our inventory held in those locations were damaged or destroyed by fire, wood infestation or other causes, our distribution processes would be disrupted, which could cause significant

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delays in delivery. This could impede our ability to stock our stores and deliver products to our customers, and cause our net sales and operating results to deteriorate.

The operation of stores in Canada and our representative office in China may present increased legal and operational risks.

We currently operate eight store locations in Canada. As a result of our limited penetration in the Canadian market, these stores may continue to be less successful than we expect. Additionally, investments in advertising and promotional activity may be required to continue to build brand awareness in that market.

We also have a representative office in Shanghai, China to facilitate our product sourcing in Asia. We have limited experience with the legal and regulatory environments and market practices outside of the United States and cannot guarantee that we will be able to operate profitably in these markets or in a manner and with results similar to those in the United States. We may also incur increased costs in complying with applicable Canadian and Chinese laws and regulations as they pertain to both our products and our operations. Further, if we fail to comply with applicable laws and regulations, we could be subject to, among other things, litigation and government and agency investigations.

Failure to effectively manage our third-party installers may present increased legal and operational risks.

We manage third-party installers who provide installation services to some of our customers. In some of these jurisdictions, we are subject to regulatory requirements and risks applicable to general contractors, which include management of licensing, permitting and quality of our third-party installers. We have established procedures designed to manage these requirements and ensure customer satisfaction with the services provided by our third-party installers. If we fail to manage these procedures effectively or provide proper oversight of these services, we may be subject to regulatory enforcement and litigation and our net sales and our profitability and reputation could be harmed.

Our founder is the lessor on a significant number of our leases and the satisfactory renewal of these as each comes due is a risk to our occupancy costs and store count.

As of December 31, 2018, we leased our Toano facility, which includes a store location, a warehouse and 29 of our other store locations from entities owned, in whole or in part, by Tom Sullivan, our founder. Although our percentage of total stores leased from such entities has decreased and our lease at the Toano facility ends on December 31, 2019, this concentration of leases subjects us to the risk of increased costs or reduction of store count in the event of an adverse action or inaction by Mr. Sullivan or such entities. Mr. Sullivan no longer serves as an employee or as a director of the Company.

Our success depends upon the retention of our personnel.

We believe that our success has depended and continues to depend on the efforts and capabilities of our employees. The loss of the services of key employees due to any negative market or industry perception, the Company's stock price, the Company's headquarters move, and/or litigation may prevent us from achieving operational goals and harm our reputation.

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Risks Related to Our Suppliers, Products and Product Sourcing

Our ability and cost to obtain cost-effective products, especially from China and other international suppliers, and the operations of many of our international suppliers are subject to risks that may be beyond our control and that could harm our operations and profitability.

We rely on a select group of international suppliers to provide us with imported flooring products that meet our specifications. In 2018, our imported product was sourced from Asia, Europe, Australia and South America. As a result, we are subject to risks associated with obtaining products from abroad, including:

- the imposition of duties (including antidumping and countervailing duties), tariffs, taxes and/or other charges on exports or imports;
- political unrest, terrorism and economic instability resulting in the disruption of trade from foreign countries where our products originate;
- currency exchange fluctuations;
- the imposition of new laws and regulations, including those relating to environmental matters and climate change issues, labor conditions, quality and safety standards, trade restrictions, and restrictions on funds transfers;
- disruptions or delays in production, shipments, delivery or processing through ports of entry; and
- differences in product standards, acceptable business practices and legal environments of the country of origin.

In 2018, we sourced approximately 47% of our products from China. Virtually all of these products had a 10% tariff imposed upon them in late 2018 and many of these products could increase further should the tariff rate increase as has been announced but postponed indefinitely, go into effect. Potential costs and any attendant impact on pricing arising from these tariffs could have a material adverse effect on our results of operations, financial condition and liquidity.

These and other factors beyond our control could disrupt the ability of our suppliers to ship certain products to us cost-effectively or at all, which could harm our operations. If our product costs and consumer demand are adversely affected by foreign trade issues (including import tariffs and other trade restrictions with China), our sales and profitability may suffer.

Failure to identify and develop relationships with a sufficient number of qualified suppliers could affect our ability to obtain products that meet our high quality standards.

We purchase flooring directly from mills located around the world. We believe that these direct supplier relationships are important to our business. In order to retain the competitive advantage that we believe results from these relationships, we need to continue to identify, develop and maintain relationships with qualified suppliers that can satisfy our high standards for quality and our requirements for the delivery of hardwood in a timely and efficient manner. We expect the need to develop new relationships to be particularly important as we seek to expand our operations, enhance our product offerings, and expand our product assortment and geographic source of origin in the future. Any inability to do so could reduce our competitiveness, slow our plans for further expansion and cause our net sales and operating results to deteriorate.

We rely on a concentrated number of suppliers for a significant portion of our supply needs. We generally do not have long-term contracts with our suppliers. In the future, our suppliers may be unable to supply us, or supply us on acceptable terms, due to various factors, which could include political instability in the supplier's country, insufficient production capacity, product line failures, collusion, a supplier's financial instability, inability or refusal to comply with

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applicable laws, trade restrictions, tariffs or our standards, duties, insufficient transport capacity and other factors beyond our control. In these circumstances, we could experience deterioration in our net sales and operating results.

The failure of our suppliers to comply with applicable laws, use ethical practices, and meet our quality standards could result in our suspending purchasing from them, negatively impacting net sales, and could expose us to reputational and legal risks.

While our suppliers agree to operate in compliance with applicable laws and regulations, we do not control our suppliers. Accordingly, despite our continued investment in quality control, we cannot guarantee that they comply with such laws and regulations or operate in a legal, ethical and responsible manner. While we monitor our suppliers' adherence to our quality standards, there is no guarantee that we will be able to identify non-compliance. Moreover, the failure of our suppliers to adhere to applicable legal requirements and the quality standards that we set for our products could lead to government investigations, litigation, write-offs and recalls, which could damage our reputation and our brands, increase our costs, and otherwise hurt our business.

Product liability claims could adversely affect our reputation, which could adversely affect our net sales and profitability.

We have faced and continue to face the risk of exposure to product liability claims in the event that the use of our products is alleged to have resulted in economic loss, personal injury or property damage or violated environmental or other laws. In the event that any of our products proves to be defective or otherwise in violation of applicable laws, we may be required to recall or redesign such products. Further, in such instances, we may be subject to legal action. We maintain insurance against some forms of product liability claims, but such coverage may not be available or adequate for the liabilities actually incurred. A successful claim brought against us in excess of available insurance coverage, or any claim or product recall that results in significant adverse publicity against us, may have a material adverse effect on our net sales and operating results.

Our ability to offer hardwood flooring, particularly products made of more exotic species of hardwood, depends on the continued availability of sufficient suitable hardwood at reasonable cost.

Our business strategy depends on offering a wide assortment of hardwood flooring to our customers. We sell flooring made from species ranging from domestic maple, oak and pine to imported cherry, koa, mahogany and teak. Some of these species are scarce, and we cannot be assured of their continued availability. Our ability to obtain an adequate volume and quality of hard-to-find species depends on our suppliers' ability to furnish those species, which, in turn, could be affected by many things including events such as forest fires, insect infestation, tree diseases, prolonged drought and other adverse weather and climate conditions. Government regulations relating to forest management practices also affect our suppliers' ability to harvest or export timber, and changes to regulations and forest management policies, or the implementation of new laws or regulations, could impede their ability to do so. If our suppliers cannot deliver sufficient hardwood and we cannot find replacement suppliers, our net sales and operating results may be negatively impacted.

The cost of the various species of hardwood that are used in our products is important to our profitability. Hardwood lumber costs fluctuate as a result of a number of factors including changes in domestic and international supply and demand, labor costs, competition, market speculation, product availability, environmental restrictions, government regulation and trade policies, duties, weather conditions, processing and freight costs, and delivery delays and disruptions. We generally do not have long-term supply contracts or guaranteed purchase amounts. As a result, we may not be able to anticipate or react to changing hardwood costs by adjusting our purchasing practices, and we may not always be able to increase the selling prices of our products in response to increases in supply costs. If we cannot address changing hardwood costs appropriately, it could cause our operating results to deteriorate.

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Risks Related to Economic Factors and Our Access to Capital

Cyclical in the home flooring industry, coupled with our lack of diversity in our lines of business, could cause volatility and risk to our business.

The hardwood flooring industry is highly dependent on the remodeling of existing homes and new home construction. Remodeling and new home construction are cyclical and depend on a number of factors which are beyond our control, including interest rates, tax policy, employment levels, consumer confidence, credit availability, real estate prices, demographic trends, weather conditions, natural disasters and general economic conditions.

In the event of a decrease in discretionary spending, home remodeling activity or new home construction, demand for our products, including hardwood flooring, could be impacted negatively and our business and operating results could be harmed.

Our insurance coverage and self-insurance reserves may not cover existing or future claims.

With the large number of pending cases and government investigations, we may be required to defend ourselves and our officers, directors and former employees and we may be subject to financial harm in the event such cases or investigations are adversely determined and insurance coverage will not, or is not sufficient to, cover any related losses. We maintain various insurance policies, including directors and officers insurance, as well as the following:

- We are self-insured on certain health insurance plans and workers' compensation coverage and are responsible for losses up to a certain limit for these respective plans.
- We continue to be responsible for losses up to a certain limit for general liability and property damage insurance.
- Our professional liability and cyber security insurance policies contain limitations on the amount and scope of coverage.

For policies under which we are responsible for losses, we record a liability that represents our estimated cost of claims incurred and unpaid as of the balance sheet date. Unanticipated changes may produce materially different amounts of expense than those recorded, which could adversely impact our operating results. Additionally, our recent experience could limit our ability to obtain satisfactory insurance coverage, subjecting us to further loss, or could require significantly increased premiums.

The inability to access our Revolving Credit Facility or other sources of capital, could cause our financial position, liquidity, and results of operations to suffer.

We have relied on and expect to continue to rely on a bank credit agreement to fund our seasonal needs for working capital. We have signed a commitment letter to increase the amounts available under this Revolving Credit Facility and may need to access additional sources of capital to satisfy our liquidity needs. Our access to the Revolving Credit Facility depends on our ability to meet the conditions for borrowing, including that all representations are true and correct at the time of the borrowing. There is no assurance that we will be able to consummate the commitment letter. Also, there is no assurance that we could obtain additional financing on acceptable terms, if at all. Our failure to meet these requirements or obtain additional or alternative sources of capital could impact:

- our ability to fund working capital, capital expenditures, store expansion and other general corporate purposes;
- our ability to meet our liquidity needs, arising from, among other things, legal matters; and

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· our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate.

Risks Related to Our Information Technology

We may incur costs and losses resulting from security risks we face in connection with our electronic processing, transmission and storage of confidential customer information.

We accept electronic payment cards for payment in our stores and through our call center. In addition, our online operations depend upon the secure transmission of confidential information over public networks, including information permitting cashless payments. As a result, we may become subject to claims for purportedly fraudulent transactions arising out of the actual or alleged theft of credit or debit card information, and we may also be subject to lawsuits or other proceedings relating to these types of incidents. Further, a compromise of our security systems that results in our customers' personal information being obtained by unauthorized persons could adversely affect our reputation with our customers and others, as well as our operations, results of operations and financial condition, and could result in litigation against us or the imposition of penalties. A security breach could also require that we expend significant additional resources related to the security of information systems and could result in a disruption of our operations, particularly our online sales operations.

Additionally, privacy and information security laws and regulations change, and compliance with them may result in cost increases due to necessary systems changes and the development of new administrative processes. If we fail to comply with these laws and regulations or experience a data security breach, our reputation could be damaged, possibly resulting in lost future business, and we could be subjected to additional legal risk as a result of non-compliance.

If our management information systems, including our website or our call center, experience disruptions, it could disrupt our business and reduce our net sales.

We depend on our management information systems to integrate the activities of our stores, website and call center, to process orders, to respond to customer inquiries, to manage inventory, to purchase merchandise and to sell and ship goods on a timely basis. We may experience operational problems with our information systems as a result of system failures, viruses, computer "hackers" or other causes. We may incur significant expenses in order to repair any such operational problems. Any significant disruption or slowdown of our systems could cause information, including data related to customer orders, to be lost or delayed, which could result in delays in the delivery of products to our stores and customers or lost sales. Moreover, our entire corporate network, including our telephone lines, is on an Internet-based network, which is vulnerable to certain risks and uncertainties, including changes in required technology interfaces, website downtime and other technical failures, security breaches and customer privacy concerns. Accordingly, if our network is disrupted or if we cannot successfully maintain our website and call center in good working order, we may experience delayed communications within our operations and between our customers and ourselves, and may not be able to communicate at all via our network, including via telephones connected to our network.

Alternative e-commerce and online shopping offerings may erode our customer base and adversely affect our business.

Our long-term future depends heavily upon the general public's willingness to use our stores as a means to purchase goods. In recent years, e-commerce has become more widely accepted as a means of purchasing consumer goods and services, which could adversely impact customer traffic in our stores. Additionally, certain of our competitors offer alternative e-commerce and online shopping. If consumers use alternative e-commerce and online shopping offerings to conduct business as opposed to our store locations, it could materially adversely impact our net sales and operating results.

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Risks Relating to Our Competitive Positioning

A tarnished brand or ineffectiveness of our advertising strategy could result in reduced customer traffic, thereby impacting net sales and profitability.

We believe that our growth thus far was achieved in part through our successful investment in local and national advertising. Historically, we have used extensive advertising to encourage customers to drive to our stores, which were generally located some distance from population centers in areas that have lower rents than traditional retail locations. Further, a significant portion of our advertising was directed at the DIY and DIFM customers. While our marketing strategy continues to support these strategies, we have broadened the reach and frequency of our advertising to increase the awareness of our value proposition and the number of customers served. If there is any negative perceptions about our brand to our customers, our advertisements fail to draw customers in the future, or if the cost of advertising or other marketing materials increases significantly, we could experience declines in our net sales and operating results.

Competition could cause price declines, decrease demand for our products and decrease our market share.

We operate in the wood flooring industry, which is highly fragmented and competitive. We face significant competition from national and regional home improvement chains, national and regional specialty flooring chains, Internet-based companies and privately owned single-site enterprises. We compete on the basis of price, customer service, store location and the range, quality and availability of the hardwood flooring that we offer our customers. If our positioning with regard to one or more of these factors should erode, deteriorate, fail to resonate with consumers or misalign with demand or expectations, our business and results may be negatively impacted.

Our competitive position is also influenced by the availability, quality and cost of merchandise, labor costs, distribution and sales efficiencies and our productivity compared to that of our competitors. Further, as we expand into new and unfamiliar markets, we may face different competitive environments than in the past. Likewise, as we continue to enhance and develop our product offerings, we may experience new competitive conditions.

Some of our competitors are larger organizations, have existed longer, are more diversified in the products they offer and have a more established market presence with substantially greater financial, marketing, personnel and other resources than we have. In addition, our competitors may forecast market developments more accurately than we do, develop products that are superior to ours, produce similar products at a lower cost or adapt more quickly to new technologies or evolving customer requirements than we do. Intense competitive pressures from one or more of our competitors could cause price declines, decrease demand for our products and decrease our market share.

Hardwood flooring may become less popular as compared to other types of floor coverings in the future. For example, our products are made using various hardwood species, including rare exotic hardwood species, and concern over the environmental impact of tree harvesting could shift consumer preferences towards synthetic or inorganic flooring. In addition, hardwood flooring competes against carpet, vinyl sheet, vinyl tile, ceramic tile, natural stone and other types of floor coverings. If consumer preferences shift toward types of floor coverings that we do not sell, we may experience decreased demand for our products.

All of these competitive factors may harm us and reduce our net sales and operating results.

Risks Related to Accounting Standards and Internal Controls

Changes in accounting standards, subjective assumptions, estimates and judgments by management related to complex accounting matters, and failures in internal control could significantly affect our financial results.

Generally accepted accounting principles and related accounting pronouncements, implementation guidelines and interpretations with regard to a wide range of matters that are relevant to our business, including but not limited to, consolidation, revenue recognition, stock-based compensation, lease accounting, sales returns reserves, inventories, self-insurance, income taxes, deferred taxes, valuation allowances, unclaimed property laws and litigation, are highly

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complex and involve many subjective assumptions, estimates and judgments by our management. Changes in these rules or their interpretation or changes in underlying assumptions, estimates or judgments by our management could significantly change our reported or expected financial performance, which may have a material effect on our results of operation.

Failure to maintain effective systems of internal and disclosure control could have a material adverse effect on our results of operation and financial condition.

Effective internal and disclosure controls are necessary for us to provide reliable financial reports and effectively prevent fraud, and to operate successfully as a public company. If we cannot provide reliable financial reports or prevent fraud, our reputation and operating results would be harmed. As part of our ongoing monitoring of internal control, we may discover material weaknesses or significant deficiencies in internal control that require remediation.

In the current period, we identified a material weakness as discussed in Item 9A. Additionally, we have in the past discovered, and may in the future discover, areas of internal controls that need improvement. Regardless, we continue to work to remediate and improve our internal controls. We cannot be certain that these measures will ensure that we implement and maintain adequate controls over our financial processes and reporting in the future. Any failure to maintain effective controls or to timely implement any necessary improvement of our internal and disclosure controls could, among other things, result in losses from fraud or error, harm our reputation, or cause investors to lose confidence in the reported financial information, all of which could have a material adverse effect on our results of operation and financial condition.

Risks Relating to Our Common Stock

Our common stock price may be volatile and all or part of any investment in our common stock may be lost.

The market price of our common stock could fluctuate significantly based on various factors, including, but not limited to:

- unfavorable market reactions to allegations regarding the safety of our products and the related litigation and/or government investigations resulting therefrom, as well as any payments, judgments or other losses in connection with such lawsuits and/or investigations;
- trading activity of our current or future stockholders, including common stock transactions by our directors and executive officers;
- industry-related trends and growth prospects; and
- our concentration in the cyclical home furnishings industry.

In addition, the stock market may experience significant price and volume fluctuations. These fluctuations may be unrelated to the operating performance of particular companies but may cause declines in the market price of our common stock. The price of our common stock could fluctuate based upon factors that have little or nothing to do with us or our performance.

Our quarterly operating results may fluctuate significantly and could fall below the expectations of research analysts and investors due to various factors.

Research analysts and investors develop expectations on how we may perform using a variety of metrics, including, but not limited to, sales, comparable store sales and gross profit. However, in any given quarter, actual performance may vary from these expectations, causing significant fluctuations in our stock price.

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Our anti-takeover defense provisions may cause our common stock to trade at market prices lower than it might absent such provisions.

Our certificate of incorporation and bylaws contain provisions that may make it more difficult or expensive for a third party to acquire control of us without the approval of our board of directors. These provisions include a staggered board, the availability of “blank check” preferred stock, provisions restricting stockholders from calling a special meeting of stockholders or from taking action by written consent and provisions that set forth advance notice procedures for stockholders’ nominations of directors and proposals of topics for consideration at meetings of stockholders. Our certificate of incorporation also provides that Section 203 of the Delaware General Corporation Law, which relates to business combinations with interested stockholders, applies to us. These provisions may delay, prevent or deter a merger, or other transaction that might otherwise result in our stockholders receiving a premium over the market price for their common stock. In addition, these provisions may cause our common stock to trade at a market price lower than it might absent such provisions.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

As of March 1, 2019, we operated 412 stores located in 47 states and Canada, including one opening and two closings since December 31, 2018. In addition to our eight stores in Ontario, Canada, the table below sets forth the locations (alphabetically by state) of our 404 U.S. stores in operation as of March 1, 2019.

State	Stores	State	Stores	State	Stores	State	Stores
Alabama	6	Iowa	3	Nebraska	2	Rhode Island	1
Arizona	6	Kansas	3	Nevada	4	South Carolina	10
Arkansas	2	Kentucky	5	New Hampshire	5	South Dakota	1
California	45	Louisiana	6	New Jersey	14	Tennessee	6
Colorado	9	Maine	3	New Mexico	1	Texas	29
Connecticut	8	Maryland	10	New York	21	Utah	3
Delaware	4	Massachusetts	10	North Carolina	14	Vermont	1
Florida	31	Michigan	11	North Dakota	1	Virginia	15
Georgia	11	Minnesota	7	Ohio	13	Washington	9
Idaho	2	Mississippi	3	Oklahoma	3	West Virginia	3
Illinois	15	Missouri	5	Oregon	8	Wisconsin	6
Indiana	8	Montana	1	Pennsylvania	20		

We lease all of our stores as well as our corporate headquarters, which is currently located in Toano, Virginia. Our corporate headquarters is located on a 74-acre plot, is 307,784 square feet, of which approximately 32,000 square feet are office space, and includes our call center, corporate offices, a distribution facility and two finishing lines. In July 2018, we announced that we will relocate our corporate headquarters and call center from Toano, Virginia to Richmond, Virginia. On October 19, 2018, we entered into an agreement to lease the new headquarters location,

which covers an existing building consisting of approximately 53,000 rentable square feet. We currently lease space near the new headquarters location as a satellite office for various administrative functions and expect to continue that lease or lease similar property in Richmond, Virginia for our call center operations. We expect the relocation to the new headquarters to take place in late 2019. Based on the Company's internal review of its Bellwood products finishing operation and related equipment in 2018, the Company ceased finishing flooring in January 2019 and outsourced this business to focus on its core retail operations.

In addition, we own a one million square foot distribution center on approximately 100 acres of land in Henrico County, Virginia. We lease a 504,016 square foot facility in Pomona, California, which, along with our facility in Virginia, serve as our primary distribution facilities.

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Item 3. Legal Proceedings.

Governmental Investigations

In March 2015, the Company received a grand jury subpoena issued in connection with a criminal investigation being conducted by the U.S. Attorney's Office for the Eastern District of Virginia (the "U.S. Attorney"). In addition, on May 19, 2015, July 13, 2015 and March 11, 2016, the Company received subpoenas from the New York Regional Office of the SEC in connection with an inquiry by the SEC staff. The focus of the investigations primarily related to compliance with disclosure, financial reporting and trading requirements under the federal securities laws. The Company cooperated with the investigations and produced documents and other information responsive to subpoenas and other requests received from the parties.

The Company has recently concluded negotiations with the U.S. Attorney, the DOJ and the SEC concerning the resolution of their criminal and civil investigations into the public disclosures the Company made in March 2015 concerning whether its Chinese made laminates were compliant with certain California state regulatory requirements (the "Investigations"). In connection with the Investigations, the Company (i) entered into a Deferred Prosecution Agreement ("DPA") with the U.S. Attorney and the DOJ on March 12, 2019 and (ii) submitted an Offer of Settlement to the SEC on March 12, 2019. On March 12, 2019 the SEC approved the Offer and issued an Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order (the "Order"). The DPA and the Order are collectively referred to herein as the "Agreements". Pursuant to the DPA, the U.S. Attorney and the DOJ filed a one count criminal information in the United States District Court for the Eastern District of Virginia, charging the Company with securities fraud in connection with the March 2015 8-K. The U.S. Attorney and the DOJ agreed that if the Company fully complies with all of its obligations under the DPA, the U.S. Attorney and the DOJ will, at the conclusion of the DPA's three-year term, seek dismissal with prejudice of the criminal information filed against the Company. Pursuant to the Order, the SEC ordered the Company to cease and desist from committing or causing any violations and any future violations of the relevant provisions of the federal securities laws and required disgorgement as discussed in the following paragraph.

Under the DPA, the Company is required, among other things, to (1) pay a fine in the amount of \$19,095,648 to the United States Treasury, (2) forfeit to the U.S. Attorney and the DOJ the sum of \$13,904,352, of which up to \$6,097,298 will be submitted by the Company to the SEC in disgorgement and prejudgment interest under the Order and (3) adopt a new compliance program, or modify its existing one, including internal controls, compliance policies, and procedures in order to ensure that the Company maintains an effective system of internal account controls designed to ensure the making and keeping of fair and accurate books, records and accounts, as well as a compliance program designed to prevent and detect violations of certain federal securities laws throughout its operations. The Company will also be required to report to the U.S. Attorney and DOJ annually during the term of the DPA regarding remediation and implementation of the compliance measures described in the DPA.

The Agreements also provide that the Company will continue to cooperate with the U.S. Attorney, the DOJ and the SEC in all matters relating to the conduct described in the Agreements and, at the request of the U.S. Attorney, the DOJ, or the SEC, the Company will cooperate fully with other domestic or foreign law enforcement authorities and agencies in any investigation of the Company in any and all matters relating to the Agreements. In the event the Company breaches the DPA, there is a risk the government would seek to impose remedies provided for in the DPA, including instituting criminal prosecution against the Company.

The Company has accrued a charge of \$33 million within selling, general and administrative expenses in its December 31, 2018 financial statements, reflecting the amounts owed under the Agreements. The Company expects to remit all

amounts within 30 days of entering into the Agreements and has included the liability in the caption “Accrual for Legal Matters and Settlements Current” on its balance sheet. The Company expects to remit all amounts within 30 days of entering into the Agreements and has included the liability in the caption “Accrual for Legal Matters and Settlements Current” on its balance sheet.

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Litigation Relating to Bamboo Flooring

On or about December 8, 2014, Dana Gold (“Gold”) filed a purported class action lawsuit in the United States District Court for the Northern District of California alleging that the Morning Star bamboo flooring that the Company sells is defective (the “Gold Litigation”). Plaintiffs have narrowed the complaint to the Company’s Morning Star Strand Bamboo flooring (the “Strand Bamboo Product”) sold to residents of California, Florida, Illinois, Minnesota, Pennsylvania and West Virginia for personal, family or household use. The Gold Litigation plaintiffs allege that the Company has engaged in deceptive trade practice acts in conjunction with the sale of the Strand Bamboo Products. The plaintiffs did not quantify any alleged damages in their complaint but, in addition to attorneys’ fees and costs, the plaintiffs sought a declaration that the Company’s actions violate the law and that it is financially responsible for notifying all purported class members, injunctive relief requiring the Company to replace and/or repair all of the Strand Bamboo Product installed in structures owned by the purported class members and a declaration that the Company must disgorge, for the benefit of the purported classes, all or part of the profits received from the sale of the allegedly defective Strand Bamboo Product and/or to make full restitution to the plaintiffs and the purported class members. In November 2017, the court granted the plaintiffs’ motion for class certification with respect to the six states. The Company appealed the decision, but the petition for appeal was denied. On January 2, 2019, the court denied the Company’s motion for summary judgment. The Company has participated in court-ordered mediation sessions. Trial, which was previously scheduled for February 25, 2019, has been postponed.

Following settlement discussions with the respect to the Gold Litigation, on March 15, 2019, the Company entered into a Memorandum of Understanding with Gold and certain other lead plaintiffs in the Gold Litigation (the “MOU”), which would resolve all disputes on a nationwide basis. Under the terms of the MOU, the Company will contribute \$14 million in cash and provide \$14 million in store-credit vouchers, with a potential additional \$2 million in store-credit vouchers based on obtaining a claim’s percentage of more than 7%, for an aggregate settlement of up to \$30 million. The MOU is subject to certain contingencies, including the execution of a definitive settlement agreement, board approval of the definitive settlement agreement, and court approvals. The entry into the MOU or any subsequent execution of a definitive settlement agreement does not constitute an admission by the Company of any fault or liability and the Company does not admit any fault or liability. There can be no assurance that a settlement will be finalized and approved or as to the ultimate outcome of the litigation. If a final, court-approved settlement is not reached, the Company will defend the matter vigorously and believes there are meritorious defenses and legal standards that must be met for, among other things, success on the merits. The Company has notified its insurance carriers and continues to pursue coverage. As the insurance claim is still pending, the Company has not recognized any insurance recovery related to the Gold Litigation.

As a result of these developments, the Company has determined that a probable loss has been incurred and has recognized a charge to earnings of \$28 million within selling general and administrative expense during the fourth quarter of 2018 with the offset in the caption “Accrual for Legal Matters – Current” on its balance sheet related to this potential settlement as of December 31, 2018. If the Company does not execute a definitive settlement agreement consistent with the MOU or incurs losses with the respect to the Bamboo Flooring Litigation, the actual losses that may result from these actions may exceed this amount. Any such losses could, potentially, have a material adverse effect, individually or collectively, on the Company’s results of operations, financial condition and liquidity.

In addition, there are a number of other claims and lawsuits alleging damages similar to those in the Gold Litigation (the “Bamboo Flooring Litigation”). While the Company believes that a loss associated with the Bamboo Flooring Litigation is reasonably possible, the Company is unable to reasonably estimate the amount or range of possible loss. Any such losses could, potentially, have a material adverse effect, individually or collectively, on the Company’s results of operations, financial condition, and liquidity. The Company disputes the claims in the Bamboo Flooring

Litigation and intends to defend such matters vigorously.

Litigation Relating to Chinese Laminates

Formaldehyde-Abrasion MDLs

Beginning on or about March 3, 2015, numerous purported class action cases were filed in various U.S. federal district courts and state courts involving claims of excessive formaldehyde emissions from the Company's Chinese-

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manufactured laminate flooring products. The purported classes consisted of all U.S. consumers that purchased the relevant products during certain time periods. Plaintiffs in these cases challenged the Company's labeling of its products as compliant with the California Air Resources Board Regulation and alleged claims for fraudulent concealment, breach of warranty, negligent misrepresentation and violation of various state consumer protection statutes. The plaintiffs sought various forms of declaratory and injunctive relief and unquantified damages, including restitution and actual, compensatory, consequential and, in certain cases, punitive damages, as well as interest, costs and attorneys' fees incurred by the plaintiffs and other purported class members in connection with the alleged claims. The United States Judicial Panel on Multidistrict Litigation (the "MDL Panel") transferred and consolidated the federal cases to the United States District Court for the Eastern District of Virginia (the "Virginia Court"). The consolidated case in the Virginia Court is captioned In re: Lumber Liquidators Chinese-Manufactured Flooring Products Marketing, Sales, Practices and Products Liability Litigation (the "Formaldehyde MDL").

Beginning on or about May 20, 2015, multiple class actions were filed in the United States District Court for the Central District of California and other district courts located in the place of residence of each non-California plaintiffs consisting of U.S. consumers who purchased the Company's Chinese-manufactured laminate flooring products challenging certain representations about the durability and abrasion class ratings of such products. These plaintiffs asserted claims for fraudulent concealment, breach of warranty and violation of various state consumer protection statutes. The plaintiffs did not quantify any alleged damages in these cases; however, in addition to attorneys' fees and costs, they did seek an order (i) certifying the action as a class action, (ii) adopting the plaintiffs' class definitions and finding that the plaintiffs are their proper representatives, (iii) appointing their counsel as class counsel, (iv) granting injunctive relief to prohibit the Company from continuing to advertise and/or sell laminate flooring products with false abrasion class ratings, (v) providing restitution of all monies the Company received from the plaintiffs and class members and (vi) providing damages (actual, compensatory and consequential), as well as punitive damages. On October 3, 2016, the MDL Panel transferred and consolidated the abrasion class actions to the Virginia Court. The consolidated case is captioned In re: Lumber Liquidators Chinese-Manufactured Laminate Flooring Durability Marketing and Sales Practices Litigation (the "Abrasion MDL").

On March 15, 2018, the Company entered into a settlement agreement to jointly settle the Formaldehyde MDL and the Abrasion MDL. Under the terms of the settlement agreement, the Company has agreed to fund \$22 million (the "Cash Payment") and provide \$14 million in store-credit vouchers for an aggregate settlement amount of \$36 million to settle claims brought on behalf of purchasers of Chinese-made laminate flooring sold by the Company between January 1, 2009 and May 31, 2015. The \$36 million aggregate settlement amount was accrued in 2017. On June 16, 2018, the Virginia Court issued an order that, among other things, granted preliminary approval of the settlement agreement. Following the preliminary approval, and pursuant to the terms of the settlement agreement, the Company, in June, paid \$0.5 million for settlement administration costs, which is part of the Cash Payment, to the plaintiffs' settlement escrow account. Subsequent to the Final Approval and Fairness Hearing held on October 3, 2018, the Court approved the settlement on October 9, 2018 and, as a result, the Company paid \$21.5 million in cash into the plaintiffs' settlement escrow account. To date, insurers have denied coverage with respect to the Formaldehyde MDL and Abrasion MDL.

On November 8, 2018, an individual filed a Notice of Appeal in the United States Court of Appeals for the Fourth Circuit (the "Appeals Court") challenging the settlement. On December 14, 2018, another individual filed a Notice of Appeal in the Appeals Court. Subsequently, the Appeals Court consolidated both appeals and entered a briefing

schedule. Vouchers, which generally have a three-year life, will be distributed by the administrator upon order of the Court. At December 31, 2018, the Company's obligations related to Formaldehyde MDL and Abrasion MDL consisted of a short-term payable of \$35.5 million with \$14 million expected to be satisfied by the issuance of vouchers. If the appeals were to result in the settlement being set aside, the Company would receive \$21.5 million back from the escrow agent. Accordingly, the Company has accounted for the payment of \$21.5 million as a deposit in the accompanying consolidated financial statements. The Company has no liability accrued related to the appeals.

In addition to those purchasers who elected to opt out of the above settlement (the "Opt Outs"), there are a number of individual claims and lawsuits alleging personal injuries, breach of warranty claims or violation of state consumer protection statutes that remain pending (collectively, the "Remaining Laminate Matters"). Certain of these Remaining Laminate Matters were settled in 2018. The Company recognized charges to earnings of \$3 million and \$1 million for the years ended December 31, 2018 and 2017, respectively, within selling, general and administrative

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expenses for these Remaining Laminate Matters. While the Company believes that a further loss associated with the Opt Outs and Remaining Laminate Matters is possible, the Company is unable to reasonably estimate the amount or range of possible loss beyond what has been provided. Any such losses could, potentially, have a material adverse effect, individually or collectively, on the Company's results of operations, financial condition and liquidity.

Canadian Litigation

On or about April 1, 2015, Sarah Steele ("Steele") filed a purported class action lawsuit in the Ontario, Canada Superior Court of Justice against the Company. In the complaint, Steele's allegations include strict liability, breach of implied warranty of fitness for a particular purpose, breach of implied warranty of merchantability, fraud by concealment, civil negligence, negligent misrepresentation and breach of implied covenant of good faith and fair dealing. Steele did not quantify any alleged damages in her complaint, but seeks compensatory damages, punitive, exemplary and aggravated damages, statutory remedies, attorneys' fees and costs. While the Company believes that a further loss associated with the Steele litigation is possible, the Company is unable to reasonably estimate the amount or range of possible loss.

Employment Cases

Mason Lawsuit

On or about August 15, 2017, Ashleigh Mason, Dan Morse, Ryan Carroll and Osagie Ehigie filed a purported class action lawsuit in the United States District Court for the Eastern District of New York on behalf of all current and former store managers, store managers in training, installation sales managers and similarly situated current and former employees holding comparable positions but different titles (collectively, the "Putative Class Employees") alleging that the Company violated the Fair Labor Standards Act ("FLSA") and New York Labor Law ("NYLL") by classifying the Putative Class Employees as exempt. The alleged violations include failure to pay for overtime work. The plaintiffs seek certification of the Putative Class Employees for (i) a collective action covering the period beginning three years and 115 days prior to the filing of the complaint through the disposition of this action for the Putative Class Employees nationwide in connection with FLSA and (ii) a class action covering the period beginning six years and 115 days prior to the filing of the complaint through the disposition of this action for members of the Putative Class Employees who currently are or were employed in New York in connection with NYLL. The plaintiffs did not quantify any alleged damages but, in addition to attorneys' fees and costs, the plaintiffs seek class certification, unspecified amount for unpaid wages and overtime wages, liquidated and/or punitive damages, declaratory relief, restitution, statutory penalties, injunctive relief and other damages. In November 2018, the plaintiffs filed a motion requesting conditional certification for all Putative Class Employees who worked within the federal statute of limitations period. The Company filed its opposition to this motion, which is now pending before the court.

Kramer Lawsuit

On or about November 17, 2017, Robert J. Kramer, on behalf of himself and all others similarly situated (collectively, the “Kramer Plaintiffs”) filed a purported class action lawsuit in the Superior Court of California, County of Sacramento on behalf of all current and former store managers, all others with similar job functions and/or titles and all current and former employees classified as non-exempt or incorrectly classified as exempt and who worked for the Company in the State of California (collectively, the “CSM Employees”) alleging violation of the California Labor Code including, among other items, failure to pay wages and overtime and engaging in unfair business practices. The Kramer Plaintiffs seek certification of the CSM Employees for a class action covering the prior four-year period prior to the filing of the complaint through the disposition of this action for the CSM Employees who currently are or were employed in California (the “California SM Class”). The Kramer Plaintiffs did not quantify any alleged damages but, in addition to attorneys’ fees and costs, the Kramer Plaintiffs seek unspecified amounts for unpaid wages and overtime wages, liquidated and/or punitive damages, declaratory relief, restitution, statutory penalties, injunctive relief and other damages. The Company disputes the Kramer Plaintiffs’ claims and intends to defend the matter vigorously. Given the uncertainty of litigation, the preliminary stage of the case and the legal standards that must be met for, among other things, class certification and success on the merits, the Company cannot estimate the reasonably possible loss or range

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of loss, if any, that may result from this action and therefore no accrual has been made related to this. Any such losses could, potentially, have a material adverse effect, individually or collectively, on the Company's results of operations, financial condition and liquidity.

Antidumping and Countervailing Duties Investigation

In October 2010, a conglomeration of domestic manufacturers of multilayered wood flooring ("Petitioners") filed a petition seeking the imposition of antidumping ("AD") and countervailing duties ("CVD") with the United States Department of Commerce ("DOC") and the United States International Trade Commission ("ITC") against imports of multilayered wood flooring from China. This ruling applies to companies importing multilayered wood flooring from Chinese suppliers subject to the AD and CVD orders. The Company's multilayered wood flooring imports from China accounted for approximately 7% and 8% of its flooring purchases in 2018 and 2017, respectively. The Company's consistent view through the course of this matter has been, and remains, that its imports are neither dumped nor subsidized.

As part of its processes in these proceedings, following the original investigation, the DOC conducts annual administrative reviews of the CVD and AD rates. In such cases, the DOC will issue preliminary rates that are not binding and are subject to comment by interested parties. After consideration of the comments received, the DOC will issue final rates for the applicable period, which may lag by a year or more. As rates are adjusted through the administrative reviews, the Company adjusts its payments prospectively based on the final rate. The Company will begin to pay the finalized rates on each applicable future purchase when recognized by U.S. Customs and Border Protection.

The DOC made its initial determinations in the original investigation regarding CVD and AD rates on April 6, 2011 and May 26, 2011, respectively. On December 8, 2011, orders were issued setting final AD and CVD rates at a maximum of 3.3% and 1.5%, respectively. These rates became effective in the form of additional duty deposits, which the Company has paid, and applied retroactively to the DOC initial determinations.

Following the issuance of these orders, a number of appeals were filed by several parties, including the Company, with the Court of International Trade ("CIT") challenging, among other things, certain facts and methodologies that may impact the validity of the AD and CVD orders and the applicable rates. The Company participated in appeals of both the AD order and CVD order. On February 15, 2017, the Court of Appeals for the Federal Circuit ("CAFC") vacated the CIT's prior decision and remanded with instructions to the DOC to recalculate its AD rate. On remand, the DOC granted a 0% AD rate to eight Chinese suppliers, but did not exclude them permanently from the AD order. Nor did the CIT terminate the AD order. In July 2018, the CIT issued a judgment sustaining the DOC's calculation of 0% for the eight suppliers, but also excluded three of them from the AD order. Certain Chinese suppliers and the Petitioners have appealed this judgment to the CAFC. The Company is evaluating the impact of the CIT's judgment on its previously recorded expense related to the AD rates in the original investigation and subsequent annual reviews discussed below. Because of the length of time for finalization of rates as well as appeals, any subsequent adjustment

of CVD and AD rates typically flows through a period different from those in which the inventory was originally purchased and/or sold.

In the first DOC annual review in this matter, AD rates for the period from May 26, 2011 through November 30, 2012, and CVD rates from April 6, 2011 through December 31, 2011, were modified to a maximum of 5.92% and a maximum of 0.83%, respectively, which resulted in an additional payment obligation for the Company, based on best estimates and shipments during the applicable window, of \$0.8 million. The Company recorded this as a long-term liability on its accompanying consolidated balance sheet and in cost of sales in its second quarter 2015 financial statements. These AD rates were appealed to the CIT by several parties, including the Company. On remand from the CIT, the DOC has reduced the AD rate to 0.73%. In June 2018, the CIT sustained the reduced AD rate of 0.73% but did remand back to the DOC the issue regarding the calculation of the electricity rate, which, depending on that outcome, may cause a revision to the final AD rate. That remand from the DOC is still pending. This ruling from the CIT resulted in the Company reversing the \$0.8 million accrual and recording a receivable of approximately \$1.3 million during the second quarter of 2018.

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The second annual review of the AD and CVD rates was initiated in February 2014. Pursuant to the second annual review, in early July 2015, the DOC finalized the AD rate for the period from December 1, 2012 through November 30, 2013 at a maximum of 13.74% and the CVD rate for the period from January 1, 2012 through December 31, 2012 at a maximum of 0.99%. The Company believes the best estimate of the probable additional amounts owed was \$4.1 million for shipments during the applicable time periods, which was recorded as a long-term liability on its accompanying consolidated balance sheet and included in cost of sales in its second quarter 2015 financial statements. Beginning in July 2015, the Company began depositing these rates on each applicable purchase. The Company and other parties appealed the AD rates relating to this second annual review to the CIT. In June 2018, the court remanded the case back to the DOC to recalculate several of its adjustments, which is likely to cause a revision to the AD rate. The DOC has requested an extension to issue its recalculation on remand to the CIT until November 2018. However, that remand from the DOC is still pending.

The third annual review of the AD and CVD rates was initiated in February 2015. The third AD review covered shipments from December 1, 2013 through November 30, 2014. The third CVD review covered shipments from January 1, 2013 through December 31, 2013. In May 2016, the DOC issued the final CVD rate in the third review, which was a maximum of 1.38%. On July 13, 2016, the DOC set the final AD rate at a maximum of 17.37%. The Company appealed the AD rates to the CIT. In November 2018, the CIT issued an opinion sustaining the DOC's results, that decision was appealed to the CAFC by certain plaintiff interveners in January 2019. The Company's best estimate of the probable additional amounts owed associated with AD and CVD is approximately \$5.5 million for shipments during the applicable time periods. During the quarter ended June 30, 2016, the Company recorded this amount in other long-term liabilities in its balance sheet and as a charge to earnings in cost of sales on its statement of operations.

In February 2016, the DOC initiated the fourth annual review of AD and CVD rates, which followed a similar schedule as the preceding review. The AD review covered shipments from December 1, 2014 through November 30, 2015. The CVD review covered shipments from January 1, 2014 through December 31, 2014. In May 2017, the DOC issued the final CVD rate in the fourth review, which was a maximum of 1.45%, and, in June 2017, the final AD rate in the fourth review, which was a maximum of 0.00%. In October 2017, Petitioners withdrew their CIT appeal of the AD rates. As a result, the CIT dismissed the case and these rates are now final. The Company paid AD rates in excess of the final rates during the periods impacted by the fourth annual review in the amount of \$2.5 million and recorded a benefit in cost of sales with a corresponding receivable. The Company collected most of this receivable during 2018 and as of December 31, 2018, had a \$0.1 million receivable remaining.

The DOC initiated the fifth annual review of AD and CVD rates in February 2017. The AD review covers shipments from December 1, 2015 through November 30, 2016. The CVD review covers shipments from January 1, 2015 through December 31, 2015. In June 2018, the DOC issued the final CVD rate in the fifth review, which was a maximum of 0.85% (with one company having a rate of 0.11%). In July 2018, the DOC issued the final AD rate in the fifth review, which was a maximum of 0.00% and, the Company recorded a receivable in the amount of \$2.8 million in other current assets in its balance sheet. In connection with the issuance of the final CVD rate, with one company having a rate of 0.11%, the Company recorded a receivable of less than \$100 thousand.

The first 5-year Sunset Review of the AD and CVD orders on multilayered wood flooring (the “Sunset Review”) began in November 2016 at the ITC to determine whether to terminate the orders. The Company participated fully in this Sunset Review. In December 2017, the ITC determined that the AD and CVD orders will remain in place. The appeal of this determination by certain importers was filed but not subsequently pursued.

The DOC initiated the sixth annual review of AD and CVD rates in February 2018. The AD review covers shipments from December 1, 2016 through November 30, 2017. The CVD review covers shipments from January 1, 2016 through December 31, 2016. In December 2018, the DOC issued non-binding preliminary results in the sixth annual review for CVD rates and AD rates. The preliminary AD rate was a maximum of 48.26% due in part to one of the two individually reviewed companies’ failure to respond fully to the DOC’s request for information. The preliminary CVD rate was a maximum of 2.81%. The final CVD and AD rates in the sixth annual review are currently expected to be issued in April 2019. If the preliminary AD rate were to be finalized, the Company currently expects that it would appeal such ruling. If the preliminary ruling regarding the AD Rate were to be finalized, the Company anticipates it would record a net liability of approximately \$1.1 million.

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The DOC initiated the seventh annual review of the AD and CVD rates in March 2019, which is expected to follow the same schedule as the preceding reviews. The AD review covers shipments from December 1, 2017 through November 30, 2018. The CVD review covers shipments from January 1, 2017 through December 31, 2017.

Outstanding AD and CVD duties are subject to interest based on the IRS quarterly published rate. The Company has recorded a net \$1.2 million of interest expense through the line item Other Expense on the Statement of Operations.

Other Matters

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

Item 4. Mine Safety Disclosures.

None.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Market Information

Our common stock trades on the New York Stock Exchange ("NYSE") under the trading symbol "LL." We are authorized to issue up to 35,000,000 shares of common stock, par value \$0.001. Total shares of common stock outstanding at March 1, 2019 were 28,640,264 and we had six stockholders of record.

Issuer Purchases of Equity Securities

The following table presents our share repurchase activity for the quarter ended December 31, 2018 (dollars in thousands, except per share amounts):

Total Number	Average	Total Number of Shares Purchased as Part of Publicly	Maximum Dollar Value of Shares That May Yet Be Purchased as Part of Publicly
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Period	of Shares Purchased ¹	Price Paid Per Share ¹	Announced Programs ²	Announced Programs ²
October 1, 2018 to October 31, 2018	—	—	—	—
November 1, 2018 to November 30, 2018	—	—	—	—
December 1, 2018 to December 31, 2018	—	—	—	—
Total	—	—	—	—

1 We repurchased 1,567 shares of our common stock, at an average price of \$12.57, in connection with the net settlement of shares issued as a result of the vesting of restricted shares during the quarter ended December 31, 2018.

2 Our initial stock repurchase program, which authorized the repurchase of up to \$50 million in common stock, was authorized by our board of directors and publicly announced on February 22, 2012. Our board of directors subsequently authorized two additional stock repurchase programs, each of which authorized the repurchase of up to an additional \$50 million in common stock. These programs were publicly announced on November 15, 2012 and

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February 19, 2014, respectively, and are currently indefinitely suspended until we are better able to evaluate the long-term customer demand and assess our estimates of operations and cash flow. At December 31, 2018, we had approximately \$14.7 million remaining under this authorization.

Dividend Policy

We have never paid any dividends on our common stock and do not expect to pay them in the near future.

Securities Authorized for Issuance Under Equity Compensation Plans

See Item 12. “Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters” for information regarding securities authorized for issuance under our equity compensation plans.

Performance Graph

The following graph compares the performance of our common stock during the period beginning December 31, 2013 through December 31, 2018, to that of the total return index for the NYSE Composite and a Custom Peer Group whose members are listed below assuming an investment of \$100 on December 31, 2013. In calculating total annual stockholder return, reinvestment of dividends, if any, is assumed. The indices are included for comparative purpose only. They do not necessarily reflect management’s opinion that such indices are an appropriate measure of the relative performance of our common stock.

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	12/31/2013	12/31/2014	12/31/2015	12/30/2016	12/31/2017	12/31/2018
Lumber Liquidators Holdings, Inc.	100.00	64.45	16.87	15.30	30.51	9.25
NYSE Composite	100.00	106.87	102.62	115.02	136.76	124.72
Peer Group ¹	100.00	132.38	158.26	160.76	227.44	214.61

¹ The Peer Group consists of industry competitors and other retailers of a similar size to the Company. They include: The Home Depot, Inc., Lowe's Companies, Inc., Floor & Décor Holdings, Inc., Tile Shop Holdings, Inc., The Sherwin-Williams Company, Pier 1 Imports, Inc., Vitamin Shoppe, Inc., Hibbett Sports, Inc. and Haverty Furniture Companies, Inc. Mattress Firm Holding Corp. ceased trading so they have been omitted from our peer group.

Item 6. Selected Financial Data.

The selected statements of income data for the years ended December 31, 2018, 2017 and 2016 and the balance sheet data as of December 31, 2018 and 2017 have been derived from our audited consolidated financial statements included in Item 8. "Consolidated Financial Statements and Supplementary Data" of this report. This information should be read in conjunction with those audited financial statements, the notes thereto, and Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" of this report.

The selected balance sheet data set forth below as of December 31, 2016, 2015 and 2014, and income data for the years ended December 31, 2015 and 2014 are derived from our audited consolidated financial statements contained in reports previously filed with the SEC, which are not included herein. Our historical results are not necessarily indicative of our results for any future period.

	Year Ended December 31,									
	2018 ¹		2017 ²		2016 ³		2015 ⁴		2014	
	(dollars in thousands, except per share amounts)									
Statement of Income Data										
Net Sales	\$ 1,084,636		\$ 1,028,933		\$ 960,588		\$ 978,776		\$ 1,047,419	
Comparable Store Net Sales										
Increase (Decrease) ⁵	2.6	%	5.4	%	(4.6)	%	(11.1)	%	(4.3)	%
Cost of Sales	691,696		659,872		656,719		699,918		629,252	
Gross Profit	392,940		369,061		303,869		278,858		418,167	
Selling, General and										
Administrative Expenses	443,513		406,027		397,504		362,051		314,094	
Operating (Loss) Income	(50,573)		(36,966)		(93,635)		(83,193)		104,073	
Other Expense	2,827		1,591		638		234		490	
(Loss) Income Before										
Income Taxes	(53,400)		(38,557)		(94,273)		(83,427)		103,583	
Income Tax Expense										
(Benefit)	979		(734)		(25,710)		(26,994)		40,212	

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Net (Loss) Income	\$ (54,379)	\$ (37,823)	\$ (68,563)	\$ (56,433)	\$ 63,371
Net (Loss) Income per Common Share:					
Basic	\$ (1.90)	\$ (1.33)	\$ (2.51)	\$ (2.08)	\$ 2.32
Diluted	\$ (1.90)	\$ (1.33)	\$ (2.51)	\$ (2.08)	\$ 2.31
Weighted Average Common Shares Outstanding:					
Basic	28,571	28,407	27,284	27,082	27,265
Diluted	28,571	28,407	27,284	27,082	27,486

1 Results for the year ended December 31, 2018 include: (i) a favorable adjustment of antidumping costs and countervailing duties of \$4.9 million associated with applicable shipments of engineered hardwood from China in a

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prior period, (ii) duties related to prior periods, (iii) incremental legal and professional fees and settlement expenses, related to our defense of various legal matters of approximately \$75.7 million and (iv) other expenses primarily related to an impairment of certain assets related to our decision to exit the finishing business totaling approximately \$1.8 million.

2 Results for the year ended December 31, 2017 include: (i) a favorable adjustment of antidumping costs and countervailing duties of \$2.8 million associated with applicable shipments of engineered hardwood from China in a prior period, (ii) reduced reserves for estimated costs to be incurred related to our indoor air quality testing program by approximately \$1 million, (iii) incremental legal and professional fees and settlement expenses, related to our defense of various legal matters of approximately \$48.3 million and (iv) other expenses primarily related to costs to dispose of certain Chinese laminate products whose sales were discontinued in 2015 and an impairment of certain assets related to a vertical integration initiative totaling approximately \$3.1 million.

3 Results for the year ended December 31, 2016 include: (i) an unfavorable adjustment of antidumping costs and countervailing duties of \$5.5 million associated with applicable shipments of engineered hardwood from China in a prior period, (ii) pre-tax expenses of \$6.2 million related to the purchase of testing kits and professional fees in connection with our indoor air quality testing program, (iii) incremental legal and professional fees and settlement expenses, related to our defense of various legal matters of approximately \$47.7 million and (iv) other expenses primarily related to employee retention initiatives totaling approximately \$2.8 million.

4 Results for the year ended December 31, 2015 include: (i) the write down of our laminates and associated moldings sourced from China totaling approximately \$22.5 million and other inventory adjustments of \$6.6 million, (ii) an adjustment of antidumping costs and countervailing duties of \$4.9 million associated with applicable shipments of engineered hardwood from China in a prior period, (iii) pre-tax expenses of \$9.4 million related to the purchase of testing kits and professional fees in connection with our indoor air quality testing program, (iv) incremental legal and professional fees and settlement expenses, related to our defense of various legal matters of approximately \$34.2 million and (v) other expenses related to the simplification of our business and employee retention totaling approximately \$11.1 million.

5 A store is generally considered comparable on the first day of the thirteenth full calendar month after opening.

	Year Ended December 31,				
	2018	2017	2016	2015	2014
	(dollars in thousands)				
Balance Sheet Data					
Cash and Cash Equivalents	\$ 11,565	\$ 19,938	\$ 10,271	\$ 26,703	\$ 20,287
Merchandise Inventories	318,272	262,280	301,892	244,402	314,371
Total Assets	475,517	410,795	482,544	445,564	482,904
Customer Deposits and Store Credits	40,332	38,546	32,639	33,771	34,943
Total Debt and Capital Lease Obligations	65,000	15,000	40,351	20,000	—
Total Stockholders' Equity	147,398	197,847	230,892	277,568	332,054
Working Capital ¹	124,179	119,835	173,683	195,044	213,030
Other Data					
Total Stores in Operation (end of period)	413	393	383	374	352
Average Sale ²	\$ 1,355	\$ 1,310	\$ 1,255	\$ 1,230	\$ 1,260

- 1 Working capital is defined as current assets minus current liabilities.
- 2 Average Sale is defined as the average invoiced sales order, measured quarterly, excluding returns as well as transactions under \$100 (which are generally sample orders or add-on/accessories to existing orders).

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

Overview

Lumber Liquidators is one of the leading specialty retailers of hard-surface flooring in North America, offering a complete purchasing solution across an extensive assortment of domestic and exotic hardwood species, engineered hardwood, laminate, resilient vinyl, waterproof vinyl plank and porcelain tile. We also feature the renewable flooring products, bamboo and cork, and provide a wide selection of flooring enhancements and accessories, including moldings, noise-reducing underlayment, adhesives and flooring tools. We offer installation and delivery services through third-party independent contractors for customers who purchase our floors. At December 31, 2018, we sold our products through 413 Lumber Liquidators stores in 47 states in the United States and in Canada, a call center and website.

We believe we have achieved a reputation for offering great value, superior service and a broad selection of high-quality flooring products. With a balance of price, selection, quality, availability and service, we believe our value proposition is the most complete within a highly fragmented hard-surface flooring market. The foundation for our value proposition is strengthened by our unique store model, the industry expertise of our people, our singular focus on hard-surface flooring, and our advertising reach and frequency.

To supplement the financial measures prepared in accordance with GAAP, we use the following non-GAAP financial measures: (i) Adjusted Gross Profit; (ii) Adjusted Gross Margin; (iii) Adjusted SG&A; (iv) Adjusted SG&A as a percentage of sales; (v) Adjusted Operating Income or Loss; (vi) Adjusted Operating Margin and (vii) Adjusted Earnings per Diluted Share. The non-GAAP financial measures should be viewed in addition to, and not in lieu of, financial measures calculated in accordance with GAAP. These supplemental measures may vary from, and may not be comparable to, similarly titled measures by other companies.

The non-GAAP financial measures are presented because management and analysts use these non-GAAP financial measures to evaluate our operating performance and management uses them to determine incentive compensation and/or to address questions it receives. Therefore, we believe that the presentation of non-GAAP financial measures provides useful supplementary information to, and facilitates additional analysis by, investors. The presented non-GAAP financial measures exclude items that management does not believe reflect our core operating performance, which include regulatory and legal settlements and associated legal and operating costs, and changes in antidumping and countervailing duties from prior periods, as such items are outside of our control or due to their inherent unusual, non-operating, unpredictable, non-recurring, or non-cash nature.

Executive Summary

In 2018, we focused on several key initiatives related to our core business that we believed strengthened our sales and operating margin and provided an improved shopping experience to our customers. These initiatives were improving operational effectiveness, enhancing the customer experience, responsible, compliant sourcing activities and expanding our business to better serve our customers.

Our results for the year ended December 31, 2018 were as follows:

- Net sales for the year ended December 31, 2018 increased \$55.7 million, or 5.4%, to \$1.08 billion from \$1.03 billion in the year ended December 31, 2017. Net sales in comparable stores increased \$26.6 million, or 2.6%, and net sales in non-comparable stores increased \$29.1 million. We opened 21 new stores and closed one during 2018, for a total of 413 stores as of December 31, 2018.
- Gross margin was 36.2% and 35.9% for the years ended December 31, 2018 and 2017, respectively. Gross profit was slightly negatively affected by the tariffs imposed on our Chinese-sourced products beginning September 24, 2018, reflecting only a partial impact of the currently imposed 10% tariff rate due to timing of goods flowing through inventory.

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- Selling, general and administrative (“SG&A”) expenses increased \$37.5 million, or 9.2%, in 2018 to \$443.5 million from \$406.0 million in 2017. Excluding the items shown in the table that follows in Results of Operations, Adjusted SG&A (a non-GAAP measure) increased \$11.5 million in 2018, driven by a combination of higher payroll and occupancy costs, which are primarily related to the 21 new stores opened this year, and increases in on-going professional fees and credit card and banking fees. These increases were partially offset by a \$2.3 million, or 3.1%, reduction in advertising.
- Included in SG&A were legal-related costs and settlements of \$75.7 million and \$48.3 million in 2018 and 2017, respectively.
- Operating loss for the year ended December 31, 2018 was \$50.6 million compared to an operating loss of \$37.0 million in the year ended December 31, 2017. Operating loss for both periods was impacted by the unusual items summarized in the tables that follow in Results of Operations. Excluding these items, Adjusted Operating Income (a non-GAAP measure) was \$20.2 million and Adjusted Operating Margin (a non-GAAP measure) was 1.9% in 2018, compared to \$10.7 million, or 1.0%, in 2017.
- Net loss for the year ended December 31, 2018 was \$54.4 million, or \$1.90 per diluted share, compared to a net loss of \$37.8 million, or \$1.33 per diluted share for the year ended December 31, 2017. Losses related to both periods were the result of litigation-related costs and settlements. Adjusted Earnings per Diluted Share (a non-GAAP measure) was \$0.57 in 2018 and \$0.34 in 2017.
- On March 8, 2019, we entered into a commitment letter with the lenders, subject to customary closing conditions, that provides for an increase in the Revolving Loan up to a maximum amount of \$175 million, and a new “First in Last Out” tranche of \$25 million incremental to the \$175 million but within the same Revolving Credit Facility. This will also extend the term of the Revolving Credit Facility until March 2024. We expect to close on this expanded Revolving Credit Facility in late March or early April 2019.

As we head into 2019, our focus will be on driving DIY, DIFM and Pro traffic into our stores, enhancing the customer experience across both our digital platform and within our stores and improving operational effectiveness. Our research indicates that the initial interest in purchasing a floor begins with digital browsing. We believe that by providing an improved digital experience and better website performance, we will not only grow our e-commerce sales, but also drive traffic into our stores. Once customers are in our stores, we believe that our store model provides a competitive advantage by allowing our knowledgeable sales associates to assist customers throughout the project design and purchase process in a more intimate environment, from product selection to installation.

Working capital and liquidity

At December 31, 2018, we had \$79.5 million in liquidity, comprised of \$11.6 million of cash and \$67.9 million in availability under our asset-based revolving loan (the “Revolving Loan”). We also had \$318.3 million in inventory and \$73.4 million in accounts payable, while borrowings against our Revolving Loan were \$65 million. At December 31, 2017, we had \$145.9 million in liquidity, comprised of \$19.9 million of cash and \$126 million in availability under our Revolving Loan. We also had \$262.3 million in inventory and \$67.7 million in accounts payable, while borrowings against our Revolving Loan were \$15 million. The reduction in liquidity at December 31, 2018 from the year earlier was driven primarily by a \$56 million investment in inventory, and the \$22 million cash deposit made to fund our obligation under the settlement related to the MDL litigation matter.

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Results of Operations

We believe the selected sales data, the percentage relationship between Net Sales and major categories in the Consolidated Statements of Operations and the percentage change in the dollar amounts of each of the items presented below are important in evaluating the performance of our business operations.

	% of Net Sales			% Increase (Decrease)	
	Year Ended December 31,			in Dollar Amounts	
	2018	2017	2016	2018	2017
				vs. 2017	vs. 2016
Net Sales					
Net Merchandise Sales	88.1 %	91.2 %	93.2 %	1.9 %	4.8 %
Net Services Sales	11.9 %	8.8 %	6.8 %	41.9 %	39.5 %
Total Net Sales	100.0 %	100.0 %	100.0 %	5.4 %	7.1 %
Gross Profit	36.2 %	35.9 %	31.6 %	6.5 %	21.5 %
Selling, General, and Administrative Expenses	40.9 %	39.5 %	41.4 %	9.2 %	2.1 %
Operating Loss	(4.7) %	(3.6) %	(9.8) %	36.8 %	(60.5) %
Other Expense (Income)	0.2 %	(0.2) %	— %	77.7 %	149.5 %
Loss Before Income Taxes	(4.9) %	(3.8) %	(9.8) %	38.5 %	(59.1) %
Income Tax Expense (Benefit)	0.1 %	(0.1) %	(2.7) %	(233.3) %	(97.1) %
Net Loss	(5.0) %	(3.7) %	(7.1) %	43.8 %	(44.8) %
SELECTED SALES DATA					
Average Sale ¹	\$ 1,355	\$ 1,310	\$ 1,255	3.4 %	4.3 %
Average Retail Price per Unit Sold ²	(0.8) %	0.4 %	(4.0) %		
Comparable Store Sales Increase (Decrease) (%)	2.6 %	5.4 %	(4.6) %		
Number of Stores Open, end of period	413	393	383		
Number of Stores Opened in Period, net	20	10	9		
Number of Stores Relocated in Period ³	1	—	3		
Comparable Stores ⁴ (% change to prior year):					
Customers Invoiced ⁵	(0.8) %	1.1 %	(6.7) %		
Net Sales of Stores Operating for 13 to 36 months	13.1 %	14.2 %	0.4 %		
Net Sales of Stores Operating for more than 36 months	2.3 %	5.0 %	(5.2) %		
Net Sales in Markets with all Stores Comparable (no cannibalization)	3.4 %	6.1 %	(2.8) %		

1 Average Sale is defined as the average invoiced sales order, measured quarterly, excluding returns as well as transactions under \$100 (which are generally sample orders or add-on/accessories to existing orders).

2 Average retail price per unit (square feet for flooring and other units of measures for moldings and accessories) sold is calculated on a total company basis and excludes non-merchandise revenue.

3 A relocated store remains a comparable store as long as it is relocated within the primary trade area.

- 4 A store is generally considered comparable on the first day of the thirteenth full calendar month after opening.
- 5 Change in number of customers invoiced is calculated by applying the average sale to total net sales at comparable stores.

The definitions of average sale and customers invoiced were revised in the quarter ended December 31, 2018 to improve the reporting of our Pro customers to better reflect separate Pro projects and transactions that had been

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aggregated into single larger transactions under the previous definition. All historical periods have been restated under this new definition. The average sale and change in customers invoiced amounts under both the old and new definitions for the quarterly and annual periods in 2018 and 2017 are shown below:

	Quarter Ended				Year Ended
	March 31, 2018	June 30, 2018	September 30, 2018	December 31, 2018	December 31, 2018
New Definition ¹					
Average Sale	\$ 1,300	\$ 1,371	\$ 1,384	\$ 1,365	\$ 1,355
Change in Customers Invoiced	-1.2%	1.0%	-1.7%	-1.8%	-0.8%
Previous Definition ²					
Average Sale	\$ 1,706	\$ 1,784	\$ 1,830	\$ 1,791	\$ 1,777
Change in Customers Invoiced	-1.8%	0.1%	-3.4%	-2.7%	-1.9%

	Quarter Ended				Year Ended
	March 31, 2017	June 30, 2017	September 30, 2017	December 31, 2017	December 31, 2017
New Definition ¹					
Average Sale	\$ 1,249	\$ 1,322	\$ 1,333	\$ 1,336	\$ 1,310
Change in Customers Invoiced	0.0%	4.2%	0.3%	0.2%	1.1%
Previous Definition ²					
Average Sale	\$ 1,630	\$ 1,706	\$ 1,735	\$ 1,738	\$ 1,700
Change in Customers Invoiced	-0.1%	5.4%	0.8%	1.1%	1.7%

¹ The new definition of average sale is defined as the average invoiced sales order, measured quarterly, excluding returns as well as transactions under \$100 (which are generally sample orders or add-on/accessories to existing orders). Invoiced sales orders include all merchandise and services added to an individual order over the course of a calendar quarter. An individual customer with multiple orders in the same quarter (often due to multiple projects) count as two or more transactions in calculating average sale and customer count. The new definition of the change in number of customers invoiced is calculated by applying the revised definition of average sale, described above, to total net sales at comparable stores.

² The previous definition of average sale, calculated on a total company basis, is defined as the average invoiced sale per customer, measured on a monthly basis, excluded transactions less than \$250 (which are generally sample orders, or add-ons or fill-ins to previous orders) and more than \$30,000 (which are usually contractor orders). It also aggregated Pro transactions into a single large transaction, rather than treating these as multiple projects, which they often are. The previous definition of the change in number of customers invoiced is calculated by applying the average sale to total net sales at comparable stores.

For an understanding of the significant factors that influenced our performance during the past three years, the following discussion should be read in conjunction with the Consolidated Financial Statements and the Notes to Consolidated Financial Statements presented in this report.

Net Sales

Net sales in 2018 increased \$55.7 million, or 5.4%, from 2017 as net sales in comparable stores increased \$26.6 million, or 2.6%, and the net sales in non-comparable stores increased \$29.1 million. The growth in comparable store

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sales reflected a 3.4% increase in average sale, which was driven by larger sales transactions from the additional attachment of installation services to transactions, as well as the growth in the mix of Pro customers. This increase was partially offset by a 0.8% decrease in the number of customers invoiced. The increased transaction size and decreased transaction count in part reflect reduced promotional activity and increased focus on Pro customers and customers seeking installation, both of which have a more involved and larger sales transaction. Installation and delivery services represented 11.9% of our sales for the year, which increased through the year, reaching 12.9% in the fourth quarter of 2018. Our Pro customer sales represented 28.5% of merchandise sales, up from 23% in the prior year.

The comparable store growth of 2.6% consisted of a decline in merchandise sales of (0.6)%, more than offset by an increase in installation sales of 41%. The growth in installation sales reflects the expansion of this program into Florida and California in late 2017 that generated incremental sales throughout 2018. The decline in merchandise sales reflect the reduced promotional activity and declines in the bamboo and hardwood categories. We believe industry softness in the fourth quarter and other competitive pressures also contributed to the declines in comparable store merchandise sales growth. In terms of categories, the manufactured category consisting of vinyl and laminate products grew 24.5% compared to prior year, reaching 36% of our merchandise sales in 2018, while the hardwood category declined 13.3% and represented 34% of our sales in 2018. The vinyl sub-category within manufactured products continues to drive the growth in that category due to its outstanding aesthetics, high resilience and waterproof characteristics.

Net sales in 2017 increased \$68.3 million, or 7.1%, from 2016 as net sales in comparable stores increased \$52.2 million, or 5.4%, and the net sales in non-comparable stores increased \$16.1 million. The growth in comparable store sales reflected a combination of an increase of 1.1% in the number of customers invoiced and an increase of 4.3% in the average sale. We believe the number of customers invoiced rose due to improved customer experience in our stores, our more complete assortment and waning negative impact of unfavorable media and assortment limitations during the first half of 2016. The increase in average sale was driven by higher attachment of installation services, the growth in our Pro business that carries higher average ticket size, and improvements in the average selling price of our products.

Gross Profit

Gross profit in 2018 increased 6.5% to \$392.9 million from \$369.1 million in 2017. Both years' gross margins were favorably impacted by the unusual items highlighted in the table that follows, and, when excluding these items, Adjusted Gross Margin (a non-GAAP measure) improved by 10 basis points. This was driven by a favorable category mix toward vinyl products with improved margins, offset by higher transportation costs, dilution from increased installation sales mix that have lower margins, and tariffs that were imposed on goods received starting September 24, 2018. This tariff impact of approximately 40 basis points reflects only a partial impact of the currently imposed 10% tariff rate on Chinese-sourced products due to the timing of goods flowing through inventory. We expect this adverse effect to continue in 2019 as the goods are fully cycled through inventory, and could increase further should the tariff rate increase. (See Risk Factors for more details on these tariffs).

Gross profit in 2017 increased 21.5% to \$369 million from \$303.9 million in 2016. Gross margin increased to 35.9% from 31.6% in 2016. This comparison was favorably impacted by the unusual items highlighted in the table below,

and when excluding these items, Adjusted Gross Margin (a non-GAAP measure) improved from 32.8% to 35.5%, or 270 basis points. This was driven by a shift in mix toward vinyl and engineered products with improved margins, lower transportation costs, as well as improved margins within engineered, vinyl, laminate, and tile categories due to sourcing and pricing initiatives. These advances were slightly offset by a higher mix of installation sales that carry lower margins, and higher warranty costs.

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We believe that each of the items below can distort the visibility of our ongoing performance and that the evaluation of our financial performance can be enhanced by use of supplemental presentation of our results that exclude the impact of these items.

Year Ended December 31,

	2018		2017		2016		Quarter Ended December 31, 2006	Quarter Ended March 31, 2007	Quarter Ended June 30, 2007	Quarter Ended September 30, 2007
Total Investment Income	\$	8,233,718	\$	8,643,778	\$	9,201,279	\$	10,607,744		
Net Investment Income		5,162,926		5,724,357		5,704,867		5,668,407		
Net Increase in Net Assets Resulting From Operations		4,163,603		4,084,851		5,964,600		738,951		
Basic Earnings per Weighted Average Common Share	\$	0.34	\$	0.33	\$	0.44	\$	0.05		
Diluted Earning per Weighted Average Common Share	\$	0.34	\$	0.33	\$	0.44	\$	0.05		

Year Ended September 30, 2006

	Quarter Ended December 31, 2005	Quarter Ended March 31, 2006	Quarter Ended June 30, 2006	Quarter Ended September 30, 2006
Total Investment Income	\$ 6,030,319	\$ 7,000,700	\$ 6,522,816	\$ 7,346,011
Net Investment Income	4,442,414	5,203,816	4,788,082	4,916,268
Net Increase in Net Assets Resulting From Operations	8,233,349	5,590,381	5,543,076	5,063,429
Basic Earnings per Weighted Average Common Share	\$ 0.73	\$ 0.49	\$ 0.49	\$ 0.44
Diluted Earning per Weighted Average Common Share	\$ 0.71	\$ 0.48	\$ 0.48	\$ 0.43

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PART C

OTHER INFORMATION

Item 25. Financial Statements and Exhibits

1. Financial Statements

The following financial statements of Gladstone Capital Corporation (the "Company" or the "Registrant") are included in the Registration Statement in "Part A: Information Required in a Prospectus:"

**GLADSTONE CAPITAL CORPORATION
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

Audited Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm	F-3
Consolidated Statements of Assets and Liabilities as of September 30, 2007 and September 30, 2006	F-4
Consolidated Schedule of Investments as of September 30, 2007	F-5
Consolidated Schedule of Investments as of September 30, 2006	F-11
Consolidated Statements of Operations for the years ended September 30, 2007, September 30, 2006 and September 30, 2005	F-15
Consolidated Statements of Changes in Net Assets for the years ended September 30, 2007, September 30, 2006 and September 30, 2005	F-16
Consolidated Statements of Cash Flows for the years ended September 30, 2007, September 30, 2006 and September 30, 2005	F-17
Financial Highlights for the years ended September 30, 2007, September 30, 2006 and September 30, 2005	F-18
Notes to Consolidated Financial Statements	F-19

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2. Exhibits

Exhibit Number	Description
2.a.1	Articles of Amendment and Restatement of the Articles of Incorporation, incorporated by reference to Exhibit a.2 to Pre-Effective Amendment No. 1 to the Registration Statement on Form N-2 (File No. 333-63700), filed July 27, 2001.
2.b.1	By-laws, incorporated by reference to Exhibit b to Pre-Effective Amendment No. 1 to the Registration Statement on Form N-2 (File No. 333-63700), filed July 27, 2001.
2.b.2	Amendment to By-laws, incorporated by reference to Exhibit 3.3 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2003 (File No. 814-00237), filed February 17, 2004.
2.b.3	Second Amendment to By-laws, incorporated by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed July 10, 2007.
2.c	Not applicable.
2.d.1	Form of Direct Registration Transaction Advice for the Registrant's common stock, par value \$0.001 per share, incorporated by reference to Exhibit d to Pre-Effective Amendment No. 1 to the Registration Statement on Form N-2 (File No. 333-63700), filed July 27, 2001.
2.d.2	Specimen Stock Certificate, incorporated by reference to Exhibit d.2 to Pre-Effective Amendment No. 3 to the Registration Statement on Form N-2 (File No. 333-63700), filed August 23, 2001.
2.d.3*	Form of Senior indenture.
2.d.4*	Form of Subordinated indenture.
2.e.1	Dividend Reinvestment Plan, incorporated by reference to Exhibit e to Pre-Effective Amendment No. 1 to the Registration Statement on Form N-2 (File No. 333-63700), filed July 27, 2001.
2.f	Not applicable.
2.g.1	Amended and Restated Investment Advisory and Management Agreement between Gladstone Capital Corporation and Gladstone Management Corporation, dated as of October 1, 2006 incorporated by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed October 5, 2006.
2.h.1*	Placement Agreement, dated as of August 21, 2007.
2.h.2*	Underwriting Agreement, dated as of October 15, 2007.
2.i.1	Joint Directors Nonqualified Excess Plan of Gladstone Commercial Corporation, Gladstone Capital Corporation and Gladstone Investment Corporations, dated as of July 11, 2006, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed July 12, 2006.
2.j.1	Custodian Agreement between Gladstone Capital Corporation and The Bank of New York, dated as of May 5, 2006, incorporated by reference to Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2006 (File No. 814-00237), filed August 1, 2006.

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- 2.k.1 Promissory Note of David Gladstone in favor of the Company, dated August 23, 2001, incorporated by reference to Exhibit 10.4 to the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2001, filed October 4, 2001.
- 2.k.2 Promissory Note of Terry Brubaker in favor of the Company, dated August 23, 2001, incorporated by reference to Exhibit 10.5 to the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2001, filed October 4, 2001.
- 2.k.3 Promissory Note of Harry Brill in favor of the Company, dated August 23, 2001, incorporated by reference to Exhibit 10.6 to the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2001, filed October 4, 2001.
- 2.k.4 Trademark License Agreement between Gladstone Management Corporation and Gladstone Capital Corporation, incorporated by reference to Exhibit 10.29 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2004 (File No. 814-00237), filed February 9, 2005.
- 2.k.5 Amended and Restated Credit Agreement by and among Gladstone Business Loan, LLC, Deutsche Bank AG, and certain other parties, dated as of May 26, 2006, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed May 30, 2006.
- 2.k.6 Amendment No. 1 to Amended and Restated Credit Agreement by and among Gladstone Business Loan, LLC, Deutsche Bank AG, and certain other parties, dated as of September 22, 2006, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed September 22, 2006.
- 2.k.7 Administration Agreement between Gladstone Capital Corporation and Gladstone Administration, LLC, dated as of October 1, 2006 incorporated by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed October 5, 2006.
- 2.k.8 Amendment No. 2 to Amended and Restated Credit Agreement by and among Gladstone Business Loan, LLC, Deutsche Bank AG, and certain other parties, dated as of February 9, 2007, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed February 12, 2007.
- 2.k.9 Amendment No. 3 to the Amended and Restated Credit Agreement by and among Gladstone Business Loan LLC, Deutsche Bank AG, and certain other parties, dated as of May 25, 2007, incorporated by reference to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed May 29, 2007.
- 2.l* Opinion of Cooley Godward Kronish LLP.
- 2.m Not applicable.
- 2.n.1 Consent of Independent Registered Public Accounting Firm.
- 2.n.2* Consent of Cooley Godward Kronish LLP (included in Exhibit 2.l).
- 2.n.3 Report of PricewaterhouseCoopers LLP, independent registered public accounting firm, regarding "Senior securities data" contained herein.
- 2.o Not applicable.
- 2.p Subscription Agreement dated May 30, 2001, incorporated by reference to incorporated by reference to Exhibit p to the Registration Statement on Form N-2 (File No. 333-63700), filed June 22, 2001.

- 2.q Not applicable.
- 2.r Code of Ethics and Business Conduct, incorporated by reference to Exhibit 14.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed October 12, 2005.
- 2.s* Power of Attorney.

*
Previously filed.

Item 26. Marketing Arrangements

The information contained under the heading "Plan of Distribution" on page 92 of the prospectus is incorporated herein by reference, and any information concerning any underwriters will be contained in the accompanying prospectus supplement, if any.

Item 27. Other Expenses of Issuance and Distribution

Commission registration fee	\$ 9,210
FINRA filing fee	\$ 30,500
Accounting fees and expenses	200,000*
Legal fees and expenses	200,000*
Printing and engraving	200,000*
	<hr/>
Total	639,710*
	<hr/>

*
Figures are estimates.

All of the expenses set forth above shall be borne by the Company.

Item 28. Persons Controlled By or Under Common Control

Gladstone Investment Advisers, Inc., a Delaware corporation and wholly-owned subsidiary of Gladstone Investment Corporation.

Noble Logistics, an affiliated investment with 12.7% ownership by Gladstone Investment Corporation.

Gladstone Acquisition-4 Corporation, a Delaware corporation and wholly-owned subsidiary of Gladstone Investment Corporation.

ASH Holdings Corp., a Delaware corporation and wholly-owned subsidiary of Gladstone Investment Corporation.

Quench Holdings Corp., a Delaware corporation and wholly-owned subsidiary of Gladstone Investment Corporation.

Chase II Holding Corp., a Delaware corporation controlled by Gladstone Investment Corporation through 59% ownership of issued and outstanding voting securities.

A. Stucki Company, a Delaware corporation controlled by Gladstone Investment Corporation through 55% ownership.

Cavert Wire Holding, Inc., a Delaware corporation controlled by Gladstone Investment Corporation through 63% ownership of issued and outstanding voting securities.

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Danco Acquisition Corporation, a Delaware corporation controlled by Gladstone Investment Corporation through 42% ownership.

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Gladstone Business Investment, LLC, a Delaware limited liability company and wholly-owned subsidiary of Gladstone Investment Corporation.

Gladstone Investment Corporation, a Delaware corporation controlled by the Registrant's officers and directors.

Gladstone Capital Advisers, Inc., a Delaware corporation and wholly-owned subsidiary of the Registrant.

Gladstone Business Loan, LLC, a Delaware limited liability company and wholly-owned subsidiary of the Registrant.

U.S. Healthcare Communications, Inc., a Delaware corporation and a wholly-owned subsidiary of the Registrant.

BERTL, Inc., a Delaware corporation and a wholly-owned subsidiary of the Registrant.

Gladstone SSBIC Corporation, a Delaware corporation and wholly-owned subsidiary of the Registrant.

Gladstone Commercial Corporation, a Maryland corporation controlled by the Registrant's officers and directors.

GCLP Business Trust I, a Massachusetts business trust controlled by Gladstone Commercial Corporation.

Gladstone Commercial Partners, LLC, a Delaware limited liability company and wholly-owned subsidiary of Gladstone Commercial Corporation.

GCLP Business Trust II, a Massachusetts business trust controlled by Gladstone Commercial Partners, LLC.

Gladstone Commercial Advisers, Inc., a Delaware corporation and wholly-owned subsidiary of Gladstone Commercial Corporation.

GCC Coco, Inc., a Delaware corporation and wholly-owned subsidiary of Gladstone Commercial Corporation.

First Park Ten COCO San Antonio GP LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

First Park Ten COCO San Antonio LP, a Delaware limited partnership controlled by its general partner, First Park Ten COCO San Antonio GP LLC.

COCO04 Austin TX GP LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

COCO04 Austin TX LP, a Delaware limited partnership controlled by its general partner, COCO04 Austin TX GP LLC.

Pocono PA GCC GP LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

Pocono PA GCC, LP, a Delaware limited partnership controlled by its general partner, Pocono PA GCC GP LLC.

Gladstone Commercial Limited Partnership, a Delaware limited partnership controlled by its general partner GCLP Business Trust II.

GCC Acquisition Holdings LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

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SLEE Grand Prairie LP, a Delaware limited partnership controlled by its general partner, GCC Acquisition Holdings, Inc.

EE 208 South Rogers Lane, Raleigh, NC LLC, Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

Gladstone Lending LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

260 Springside Drive Akron OH LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

Little Arch04 Charlotte NC Member LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

Little Arch Charlotte NC LLC, a Delaware limited liability company controlled by its sole member, Little Arch04 Charlotte NC Member LLC.

CMI04 Canton NC LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

OB Midway NC Gladstone Commercial LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

GCC Granby LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

GCC Dorval LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

3094174 Nova Scotia Company, a Nova Scotia corporation controlled by its sole stockholder, Gladstone Commercial Limited Partnership.

3094175 Nova Scotia Company, a Nova Scotia corporation controlled by its sole stockholder, Gladstone Commercial Limited Partnership.

GCC Norfolk LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

WMI05 Columbus OH LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

2525 N Woodlawn Vstrm Wichita KS LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

Corning Big Flats LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

OB Crenshaw SPE GP LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

OB Crenshaw GCC LP, a Delaware limited partnership controlled by its general partner, OB Crenshaw SPE GP LLC.

HMBF05 Newburyport MA LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

YorkTC05 Eatontown NJ LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

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STI05 Franklin NJ LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

AFL05 Duncan SC Member LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

AFL05 Duncan SC LLC, a Delaware limited liability company controlled by its sole member, AFL05 Duncan SC Member LLC.

MSI05-3 LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

WMI05 Hazelwood MO LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

CI05 Clintonville WI LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

PZ05 Maple Heights OH LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

YCC06 South Hadley MA LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

NW05 Richmond VA LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

SVMCM05 Toledo OH LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

ACI06 Champaign IL LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

UC06 Roseville MN LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

TCI06 Burnsville MN LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

RC06 Menomonee Falls WI LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

SJMH06 Baytown TX GP LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

SJMH06 Baytown TX LP, a Delaware limited partnership controlled by its general partner, SJMH06 Baytown TX GP LLC.

NJT06 Sterling Heights MI LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

CMS06-3 LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

MPI06 Mason OH LLC, a Delaware limited liability company, controlled by its manager, Gladstone Commercial Limited Partnership.

EE07 Raleigh NC GP LLC, a Delaware limited liability company, controlled by its manager, Gladstone Commercial Limited Partnership.

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EE07 Raleigh NC, L.P., a Delaware limited partnership, controlled by its General Partner, EE07 Raleigh NC LP LLC.

APML07 Hialeah FL LLC, a Delaware limited liability company, controlled by its manager, Gladstone Commercial Limited Partnership.

WP107 Tulsa OK LLC, a Delaware limited liability company, controlled by its manager, Gladstone Commercial Limited Partnership.

EI07 Tewksbury MA LLC, a Delaware limited liability company, controlled by its manager, Gladstone Commercial Limited Partnership.

AC07 Lawrenceville GA LLC, a Delaware limited liability company, controlled by its manager, Gladstone Commercial Limited Partnership.

GBI07 Syracuse NY LLC, a Delaware limited liability company, controlled by its manager, Gladstone Commercial Limited Partnership.

CDLCI07 Mason OH LLC, a Delaware limited liability company, controlled by its manager, Gladstone Commercial Limited Partnership.

FTCHI07 Grand Rapids MI LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

DBPI07 Bolingbrook IL LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

RCOG07 Georgia, LLC, a Delaware limited liability company controlled by its manager, Gladstone Commercial Limited Partnership.

Gladstone Land Corporation, a Delaware corporation controlled by David Gladstone through indirect 100% stock ownership.

Gladstone Land Partners, LLC, a Delaware limited liability company controlled by its manager, Gladstone Land Corporation.

SC Land, Inc., a California corporation and wholly-owned subsidiary of Gladstone Land Limited Partnership.

Gladstone Land Limited Partnership, a Delaware limited partnership controlled by its general partner, Gladstone Land Partners, LLC.

San Andreas Road Watsonville LLC, a California limited liability company controlled by its manager, Gladstone Land Limited Partnership.

West Gonzales Road Oxnard LLC, a California limited liability company controlled by its manager, Gladstone Land Limited Partnership.

Coastal Farming Corporation, a California corporation controlled by David Gladstone through 100% indirect stock ownership.

Gladstone Management Corporation, a Delaware corporation controlled by David Gladstone through 100% indirect stock ownership.

Gladstone Administration, LLC, a Delaware limited liability company and wholly-owned subsidiary of Gladstone Management Corporation.

Gladstone General Partner, LLC, a Delaware limited liability company controlled by its manager, Gladstone Management Corporation.

Gladstone Participation Fund LLC, a Delaware limited liability company controlled by Gladstone General Partner, LLC.

Gladstone Partners Fund, LP, a Delaware limited partnership controlled by its General Partner, Gladstone Management Corporation.

Item 29. Number of Holders of Securities

The following table sets forth the approximate number of record holders of the Company's common stock at January 18, 2008.

Title of Class	Number of Record Holders
Common stock, par value \$0.001 per share	79

Item 30. Indemnification

Subject to the Investment Company Act of 1940, as amended (the "1940 Act") or any valid rule, regulation or order of the Securities and Exchange Commission ("SEC") thereunder, our articles of incorporation and bylaws provide that we will indemnify any person who was or is a party or is threatened to be made a party to any threatened action, suit or proceeding whether civil, criminal, administrative or investigative, by reason of the fact that he is or was our director or officer, or is or was serving at our request as a director, officer, partner or trustee of another corporation, real estate investment trust, partnership, joint venture, trust, employee benefit plan or other enterprise to the maximum extent permitted by Section 2-418 of the Annotated Code of Maryland, Corporations and Associations (the "Maryland Law"). The 1940 Act provides that a company may not indemnify any director or officer against liability to it or its security holders to which he or she might otherwise be subject by reason of his or her willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his or her office unless a determination is made by final decision of a court, by vote of a majority of a quorum of directors who are disinterested, non-party directors or by independent legal counsel that the liability for which indemnification is sought did not arise out of the foregoing conduct. In addition to any indemnification to which our directors and officers are entitled pursuant to our articles of incorporation and bylaws and Maryland Law, our articles of incorporation and bylaws permit us to indemnify our other employees and agents to the fullest extent permitted by Maryland Law, whether such employees or agents are serving us or, at our request, any other entity.

In addition, the investment advisory and management agreement between us and our investment adviser, Gladstone Management Corporation (the "Adviser"), as well as the administration agreement between us and our administrator Gladstone Administration, LLC (the "Administrator"), each provide that, absent willful misfeasance, bad faith, or gross negligence in the performance of their respective duties or by reason of the reckless disregard of their respective duties and obligations, our Adviser or our Administrator, as applicable, and their respective officers, managers, partners, agents, employees, controlling persons, members, and any other person or entity affiliated with it are entitled to indemnification from us for any damages, liabilities, costs, and expenses (including reasonable attorneys' fees and amounts reasonably paid in settlement) arising from the rendering of our Adviser's services under the investment advisory and management agreement or otherwise as our investment adviser, or the rendering of our Administrator's services under the administration agreement, as applicable.

Item 31. Business and Other Connections of Investment Adviser

A description of any other business, profession, vocation or employment of a substantial nature in which our Adviser, and each director or executive officer of our Adviser, is or has been during the past two fiscal years, engaged in for his or her own account or in the capacity of director, officer, employee, partner or trustee, is set forth in Part A of this Registration Statement in the section entitled "Management." Additional information regarding our Adviser and its officers and directors is set forth in its Form ADV, as filed with the SEC, and is incorporated herein by reference.

Item 32. Location of Accounts and Records

All accounts, books or other documents required to be maintained by Section 31(a) of the 1940 Act and the rules thereunder are maintained at the offices of:

- (1) the Registrant, Gladstone Capital Corporation, 1521 Westbranch Drive, Suite 200, McLean, VA 22102;
- (2) the Transfer Agent, The Bank of New York, 101 Barclay Street, Suite 11E, New York, NY 10286;
- (3) our Adviser, Gladstone Management Corporation, 1521 Westbranch Drive, Suite 200, McLean, VA 22102;
- (4) the Custodian, The Bank of New York, 30 Broad Street, New York, NY 10005; and
- (5) the Collateral Custodian, The Bank of New York Trust Company, N.A., 2 North La Salle Street; Suite 1020, Chicago, IL 60602.

Item 33. Management Services

Not applicable.

Item 34. Undertakings

1. We hereby undertake to suspend the offering of shares until the prospectus is amended if subsequent to the effective date of this registration statement, our net asset value declines more than ten percent from our net asset value as of the effective date of this registration statement.

2. We hereby undertake:

(a) to file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement:

(i) to include any prospectus required by Section 10(a) (3) of the Securities Act of 1933, as amended (the "Securities Act");

(ii) to reflect in the prospectus any facts or events arising after the effective date of this registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement; and

(iii) to include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement.

(b) that, for the purpose of determining any liability under the Securities Act, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of those securities at that time shall be deemed to be the initial bona fide offering thereof;

(c) to remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering; and

(d) that, for the purpose of determining liability under the Securities Act to any purchaser, if the Registrant is subject to Rule 430C: Each prospectus filed pursuant to Rule 497(b), (c), (d) or (e) under the Securities Act as part of a registration statement relating to an offering, other than prospectuses filed in reliance on Rule 430A under the Securities Act, shall be deemed to be part of

and included in the registration statement as of the date it is first used after effectiveness.

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Provided, however, that no statement made in a registration statement or prospectus that is part of the registration statement or made in a document incorporated or deemed incorporated by reference into the registration statement or prospectus that is part of the registration statement will, as to a purchaser with a time of contract of sale prior to such first use, supersede or modify any statement that was made in the registration statement or prospectus that was part of the registration statement or made in any such document immediately prior to such date of first use;

(e) that for the purpose of determining liability of the Registrant under the Securities Act to any purchaser in the initial distribution of securities: The undersigned Registrant undertakes that in a primary offering of securities of the undersigned Registrant pursuant to this registration statement, regardless of the underwriting method used to sell the securities to the purchaser, if the securities are offered or sold to such purchaser by means of any of the following communications, the undersigned Registrant will be a seller to the purchaser and will be considered to offer or sell such securities to the purchaser:

(i) any preliminary prospectus or prospectus of the undersigned Registrant relating to the offering required to be filed pursuant to Rule 497 under the Securities Act;

(ii) the portion of any advertisement pursuant to Rule 482 under the Securities Act relating to the offering containing material information about the undersigned Registrant or its securities provided by or on behalf of the undersigned Registrant; and

(iii) any other communication that is an offer in the offering made by the undersigned Registrant to the purchaser.

3. We hereby undertake that:

(a) for the purpose of determining any liability under the Securities Act, the information omitted from the form of prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in a form of prospectus filed by us under Rule 497(h) under the Securities Act shall be deemed to be part of this registration statement as of the time it was declared effective; and

(b) for the purpose of determining any liability under the Securities Act, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of the securities at that time shall be deemed to be the initial bona fide offering thereof.

SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, as amended, and the Investment Company Act of 1940, as amended, the Registrant has duly caused this Post-Effective Amendment No. 6 to Registration Statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of McLean and Commonwealth of Virginia, on the 22nd day of January, 2008.

GLADSTONE CAPITAL CORPORATION

By: /s/ DAVID GLADSTONE

David Gladstone
Chairman of the Board and Chief Executive Officer

Pursuant to the requirements of the Securities Act of 1933, as amended, this Post-Effective Amendment No. 6 to Registration Statement has been signed below by the following persons in the capacities on January 22, 2008:

By: *

David Gladstone
Chief Executive Officer and Chairman of the Board of Directors
(principal executive officer)

By: *

Terry L. Brubaker
Vice Chairman, Chief Operating Officer, Secretary and Director

By: *

Harry T. Brill, Jr.
Chief Financial Officer
(principal financial and accounting officer)

By: *

George Stelljes III
President, Chief Investment Officer and Director

By: *

David A.R. Dullum
Director

By: *

Anthony W. Parker
Director

By: *

Michela A. English
Director

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By: *

Paul W. Adलगren
Director

By: *

Maurice W. Coulon
Director

By: *

John H. Outland
Director

By: *

Gerard Mead
Director

By: /s/ DAVID GLADSTONE

David Gladstone
(attorney-in-fact)

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Exhibit List

Exhibit Number	Description
2.a.1	Articles of Amendment and Restatement of the Articles of Incorporation, incorporated by reference to Exhibit a.2 to Pre-Effective Amendment No. 1 to the Registration Statement on Form N-2 (File No. 333-63700), filed July 27, 2001.
2.b.1	By-laws, incorporated by reference to Exhibit b to Pre-Effective Amendment No. 1 to the Registration Statement on Form N-2 (File No. 333-63700), filed July 27, 2001.
2.b.2	Amendment to By-laws, incorporated by reference to Exhibit 3.3 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2003 (File No. 814-00237), filed February 17, 2004.
2.b.3	Second Amendment to By-laws, incorporated by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed July 10, 2007.
2.c	Not applicable.
2.d.1	Form of Direct Registration Transaction Advice for the Registrant's common stock, par value \$0.001 per share, incorporated by reference to Exhibit d to Pre-Effective Amendment No. 1 to the Registration Statement on Form N-2 (File No. 333-63700), filed July 27, 2001.
2.d.2	Specimen Stock Certificate, incorporated by reference to Exhibit d.2 to Pre-Effective Amendment No. 3 to the Registration Statement on Form N-2 (File No. 333-63700), filed August 23, 2001.
2.d.3*	Form of Senior indenture.
2.d.4*	Form of Subordinated indenture.
2.e.1	Dividend Reinvestment Plan, incorporated by reference to Exhibit e to Pre-Effective Amendment No. 1 to the Registration Statement on Form N-2 (File No. 333-63700), filed July 27, 2001.
2.f	Not applicable.
2.g.1	Amended and Restated Investment Advisory and Management Agreement between Gladstone Capital Corporation and Gladstone Management Corporation, dated as of October 1, 2006 incorporated by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed October 5, 2006.
2.h.1*	Placement Agreement, dated as of August 21, 2007.
2.h.2*	Underwriting Agreement, dated as of October 15, 2007.
2.i.1	Joint Directors Nonqualified Excess Plan of Gladstone Commercial Corporation, Gladstone Capital Corporation and Gladstone Investment Corporations, dated as of July 11, 2006, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed July 12, 2006.
2.j.1	Custodian Agreement between Gladstone Capital Corporation and The Bank of New York, dated as of May 5, 2006, incorporated by reference to Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2006 (File No. 814-00237), filed August 1, 2006.
2.k.1	Promissory Note of David Gladstone in favor of the Company, dated August 23, 2001, incorporated by reference to Exhibit 10.4 to the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2001, filed October 4, 2001.

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- 2.k.2 Promissory Note of Terry Brubaker in favor of the Company, dated August 23, 2001, incorporated by reference to Exhibit 10.5 to the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2001, filed October 4, 2001.
- 2.k.3 Promissory Note of Harry Brill in favor of the Company, dated August 23, 2001, incorporated by reference to Exhibit 10.6 to the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2001, filed October 4, 2001.
- 2.k.4 Trademark License Agreement between Gladstone Management Corporation and Gladstone Capital Corporation, incorporated by reference to Exhibit 10.29 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2004 (File No. 814-00237), filed February 9, 2005.
- 2.k.5 Amended and Restated Credit Agreement by and among Gladstone Business Loan, LLC, Deutsche Bank AG, and certain other parties, dated as of May 26, 2006, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed May 30, 2006.
- 2.k.6 Amendment No. 1 to Amended and Restated Credit Agreement by and among Gladstone Business Loan, LLC, Deutsche Bank AG, and certain other parties, dated as of September 22, 2006, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed September 22, 2006.
- 2.k.7 Administration Agreement between Gladstone Capital Corporation and Gladstone Administration, LLC, dated as of October 1, 2006 incorporated by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed October 5, 2006.
- 2.k.8 Amendment No. 2 to Amended and Restated Credit Agreement by and among Gladstone Business Loan, LLC, Deutsche Bank AG, and certain other parties, dated as of February 9, 2007, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed February 12, 2007.
- 2.k.9 Amendment No. 3 to the Amended and Restated Credit Agreement by and among Gladstone Business Loan LLC, Deutsche Bank AG, and certain other parties, dated as of May 25, 2007, incorporated by reference to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed May 29, 2007.
- 2.l* Opinion of Cooley Godward Kronish LLP.
- 2.m Not applicable.
- 2.n.1 Consent of Independent Registered Public Accounting Firm.
- 2.n.2* Consent of Cooley Godward Kronish LLP (included in Exhibit 2.1).
- 2.n.3 Report of PricewaterhouseCoopers LLP, independent registered public accounting firm, regarding "Senior securities data" contained herein.
- 2.o Not applicable.
- 2.p Subscription Agreement dated May 30, 2001, incorporated by reference to incorporated by reference to Exhibit p to the Registration Statement on Form N-2 (File No. 333-63700), filed June 22, 2001.
- 2.q Not applicable.
- 2.r Code of Ethics and Business Conduct, incorporated by reference to Exhibit 14.1 to the Registrant's Current Report on Form 8-K (File No. 814-00237), filed October 12, 2005.
- 2.s* Power of Attorney.

*

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