

Lumber Liquidators Holdings, Inc.  
Form 10-K  
February 25, 2015

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-K**

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2014  
OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from            to

**Commission file number: 001-33767**

**Lumber Liquidators Holdings, Inc.**

(Exact Name of Registrant as Specified in its Charter)

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Delaware  
(State or other jurisdiction of incorporation or organization)  
3000 John Deere Road, Toano, Virginia  
(Address of principal executive offices)

27-1310817  
(I.R.S. Employer Identification No.)  
**23168**  
(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	<b>New York Stock Exchange</b>

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

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

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

Large Accelerated Filer  Accelerated Filer  Non-accelerated Filer  Smaller Reporting Company   
(do not check if a smaller reporting company)

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

At June 30, 2014, the last business day of the Registrant's most recently completed second fiscal quarter, the aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant (based upon the closing sale price of such shares on New York Stock Exchange on June 30, 2014) was approximately \$1.5 billion. Shares of Registrant's common stock held by each executive officer and director and by each entity or person that, to the Registrant's knowledge, owned 10% or more of Registrant's outstanding common stock as of June 30, 2014 have been excluded, in that such persons may be deemed to be affiliates of the Registrant. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

Indicate the number of shares outstanding of each of the Registrant's classes of common stock as of February 23, 2015:

Title of Class	Number of Shares
Common Stock, \$0.001 par value	27,069,307

## **DOCUMENTS INCORPORATED BY REFERENCE**

Part III incorporates certain information by reference from the Registrant's proxy statement for the 2015 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, 2014.

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## **CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENT**

This report includes statements of our 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, predicts, could, projects, potential and other similar terms and phrases, are based on the beliefs of our management well as assumptions made by, and information currently available to, our 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 our control. Forward-looking statements in this report may include, without limitation, statements regarding sales growth, comparable store net sales, number of stores providing installation services, impact of cannibalization, price changes, inventory availability and inventory per store, impact of constrained inventory, earnings performance, stock-based compensation expense, margins, return on invested capital, advertising costs, strategic direction, supply chain, clearance events, the demand for our products, benefits from an improving housing market, the completion of our second finishing line, construction of engineered hardwood as to not be subject to anti-dumping and countervailing duties, and store openings and remodels. Our actual results could differ materially from those projected in or contemplated by the forward-looking statements as a result of potential risks, uncertainties and other factors including, but not limited to, changes in general economic and financial conditions, such as the rate of unemployment, consumer access to credit, and interest rate; the volatility in mortgage rates; the legislative/regulatory climate; political unrest in the countries of our suppliers; the availability of sufficient suitable hardwood; our suppliers ability to meet our quality assurance requirements; disruption in our suppliers abilities to supply needed inventory; disruptions or delays in the production, shipment, delivery or processing through ports of entry, including, without limitation, those resulting from strikes, lockouts, work-stoppages or slowdowns, or other forms of labor unrest; the strength of our competitors and their ability to increase their market share; slower growth in personal income; changes in business and consumer spending; changes in transportation costs; the rate of growth of residential remodeling and new home construction; the impact weather may have on customer traffic and sales; the demand for and profitability of installation services; changes in the scope or rates of any antidumping or countervailing duty rates applicable to our products; and inventory levels. We specifically disclaim 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 and Lumber Liquidators generally refers to Lumber Liquidators Holdings, Inc. and its consolidated subsidiaries collectively and, where applicable, individually.

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## PART I

### Item 1. Business.

#### Overview

Lumber Liquidators Holdings, Inc. and its subsidiaries operated 352 retail stores as of December 31, 2014, with 343 located throughout the United States ( U.S. ) and nine in Ontario, Canada. We are the largest specialty retailer of hardwood flooring in North America. We operate as a single business segment, with our call center, website and customer service network supporting our retail store operations. We believe we offer the most complete value proposition across an extensive assortment of exotic and domestic hardwood species, engineered hardwood, laminate, vinyl plank, bamboo and cork. Sourcing directly from the mill and our unique store model provides the foundation for our value proposition, which we market aggressively to the homeowner, or a contractor on behalf of a homeowner.

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 and Lumber Liquidators Canada Inc., conducting our operations. Lumber Liquidators Holdings, Inc. is a Delaware corporation with headquarters in Toano, Virginia.

#### Competitive Strengths

##### Our Value Proposition

We compete across our value proposition with retailers ranging from the national home improvement chains to local flooring stores in each market. The components of our value proposition include:

**Price.** Our retail prices in each merchandise category are generally lower than our competitors. This pricing advantage is usually greatest in the premium products, and less at the entry or commodity level. We are able to maintain these prices by sourcing proprietary products direct from the mill, the singular focus of our supply chain on hard surface flooring and our highly profitable store model.

**Selection.** We offer a broad assortment of flooring in varying widths, species and constructions, including solid and engineered hardwood, laminate, vinyl plank, bamboo and cork. We also offer an extensive selection of moldings and accessories, staircases and butcher block. Our products are sold under proprietary brands across a range of price points that allow us to target discrete market segments and appeal to diverse groups of customers.

**Quality.** We invest significant resources to design and produce products of the highest quality, including our flagship Bellawood brand. We source directly from mills all over the world, and often are a mill's most significant relationship. Proprietary brands allow us greater control over product design and production, which we monitor through an expansive network of experienced quality control and assurance professionals.

**Availability.** Our commitment to in-stock inventory levels and our focused supply chain allow our entire assortment to be available to meet our customers' expectations in a manner which we believe is more timely than our competitors. We maintain our best selling products as in-stock inventory at our retail store locations and our distribution facilities maintain inventory levels of our entire assortment to fulfill customer orders.

**People.** We position ourselves as hardwood flooring experts. The training of our store associates is focused on product knowledge and techniques for engaging the customer in a dialogue designed to elicit information to identify

purchase options. Among other things, our associates are trained to ask questions leading to the species and construction of flooring which is best aligned with climate, room type, site conditions and expected wear, all while satisfying each customer's budgetary requirements. Our associates, supported by a call center staff, are trained to understand the unique characteristics and preferred installation method across the broad range of hardwood flooring alternatives we offer.

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**Our Direct Sourcing Model**

*Supplier Relationships.* We believe sourcing directly from mills enables us to offer a broad assortment of high-quality, proprietary products to our customers at a consistently lower cost than our competitors. We seek to establish strong relationships with mills around the world where the significance of our scale, breadth of assortment and liquidity allow for both higher quality and lower cost. We believe our collaborative relationship enhances the mills' productivity, yield and financial flexibility, such that we access lower net costs than our competitors. We are able to set demanding specifications for product quality and our own quality control and assurance teams are on-site at certain mills, coordinating inspection and assurance procedures. We believe the advantages a mill gains by working with us attracts interest from around the world. As a result, we have diversified our purchases across approximately 130 domestic and international mills.

We seek long-term, core relationships with mills committed to our demanding product specifications, sustainable supply and regulatory compliance. As a result, our top 20 suppliers accounted for approximately 62% of our supply purchases in 2014 and our largest mill partner represented approximately 7%. Outside of the core group, we seek mill diversification and utilize sourcing initiatives which challenge the structure of each relationship, ultimately producing the best combination of quality and value at the lowest cost.

We are committed to uncompromising integrity across our operations, and quality is a key component of our value proposition. With over 310 million square feet of flooring sold through over 620,000 customer transactions in 2014, the scale of our purchasing and diversity of products require sustainable forestry. We invest significant time and resources to safeguard quality and comply with regulatory requirements. We discontinue sourcing from suppliers that are unable to meet our standards. We seek long-term relationships with mills that can provide sustainable and growing supplies of high-quality product.

In the first quarter of 2015, we expect to begin operating a 1,500 square foot lab within our new East Coast distribution facility. The lab will feature two temperature and humidity controlled conditioning rooms and two emission chambers correlated to a California Air Resources Board ( CARB )-approved Third Party Certifier. This equipment mirrors the capabilities of CARB and other state-of-the-art emission testing facilities. We believe no other flooring retailer has comparable facilities. This new lab will complement and augment the capabilities of the facilities we operate in Toano, Virginia and in Shanghai, China, as well as those utilized by our suppliers.

*Our Products.* We offer an extensive assortment of wood flooring under 18 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. We expect to continue to invest resources in our advertising and marketing as a percentage of net sales that we believe is greater than our competitors. We believe Lumber Liquidators is now recognized across the U.S. as a destination for high-quality hardwood flooring at low prices, while our Bellawood brand is known as a premium flooring brand within the industry.

Our hardwood flooring products are available in various widths and lengths and generally differentiated in terms of quality and price based on 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, and as a result, represent more than 95% of the flooring we sell. We also offer a broad assortment of flooring enhancements and installation accessories, including moldings, noise-reducing underlay and tools, that complement our assortment of floor offerings. In total, we offer more than 400 different flooring product stock-keeping units; however, no single flooring product represented more than 2% of our sales mix. By major product category, our sales mix was as follows:

	2014	2013	2012		
	percentage of net sales				
Solid and Engineered Hardwood	43 %	44 %	48 %		
Laminate, Bamboo, Cork and Vinyl Plank	38 %	38 %	36 %		
Moldings and Accessories	19 %	18 %	16 %		
Total	100 %	100 %	100 %		

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Changes in our sales mix are often the primary driver of changes in our sourcing mix for flooring products. We seek the highest quality at the best value, in consideration of where the raw material grows, the labor to construct or produce the unfinished plank or finished board, and the transit time and transportation costs, including duties, to our distribution centers or stores. In addition, though our merchandise purchase orders are in U.S. dollars, currency fluctuations may present opportunities to reduce product costs. We also seek geographic diversity to reduce sourcing risks. In 2014, we pursued opportunities for cost reduction and/or diversification by increasing the percentage of products sourced from North America and Europe. Our sourcing mix by continent was as follows:

Continent	Primary Products Sourced	2014	2013	2012
		percentage of merchandise purchases		
North America	Solid Domestic and Handscraped Hardwood, Laminate, Moldings and Accessories	49 %	40 %	50 %
Asia	Laminate, Bamboo, Cork, Vinyl Plank and certain Handscraped and Engineered Hardwood	40 %	50 %	43 %
South America	Solid Exotic and Engineered Hardwood	6 %	7 %	6 %
Europe and Australia	Laminate and Exotic Hardwood	5 %	3 %	1 %
		100%	100%	100 %

Major product categories include:

**Solid and Engineered Hardwood.** Our proprietary solid hardwood products are milled from one thick piece of wood, which can be sanded and refinished numerous times, and our proprietary engineered hardwood products are produced by bonding a layer of hardwood to a plywood or high-density fiber board backing. Engineered flooring is designed primarily to be installed in areas where traditional hardwood is not conducive, such as slab construction, basements and areas where moisture may be a factor. We offer flooring products made from more than 25 wood species, including both domestic woods, such as beech, birch, hickory and northern red oak, and exotic woods, such as cherry, ebony, koa and teak. We sell our solid hardwood products either prefinished or unfinished, and our engineered hardwood products in either glue down or floating application. Our prefinished hardwoods typically carry a limited wear warranty from 10 to 30 years, and our Bellawood products, offered in both solid and engineered, carry a 100-year, transferable limited warranty.

**Laminate.** Our proprietary laminate flooring is typically constructed with a high-density fiber board core, inserted between a melamine laminate backing and high-quality photographic paper displaying an image of wood with a ceramic finish, abrasion-resistant laminate top. Our laminate flooring brands allow for easy-click installation, and some include a pre-glued undersurface, moisture repellent, soundproofing, single-strip format or a handscraped textured finish. Our laminates carry limited wear warranties ranging from 20 to 30 years.

**Bamboo, Cork and Vinyl Plank.** Our proprietary bamboo products, harvested from the fast growing bamboo plant, are offered as a prefinished, natural or stained, solid or engineered floor. Our proprietary cork flooring is produced by harvesting the outer bark of the cork oak tree, and it is durable, acoustical and acts as an insulator. Produced from recycled materials, our vinyl plank flooring comes in realistic wood and tile looks, is water-resistant, highly durable and installs with peel-and-stick or click-together ease. Our bamboo, cork and vinyl plank flooring products carry wear limited warranties ranging from 25 to 50 years, and our Bellawood bamboo products carry a 100-year, transferable limited warranty.

Moldings and Accessories. We offer a wide variety of wood flooring moldings and accessories. Moldings are a required finishing detail to every floor and we sell a complete selection that matches virtually all of our floors or can complement them. We also sell butcher block kitchen countertops and staircase treads and risers. Accessories include sealers, adhesives and underlayment that are placed between the new floor and the sub-floor to insulate sound, protect against moisture and cushion the floors. In addition, we sell flooring tools and floor cleaning supplies.

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*Bellawood.* Bellawood is a collection of solid and engineered hardwood flooring, bamboo flooring, moldings and accessories and is our flagship brand. In 2014, we invested in new finishes to strengthen further Bellawood as an industry leader in the five key features hardwood flooring is judged: scratch and abrasion resistance, stain and scuff resistance, and gloss retention. These new finishes featured a lower sheen gloss than previously offered and we further expanded the assortment with new stains and matte finishes. Across all flooring lines, Bellawood brands were 16.3% of our flooring sales mix in 2014, up from 15.9% in 2013.

In order to control the quality of our Bellawood brand, we maintain a finishing facility in Toano, Virginia. In 2014, we finished more than 28 million square feet of flooring, including approximately 92% of the Bellawood demand. To supplement the Bellawood production needed, we utilize, certify and continually monitor the finishing processes of certain mills in both North America and South America. In 2014, we invested in a second finishing line at our Toano facility to more than double our finishing capacity. We have planned a total investment of approximately \$5.1 million in connection with this project, with \$4.3 million expended in 2014, and expect the second line to be operational in the first quarter of 2015.

In addition, we continue to evaluate vertical integration opportunities that may increase the supply of domestic wood to feed the two finishing lines. We believe increasing our control over the raw material, drying process and milling will not only lower net product costs, but also provide greater stability in supply and quality in the finished product. In 2014, we invested approximately \$5.2 million in equipment to dry enough green wood to ultimately yield approximately 10% of our annual hardwood supply. We evaluate investments in both finishing and vertical integration to improve the quality and costs of our products relative to the marketplace availability.

*Supply Chain.* Our supply chain is wholly focused on delivering our complete assortment of products to our customers more timely than our competitors. Our distribution facilities are located in California and Virginia. Additionally, we lease the services of a third party consolidation center in China to break bulk shipments from mills into quantities and assortments that can be sent directly to our store locations, and a number of our vendors maintain inventory levels for shipment directly to our stores or customers. Our product is generally transported boxed and palletized, and the weight of our product generally increases our supply chain costs. Our transportation costs are significant, representing 7.9% of net sales in 2014, and are impacted by international container rates, customs and duty charges, and domestic costs, including fuel, fuel surcharges and drivers. Our supply chain initiatives seek the lowest rates, reductions in the number of miles traveled and the most efficient means to minimize the total cost per mile.

Transportation costs include:

- international and domestic inbound transportation to either our distribution centers or stores;
- transportation charges from our distribution centers to our stores; and
- transportation charges between stores.

In the first quarter of 2014, we began operating a 500,000 square foot leased distribution center in Pomona, California as the primary distribution center for over 90 of our western stores. In the fourth quarter of 2014, we completed construction of a million square foot distribution center on 110 acres of land we own in Henrico County, Virginia to consolidate existing distribution facilities located in Hampton Roads, Virginia, increase the efficiency of our East Coast operations and provide a foundation for future store base expansion. We began the transition of our operations from these existing facilities to the new facility in the fourth quarter of 2014, and the facility was fully operational in January 2015.

## **Our Unique Store Model**

Generally, flooring is a considered, well-researched purchase, and we believe our value proposition makes us a

destination location. We generally seek locations with lower rent than those retail concepts requiring high traffic or impulse purchases and we are able to adapt a range of existing buildings to our format, from free-standing to strip center to small shopping center. Our stores are approximately 6,000 to 7,000 square feet, which includes a showroom format designed to emphasize our products and a small warehouse. Our real estate strategy considers total long-term share within a market over unit-based analysis. 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 believe that our store design and locations reinforce our customers' belief that they get a good deal when they buy from us.

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We currently target retail corridors within a market over the more industrial locations we historically have occupied. We implemented an improved store design in January 2013 to enhance the shopping experience for our customers and improve the efficiency of our operations. We designated the new design as our store of the future. The store of the future retains our targeted location size but expands the average showroom to a structured design of approximately 1,600 square feet, from a general historical size of approximately 1,000 to 1,200 square feet. The assortment of flooring options presented has expanded, grouped by product category, displayed within color palate and in a good-better-best format. The assortment of moldings and accessories displayed has expanded significantly. We believe the expanded showroom format has combined well with our advertising message resonating with a larger base of casual customers, our real estate strategy of locating stores in retail areas more familiar to the customer and increased in-store service levels through our Best People initiative.

All of our new stores opened in 2013 and 2014 featured the new design, and we have remodeled 39 existing stores, including 17 in 2014. Pleased with the results we have seen from the new format, we expect to feature it in all of our new stores and to remodel a majority of our existing stores, either in place or through relocation within the primary trade area, over the next six to eight years.

Store location activity in the expanded showroom format is as follows:

Number of stores featuring the expanded showroom:	2014	2013
Number of stores at January 1	52	
New stores opened during the period	34	30
Existing stores remodeled during the period <sup>(1)</sup>	17	22
Number of stores at December 31	<b>103</b>	<b>52</b>
Expanded showroom stores as a percentage of total stores	<b>29.3 %</b>	<b>16.4 %</b>

(1) A remodeled store remains a comparable store as long as it is relocated within the primary trade area. Our store showrooms have wall racks holding one-foot by two-foot display boards of our flooring products, presented within color palate and in a good-better-best format, and larger sample squares serving as the showroom floor. The showroom also displays an expanded selection of flooring enhancements and accessories to install, complement and maintain a customer's new floor. A typical store staff consists of a manager and three to four associates, with a compensation structure that generally weights sales-driven commission bonuses over relatively low base salaries. The store manager is responsible both for store operations and for overseeing our customers' shopping experience. A store's warehouse is stocked with a combination of that store's most popular products and high-volume items, as well as customer-specific inventory waiting to be picked up or delivered. By generally requiring a 50% deposit when an order is placed for product not taken home that day, we reduce store-level working capital requirements.

## **Our People as Flooring Experts**

A flooring purchase is generally a large-ticket, discretionary purchase that most residential homeowners purchase infrequently. Few home improvements, however, have as much consequence to the ambience of a room as the flooring. A flooring purchase is often well-researched, but can be influenced by emotion. 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 a do-it-yourself (DIY) customer. 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 for additional rooms in the existing house or even to the remodeling of a new home.

In conjunction with our Best People initiative, we place an emphasis on identifying, hiring and empowering top performing 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 for our store associates, ranging from topic-specific modules offered on our online learning management system to participation in our Lumber Liquidators University ( LLU ) program. LLU is an annual training event for all of our regional and store managers that focuses on enhanced selling techniques, in-depth product training and strategic discussions with senior executives.

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We divide our U.S. stores into four primary geographic zones, each with a vice-president of sales, and further segregate stores into regions with 10 to 15 stores overseen by a regional manager. Our hours of operation are generally less than traditional retail and sales are less weighted to weekends. Combined with a low number of associates supervised per location and average annual compensation of \$80,000 to \$90,000, we believe our store manager position is valued in retail and our turnover is low compared to other retailers.

## **Sales Approach**

We seek to appeal to customers who desire high-quality product at an attractive value. We sell our products and services principally to existing homeowners who we believe represent over 90% of our customer count. Most of our other sales are to contractors, who are primarily small businesses that are either building a limited number of new homes or have been hired by a residential owner to put in a new floor.

Historically, our customers are in their mid-30s or older, are well-educated and have income levels above the average domestic household. We have found that homeowners prefer an assortment with a range of characteristics, including appearance and durability, ease of installation and renewability of resources. Our research indicates that our customers will choose to replace their flooring primarily after they have lived in the home for a certain number of years, when a life event occurs such as a change in household members, and/or prior to or shortly after moving into a new home. According to Catalina Research, Inc. (Catalina), approximately 28% of buyers of an existing home undertake some type of flooring replacement project in the first year of ownership.

Our primary focus has been on customers who are passionate about their flooring purchase and who often define themselves as DIY. In recent years, we believe our value proposition has reached, and resonated with, both the DIY customer and a customer considered more casual. The casual consumer generally has less knowledge of the range of hard surface flooring products available or the purchase process itself, including the key questions needed for the best flooring solution. In comparison to the DIY customer, this customer generally requires a broader range of assistance from our sales associates and traditionally selects additional services such as delivery and installation.

We compete for the DIY and more casual customers in a highly fragmented marketplace, where we believe no one retailer has captured more than a 15% share of the market for hardwood flooring. We believe the majority of the market 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. While these independent retailers once numbered over 13,000 and suffered during the downturn in residential home improvement, Catalina estimates there are still approximately 9,000 specialty floor coverings stores. In order to react to local market conditions, our store managers have certain limited flexibility in the price they can offer to each customer, including the ability to offer a discount from an advertised price. We control this ad-hoc discounting through management reporting and daily follow-up, enhanced training of best practices and limiting the range of discount that can be given by products. Where we believe no competitor has a comparable product, we restrict all ad-hoc discounting.

We also compete against the national home improvement warehouse chains, including Home Depot and Lowes, which together have over 4,000 store locations in the U.S. Catalina estimates that Lumber Liquidators, Home Depot and Lowes combined represent approximately one-third of hardwood flooring retail sales. We believe our product categories represent less than 2% of sales at an average Home Depot or Lowes store.

## Advertising

*Advertising Reach and Frequency.* Our advertising strategy includes a focus on broadening the reach and frequency of our message to increase the recognition of our value proposition and ultimately the number of customers served.

We utilize a mix of traditional and new media, direct mail and financing offers to emphasize product credibility, value, brand awareness, customer education and direct selling. We also utilize local and national radio, primarily for promotional messaging. On the Internet, our advertising efforts include the use of banner advertising, sponsoring links on well-known search engines, having storefronts with large e-tailers and having a large network of online affiliate partners.

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We increase brand awareness in a variety of ways, including celebrity endorsements and product placement opportunities. We have on-going relationships with respected, well-known home improvement celebrities Bob Vila and Ty Pennington. We conduct ad campaigns on both a national and local level using both traditional and new media. We work with shows such as HGTV's *Dream Home Sweepstakes* and *This Old House*, which use our products and enable potential customers to see both what our flooring will look like after installation and the relative ease with which it can be installed. We use targeted television advertising across both cable and national networks. We engage in sports marketing by participating in opportunities with, among others, Major League Baseball and National Basketball Association teams.

Our direct mail strategy focuses on regular contact with our customers and the targeting of prospective purchasers. We have a healthy and growing database that we utilize to drive our direct mail and overall marketing strategies. We distribute our catalogs, as well as other direct mailings, to key consumer and commercial segments around specific store locations. Copies of our catalogs can also be obtained through our stores, our call center and our website.

*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 at 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 to tender installation services provided by our third party service provider.

We offer our commercial customers a financing alternative through the Lumber Liquidators Commercial Credit Program, A Credit Line for Pros. This program is underwritten by a third party financial institution, generally at no recourse to us. The commercial credit program also provides our professional customers a range of additional services that we believe add efficiency to their businesses.

## **Services**

We 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 hardwood 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 average length for a hardwood flooring purchase, from initial interest to final sale, is approximately 100 days.

As flooring experts, we strive to support all stages of the purchase cycle. Our objective is to help the consumer throughout the process from aspiration to installation advice, whether in our store or in their home. Our sales strategy emphasizes customer service by providing superior, convenient, educational tools for our customers to learn about our products and the installation process. Our website contains a broad range of information regarding our floors and accessories. Visitors to our website can search through a comprehensive knowledge base of tools on wood flooring, including browsing product reviews, frequently asked questions and an extensive before and after gallery from previous customers, as well as research detailed product information and how-to videos that explain the installation process. A consumer also has the ability to chat live with a flooring expert for questions about a flooring purchase or installation, either online or over the phone. We have also developed several new responsive mobile, tablet and website functions to assist consumers with their flooring choice. For example, our Designer Toolbox brings together several functions such as a virtual room designer and Color Match, which allows customers to match their floor to a

specific color, cabinet, furniture or competitive option.

Flooring samples of all the products we offer are available in our stores, and can be ordered through our call center and website. In addition, our iPhone and iPad app, The Floor Finder, gives consumers access to approximately 200 digital samples as well as a variety of tools designed to facilitate flooring purchase decisions, including visualizing any floor in their own home. The app also gives consumers flooring specifications, such as hardness and installation information. We engage and interact in social media in

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order to connect to our consumers in the most convenient manner possible as well as build relationships with our satisfied customers. We have an active presence on Facebook, Pinterest, YouTube and two unique Twitter accounts.

We strive to use our various sales channels to make our customers' transactions easy and efficient. Customers can purchase our complete assortment of products in our stores, or through our call center, website, a smartphone or a tablet. The prices available on our website and from our call center are the same as the prices in our stores. Once an order is placed, customers may have their purchases delivered or pick them up at a nearby store location. Our average sale was approximately \$1,675 in 2014, and generally represents one or two rooms of flooring. We define average sale as the average invoiced sale per customer, measured on a monthly basis and excluding transactions of less than \$250 (which are generally sample orders, or add-ons or fill-ins to previous orders) and of more than \$30,000 (which are usually contractor orders). 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.

We are committed to responding timely to our potential and existing customers. 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.

*Store to Customer Delivery.* Once an order is placed, a customer chooses to either pick up at a nearby store location or have their purchases delivered. We engage third parties to deliver our products from the store to an address designated by the customer. The cost of the delivery varies based on weight and distance, and we pass our actual cost onto the customer with a small markup to cover administration. In 2014, actual third party delivery charges included in cost of sales were 91% of the delivery revenue included in net sales. We believe the percentage of customers opting for non-merchandise services will grow as our value proposition resonates with a greater number of customers who do not consider themselves DIY consumers. Approximately one in five of our customers opt for delivery services over in-store pickup.

*Installation.* Approximately one in 10 of our customers opt to utilize the fully-insured and licensed professional installation services which we make available to measure and install flooring at competitive prices at each of our stores. As of December 31, 2014, installation services are managed through a national arrangement with a third-party in 267 of our stores. Under this national arrangement, we receive certain reimbursements based on volume, which offset other expenses. In the remaining 85 stores, we are testing structural alternatives to the national arrangement. In these stores, our own associates perform certain customer-facing, consultative services and coordinate the actual installation services provided by third-party professional installers. Service revenue for installation transactions we control is included in net sales, with the corresponding costs in cost of sales. The installation transactions we facilitated increased operating income in 2014, but with gross margins generally less than our average merchandise transaction. We believe our greater interaction with the customer and greater control over the third party services provided will ultimately result in higher utilization by the customer.

## **Market**

According to the July 2014 Floor Coverings Industry report and quarterly updates from Catalina, the hardwood flooring market represents approximately 14% of the overall U.S. floor coverings market, which includes carpeting and area rugs, solid and engineered hardwood, softwood and bamboo flooring, ceramic and stone floor and wall tile, resilient sheet and floor tile, and laminate flooring. Using Catalina estimates as a basis, we believe the 2014 retail

value of the U.S. hardwood and laminate flooring markets were approximately \$4.8 billion and \$1.9 billion, respectively. These products represented approximately 57% of our sales mix in 2014 and we believe our combined share of these two markets was approximately 9% in 2014. Overall, we believe improvements in the quality and construction of certain products, ease of installation and a broad range of retail price points, will drive continued hard surface flooring share gain versus soft surface flooring.

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The residential replacement market for wood flooring is dependent on home-related, large-ticket discretionary spending, which is itself influenced by a number of complex economic and demographic factors that may vary locally, regionally and nationally. We believe this market is impacted by, among other things, home remodeling activity, weather, employment levels, housing turnover (specifically, single family existing home sales), home prices, new housing starts, consumer confidence, borrowing rates, credit availability and the general health of consumer discretionary spending. The aggregate sales of single family homes displayed year-over-year strength from the latter half of 2011 through the third quarter of 2013, but became and remained negative on a year-over-year basis from the fourth quarter of 2013 through September 2014. We continue to believe we are in a multi-year home remodeling recovery which began in 2009, which has been and will continue to be marked by periodic volatility when our customer is likely to be cautious and price-sensitive. Catalina projects the hardwood flooring market will have average annual growth of 4.0% to 5.0% for the next several years, subject to the pace of macroeconomic recovery, and we believe we are well-positioned to benefit from an improving housing market.

## **Employees**

As of December 31, 2014, we had 1,891 employees, 95% of whom were full-time and none of whom were represented by a union. Of these employees, 71% work in our stores, 16% work in corporate store support infrastructure or similar functions (including our call center employees) and 13% work either on our finishing line or in our distribution centers. We believe that we have good relations with our employees.

## **Seasonality and Quarterly Results**

Our quarterly results of operations 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 are taking place, and lower than average net sales in the winter months and during the hottest summer months. These seasonal fluctuations, however, are minimized to some extent by our national presence, as markets experience different seasonal characteristics.

## **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®, 1-800-FLOORING®, Dura-Wood®, 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® 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. We are not aware of any facts that could be expected to have a material adverse effect on our intellectual property.

## **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,

public health and safety, zoning, accommodations for person with disabilities, and fire codes. We operate each of our stores, offices, finishing facility and distribution centers in accordance with standards and procedures designed to comply with applicable laws, codes and regulations. 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.



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Our suppliers are subject to the laws and regulations of their home countries, including in particular laws regulating labor, forestry and the environment. We consult with our suppliers, as appropriate, to ensure that they are in compliance with their applicable home country laws. 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 the importation, acquisition or sale of illegally harvested plants and plant products and the emissions of hazardous materials. We work closely with our suppliers in order to comply with the applicable laws and regulations in these areas.

We monitor changes in applicable laws and regulations and believe that we currently conduct, and in the past have conducted, our activities and operations in substantial compliance with applicable laws and regulations relating to the environment and protection of natural resources. However, there can be no assurance that such laws will not become more stringent in the future or that we will not incur additional costs in the future in order to comply with such laws.

## **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 report. 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. In addition, you may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. 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.

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**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 to all 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 Economic Factors and Our Industry**

**Changes in economic conditions may adversely impact demand for our products, reduce access to credit and cause our customers and others with whom we do business to suffer financial hardship, all of which could adversely impact our business, results of operations and financial condition.**

Our business, financial condition and results of operations have and may continue to be affected by various economic factors. Changes in the current economic environment and uncertainty about the future could lead to reduced consumer and business spending, including by our customers. Such changes may also cause customers to shift their spending to products we either do not sell or do not sell as profitably. Further, a reduced access to credit may adversely affect the ability of consumers to purchase our products. This potential reduction in access to credit may impact our ability to offer customers credit card financing through third party credit providers on terms similar to those offered previously, or at all. In addition, economic conditions, including decreased access to credit, may result in financial difficulties leading to restructurings, bankruptcies, liquidations and other unfavorable events for our customers, suppliers and other service providers. If such conditions deteriorate, our industry, business and results of operations may be severely impacted.

**The hardwood flooring industry depends on the economy, home remodeling activity, the homebuilding industry and other important factors.**

The hardwood flooring industry is highly dependent on the remodeling of existing homes and new home construction. In turn, remodeling and new home construction 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. For example, discretionary consumer spending could be limited, spending on remodeling of existing homes could be reduced and purchases of new homes could decline if:

the national economy or any regional or local economy where we operate weakens;  
interest rates rise;  
credit becomes less available;  
tax rates and health care costs increase;  
regions where we operate experience unfavorable demographic trends;  
fuel costs or utility expenses increase; or  
home prices depreciate.

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.

**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 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 impacted negatively.

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Our competitive position is also influenced by the availability, quality and cost of merchandise, labor costs, finishing, 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 or 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 preference 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 other than hardwood flooring, 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 Our Suppliers, Products and Product Sourcing**

### **Our ability to obtain products from abroad and the operations of many of our international suppliers are subject to risks that are beyond our control and that could harm our operations.**

We rely on a select group of international suppliers to provide us with flooring products that meet our specifications. In 2014, approximately 40% of our product was sourced from Asia, approximately 6% was sourced from South America and approximately 5% was sourced from Europe and Australia. As a result, we are subject to risks associated with obtaining products from abroad, including:

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;

the imposition of new or different duties (including antidumping and countervailing duties), tariffs, taxes and/or other charges on exports or imports, including as a result of errors in the classification of products upon entry or changes in the interpretation or application of rates or regulations relating to the import or export of our products;

disruptions or delays in production, shipments, delivery or processing through ports of entry (including those resulting from strikes, lockouts, work-stoppages or slowdowns, or other forms of labor unrest); and

changes in local economic conditions in countries where our suppliers are located.

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.

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

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

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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.

**Our dependence on certain suppliers makes us vulnerable to the extent we rely on them.**

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, and we typically obtain our hardwood supplies on an order-by-order basis, writing orders for future deliveries from 90 to 180 days before delivery. 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, a supplier s financial instability, inability or refusal to comply with applicable laws, trade restrictions, tariffs or our standards, duties, insufficient transport capacity and other factors beyond our control. If we can no longer obtain merchandise from our larger suppliers, or they refuse to continue to supply us on commercially reasonable terms or at all, and we cannot find replacement suppliers, we could experience deterioration in our net sales and operating results.

**If we fail to identify and develop relationships with a sufficient number of qualified suppliers, our ability to obtain products that meet our high quality standards could be harmed.**

We purchase flooring directly from mills located around the world. We believe that these direct supplier relationships are relatively unique in our industry. 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 hardwood in a timely and efficient manner. The need to develop new relationships will be particularly important as we seek to expand our operations and enhance our product offerings 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.

**If our suppliers do not use ethical business practices, comply with applicable laws and regulations and ensure that their products meet our quality standards, our reputation could be harmed due to negative publicity and we could be subject to legal risk.**

While our suppliers agree to operate in compliance with applicable laws and regulations, including those relating to environmental and labor practices, 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. Violation of environmental, labor or other laws by our suppliers or their failure to operate in a legal, ethical and responsible manner, could reduce demand for our products if, as a result of such violation or failure, we were to attract negative publicity. Further, we require our suppliers to adhere to our quality standards. While we do monitor our suppliers adherence to such standards, there is no guarantee that we will identify every instance of

non-compliance, if any. 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 litigation and recalls, which could damage our reputation and our brands, increase our costs, and otherwise hurt our business.

### **Increased hardwood costs could harm our results of operations.**

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

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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.

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

We face an inherent 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. In the event that any of our products proves to be defective, 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 adequate for 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.

### **We may not be able to successfully anticipate consumer trends and our failure to do so may adversely impact our net sales and profitability.**

As part of our business proposition, it is important for us to anticipate and respond to changing preferences and consumer demands in a timely manner. If we fail to identify and respond to emerging trends, consumer acceptance of the merchandise in our stores and our image with our customers may be harmed, which could reduce customer traffic in our stores and adversely affect our net sales. Moreover, consumer demand within our mix of products may shift and such change may negatively impact our net sales and operating results.

## **Risks Related to Our Operations**

### **Federal, provincial, state or local laws and regulations, or our failure to comply with such laws and regulations, 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 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. In addition, various federal, provincial and state laws govern our relationship with and other matters pertaining to our employees, including wage and hour laws, requirements to provide meal and rest periods or other benefits, health care insurance issues, minimum wage standards, family leave mandates, requirements regarding working conditions and accommodations to certain employees, citizenship or work authorization and related requirements, insurance and workers' compensation rules and anti-discrimination 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 the use, storage, handling, generation, treatment, emission, release, discharge and disposal of certain hazardous materials and wastes, the remediation of



contaminated soil and groundwater and the health and safety of employees. If we are unable to 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 may spend significant time and resources in order to comply with applicable advertising, importation, exportation, environmental, 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 or penalties, 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 or incur decreased efficiency in order to adhere to the new standards.

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

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 Report and Note 10 to the consolidated financial statements included in Item 8 of this Report). We cannot predict with certainty the outcomes of these legal proceedings. The outcome of some of these legal proceeding could require us to take, or refrain from taking, actions which could negatively affect our operations or could require us to pay substantial amounts of money adversely affecting our financial condition and results of operations. Additionally, defending against lawsuits and legal proceedings may involve significant expense and diversion of management's attention and resources. Negative publicity surrounding such legal proceedings may also harm our reputation and adversely impact our business and results.

**Increasing our net sales and profitability depends substantially on our ability to open new stores and is subject to many unpredictable factors.**

As of December 31, 2014, we had 352 stores throughout the United States and Canada, 166 of which we opened after January 1, 2010. We plan to open a significant number of new stores during each of 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 will depend on various factors, including the following:

- the successful selection of new markets and store locations;
- the implementation of and results generated by our new showroom format;
- our ability to negotiate leases on acceptable terms;
- management of store opening costs;
- the quality of our operations;
- consumer recognition of the quality of our products;
- our ability to meet customer demand;
- the continued popularity of hardwood flooring; and
- general economic conditions.

In addition, the following may impact the net sales and performance of our new stores compared to prior years:

- as we open more stores, our rate of expansion relative to the size of our store base will decline;
- we may not be able to identify suitable store locations in markets into which we seek to expand and may not be able to open as many stores as planned;
- 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, or may have lower average store net sales, than stores opened in the past;
- we may experience difficulties, delays or failures in obtaining the necessary licenses, permits or other approvals necessary to open and operate particular store locations;
- we may incur higher maintenance costs than in the past;

newly opened stores may not succeed or may reach profitability more slowly than we expect, and the ramp-up to profitability may become longer 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

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future markets and stores may not be successful and, even if we are successful, our average store net sales and our comparable store net sales may not increase at historical rates.

Finally, our progress in opening new stores from quarter to quarter may occur at an uneven rate, which may result in quarterly net sales and profit growth falling short of market expectations in some periods.

**Our net sales and profit growth could be adversely affected if comparable store net sales are less than we expect.**

While future net sales growth will depend substantially on our plans for new store openings, the level of comparable store net sales (which represent the change in period-over-period net sales for stores beginning their thirteenth full month of operation) will also affect our net sales growth and business results. Among other things, increases in our baseline store volumes and the number of new stores opened in existing markets, which tend to open at a higher base level of net sales, will impact our comparable store net sales. As a result, it is possible that we will not achieve our targeted comparable store net sales growth or that the change in comparable store net sales could be negative. If this were to happen, net sales and profit growth would be adversely affected.

**Increased transportation costs, particularly those relating to the cost of fuel, 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 in the fees delivery companies charge us to transport our products to our stores and customers. We may be unable to increase the price of our products to offset increased transportation charges, which could cause our operating results to deteriorate.

**Business and operation risks exist in connection with our distribution centers.**

In 2013, we purchased 110 acres of undeveloped land in Henrico County, Virginia upon which we constructed a million square foot distribution center. The facility became fully operational in January 2015. This was our first real estate purchase and is the first distribution center owned by us. The cost of operating and managing the East Coast distribution center may exceed our expectations and we may not achieve the benefits that we anticipate from consolidating our East Coast facilities into this East Coast distribution center.

In addition, since early 2014, we have leased and operated a 500,000 square foot distribution center in Pomona, California, our first distribution center located outside of Virginia. Given the limited period of time that we have been in the facility, the costs of operating may exceed our expectations and we may not achieve the benefits that we anticipate. Further, we may face challenges relating to the management of inventory in separate warehouse facilities located on opposite coasts and the impact of the new East Coast distribution facility.

If either of these facilities 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 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.

Our net sales and profit growth could be adversely affected if comparable store net sales are less than we expect.

**Damage, destruction or disruption of our Toano facility could significantly impact our operations and impede our ability to finish and distribute certain of our products.**

Our Toano, Virginia facility serves as our corporate headquarters and, among other things, houses our primary computer systems, which control our management information and inventory management systems. In addition, we currently finish approximately 92% of all Bellawood products, as well as small quantities of certain other products, there. In 2014, Bellawood flooring accounted for approximately 13% of our net sales. If the Toano facility were damaged or destroyed, it could harm our operations, cause significant lost production and impact our ability to fulfill customer demand.

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**The operation of stores in Canada may present increased legal and operational risks.**

We opened our first stores in Canada in 2011 and currently operate nine store locations there. As a result of our limited operations in the Canadian market, these stores may be less successful than we expect. Additionally, greater investments in advertising and promotional activity may be required to continue to build brand awareness in that market. Furthermore, 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 the Canadian market or in a manner and with results similar to our U.S. stores. We may also incur increased costs in complying with applicable Canadian laws and regulations as they pertain to both our products and our operations.

**The operation of our Representative Office in China may present increased legal and operational risks.**

In September 2011, we established a representative office in Shanghai, China to control our product sourcing in Asia. Our experience with the legal and regulatory practices and requirements in China is limited in scope and duration. As a result, we may incur costs in complying with applicable Chinese laws and regulations that exceed our expectations.

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.**

In certain geographical regions, we manage third party installers who provide installation services to some of our customers. As such, in some 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 processes and 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 processes 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.

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

Our plans call for a significant number of new stores, and increased orders from our website, call center and catalogs.

Our existing management information systems, including our store management systems and financial and management 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 managers, store managers and store associates. We may not respond quickly enough to the changing demands that our expansion will impose on our management, associates and existing infrastructure. Any failure to manage our growth effectively could harm our business and operating results.

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

We maintain various insurance policies for employee health, workers' compensation, general liability and property damage. We are self-insured on certain health insurance plans 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. Beginning in 2013, we are self-insured with regard to workers' compensation coverage, in which case we are responsible for losses up to certain retention limits on both a per-claim and aggregate basis.

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. Our estimated liability is not discounted and is based on a number of assumptions and factors, including historical trends, actuarial assumptions and economic conditions, and is closely monitored and adjusted when warranted by changing circumstances. Fluctuating healthcare costs, our significant growth rate and changes from our past experience with workers' compensation claims could affect the accuracy of estimates based on historical experience. Should a greater amount of claims occur compared to what was estimated or medical costs increase beyond what was expected, our accrued liabilities might not be sufficient and we may be required to record additional expense. Unanticipated changes may produce materially different amounts of expense than that reported under these programs, which could adversely impact our operating results.

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**We have entered into a number of lease agreements with companies controlled by our founder and this concentration of leases may pose certain business risks.**

As of December 31, 2014, we lease our Toano facility, which includes a store location, and 30 of our other store locations from entities owned, in whole or in part, by Tom Sullivan, our founder and current chairman of our board of directors. Although our percentage of total stores leased from such entities has decreased over the last year, this concentration of leases subjects us to risk in the event action or inaction by Tom or such entities impacts our leasehold interests in the locations.

**Risks Related to Our Information Technology**

**If our management information systems 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. Accordingly, if our network is disrupted, 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.

**The selection and implementation of information technology initiatives may impact our operational efficiency and productivity.**

In order to better manage our business, we expect to invest in our information systems. In doing so, we must select the correct investments and implement them in an efficient manner. The costs, potential problems and interruptions associated with implementing technology initiatives could disrupt or reduce the efficiency of our operations. Furthermore, these initiatives might not provide the anticipated benefits or provide them in a delayed or more costly manner. Accordingly, issues relating to our selection and implementation of information technology initiatives may negatively impact our business and operating results.

**Any disruption of our website or our call center could disrupt our business and lead to reduced net sales and reputational damage.**

Our website and our call center are integral parts of our integrated multi-channel strategy. Customers use our website and our call center as information sources on the range of products available to them and to order our products, samples or catalogs. Our website, in particular, is vulnerable to certain risks and uncertainties associated with the Internet, including changes in required technology interfaces, website downtime and other technical failures, security breaches and consumer privacy concerns. If we cannot successfully maintain our website and call center in good working order, it could reduce our net sales and damage our reputation. Further, the costs associated with such

We have entered into a number of lease agreements with companies controlled by our founder and this concentration



maintenance may exceed our estimations.

**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

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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.

## **Risks Related to Our Personnel**

### **Our success depends substantially upon the continued retention of certain key personnel.**

We believe that our success has depended and continues to depend to a significant extent on the efforts and abilities of our senior management team. The loss, for any reason, of the services of any of these key individuals and any negative market or industry perception arising from such loss, could damage our business and harm our reputation.

### **Our success depends upon our ability to meet our labor needs.**

Our success depends in part on our ability to attract, hire, train and retain qualified managers and associates. Buying hardwood flooring is an infrequent event, and typical consumers have very little knowledge of the range, characteristics and suitability of the products available to them before starting the purchasing process. Therefore, consumers in the hardwood flooring market expect to have sales associates serving them who are knowledgeable about the entire assortment of products offered by the retailer and the process of choosing and installing hardwood flooring. As a result, competition for qualified store managers and sales associates among flooring retailers is intense. We may not succeed in attracting and retaining the personnel we require to conduct our current operations and support our potential future growth. In addition, as we expand into new markets, we may find it more difficult to hire, motivate and retain qualified employees.

Although none of our employees are currently covered under collective bargaining agreements, we cannot guarantee that our employees will not elect to be represented by labor unions in the future. If some or our entire workforce were to become unionized and collective bargaining agreement terms were significantly different from our current compensation arrangements or work practices, it could have a material adverse effect on our business and operating results.

## **Risks Relating to Our Marketing and Advertising**

### **Our success depends on the effectiveness of our advertising strategy.**

We believe that our growth 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 typically 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 consumer. While our marketing strategy continues to support our real estate strategy and remains focused on retaining the DIY customer, we have broadened the reach and

We may incur costs and losses resulting from security risks we face in connection with our electronic processing, tra

frequency of our advertising to increase the recognition of our value proposition and the number of customers served.

We may need to further increase our advertising expense to support our business strategies in the future. If 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.

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**Failure to maintain relevant product endorsement agreements and product placement arrangements could harm our reputation and cause our net sales to deteriorate.**

We have established relationships with well-known and respected home improvement celebrities to evaluate, promote and help establish with consumers the high-quality nature of our products. If these individuals were to stop promoting our products, if we were unable to renew our endorsement contracts with them or if we could not find other endorsers of a similar caliber, our net sales and reputation could be harmed. Similarly, any actions that persons endorsing our products may take, whether or not associated with our products, which harm their or our reputations could also harm our brand image with consumers and our reputation, and cause our net sales to deteriorate. We also have a number of product placement arrangements with home improvement-related television shows. We rely on these arrangements to increase awareness of our brands, and to enable potential customers to see both what our flooring will look like after installation and the relative ease with which it can be installed. Any failure to continue these arrangements could cause our brands to become less well-known and cause our net sales to deteriorate.

**We may not be able to adequately protect our intellectual property, which could harm the value of our brands and impact our business.**

Our intellectual property is material to the conduct of our business. The successful implementation of our business plan successfully depends in part on our ability to further build brand recognition using our trademarks, service marks and other proprietary intellectual property, including our name and logo and the names and logos of our brands. We may incur significant costs and expenses relating to our efforts to enforce our intellectual property rights. If our efforts to protect our intellectual property are inadequate, or if any third party infringes on or misappropriates our intellectual property, the value of our brands may be harmed, which could adversely affect our business and might prevent our brands from achieving or maintaining market acceptance.

We may initiate claims or litigation against parties for infringement of our intellectual property rights or to establish the invalidity, non-infringement, or unenforceability of the proprietary rights of others. Likewise, we may have similar claims or litigation brought against us by competitors and others. Under either situation and regardless of any ultimate determination on the merits, we could incur significant expense and be forced to divert the efforts of key employees from our operations. Moreover, such claims or litigation could harm our image, brand or competitive position and cause us to incur significant penalties and costs.

**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. Those fluctuations could be based on various factors in addition to those otherwise described in this report, including:

- our operating performance and the performance of our competitors;
- the public's reaction to our filings with the SEC, our press releases and other public announcements;
- changes in recommendations or earnings estimates by research analysts who follow Lumber Liquidators or other companies in our industry;

Failure to maintain relevant product endorsement agreements and product placement arrangements could harm our

variations in general economic conditions;  
actions of our current stockholders, including sales of common stock by our directors and executive officers;  
the arrival or departure of key personnel; and  
other developments affecting us, our industry or our competitors.

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 our company or its performance.

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

Our quarterly operating results may fluctuate significantly because of various factors, including:

changes in comparable store net sales and customer transactions, including as a result of declining consumer confidence or the introduction of new products;

the timing of new store openings and related net sales and expenses;

profitability and performance of our stores;

the timing of remodels and relocations of existing stores and related net sales and expenses;

the impact of inclement weather, natural disasters and other calamities;

variations in general economic conditions;

the timing and scope of sales promotions and product introductions;

changes in consumer preferences and discretionary spending;

fluctuations in supply prices; and

tax expenses, impairment charges and other non-operating costs.

Due to these factors, results for any one quarter are not necessarily indicative of results to be expected for any other quarter or for any year. Average store net sales or comparable store net sales in any particular future period may decrease. In the future, operating results may fall below the expectations of research analysts and investors, which could cause the price of our common stock to fall.

**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 several 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 requiring one to be called 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, acquisition, tender offer, proxy contest 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.

**Risk Related to Accounting Standards**

**Changes in accounting standards and subjective assumptions, estimates and judgments by management related to complex accounting matters 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,

Our quarterly operating results may fluctuate significantly and could fall below the expectations of research analysts

consolidation, revenue recognition, stock-based compensation, lease accounting, sales returns reserves, inventories, self-insurance, income taxes, unclaimed property laws and litigation, etc. are highly 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.

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None.

**Item 2. Properties.**

As of February 23, 2015, we operated 354 stores located in 46 states and Canada, including two opened since December 31, 2014. In addition to our nine stores in Ontario, Canada, the table below sets forth the locations (alphabetically by state) of our 345 U.S. stores in operation as of February 23, 2015.

State	Stores	State	Stores	State	Stores	State	Stores
Alabama	5	Iowa	3	Nevada	3	Rhode Island	1
Arizona	5	Kansas	3	New Hampshire	5	South Carolina	6
Arkansas	2	Kentucky	4	New Jersey	13	South Dakota	1
California	37	Louisiana	5	New Mexico	1	Tennessee	6
Colorado	7	Maine	3	New York	19	Texas	27
Connecticut	6	Maryland	9	North Carolina	11	Utah	2
Delaware	3	Massachusetts	10	North Dakota	1	Vermont	1
Florida	21	Michigan	10	Ohio	13	Virginia	12
Georgia	10	Minnesota	6	Oklahoma	3	Washington	7
Idaho	2	Mississippi	2	Oregon	4	West Virginia	3
Illinois	15	Missouri	5	Pennsylvania	19	Wisconsin	5
Indiana	7	Nebraska	2				

We lease all of our stores and our corporate headquarters located in Toano, Virginia, which includes our call center, corporate offices, and distribution and finishing facility. Our corporate headquarters has 307,784 square feet, of which approximately 32,000 square feet are office space, and is located on a 74-acre plot. We own approximately 110 acres of land in Henrico County, Virginia where we constructed a million square foot distribution center that became fully operational in January 2015. We currently lease 665,486 square feet near the port in the Hampton Roads area in Virginia but those leases are scheduled to expire by March 31, 2015. We lease a 504,016 square feet facility in Pomona, California, which, along with our new facility in Virginia, serve as our primary distribution facilities.

As of February 23, 2015, 31 of our store locations are leased from related parties. See discussion of properties leased from related parties in Note 4 to the consolidated financial statements included in Item 8 of this report and within Certain Relationships and Related Transactions, and Director Independence in Item 13 of this report.

**Item 3. Legal Proceedings.****Prusak Matter**

On August 30, 2012, Jaroslaw Prusak, a purported customer ( Prusak ), filed a putative class action lawsuit, which was subsequently amended, against us in the United States District Court for the Northern District of Illinois (the Prusak Lawsuit ). Prusak alleged that we willfully violated the Fair and Accurate Credit Transactions Act amendments to the Fair Credit Reporting Act in connection with electronically printed credit card receipts provided to certain of its customers. In the operative complaint, Prusak, for himself and the putative class, sought statutory and punitive damages, attorneys fees and costs, and other relief. Although we believed we had valid defenses to the claims asserted,



we agreed to a settlement of the claims in the lawsuit for approximately \$705,000, which was previously accrued. At December 31, 2014, we had a remaining accrual of \$468,000, which was subsequently paid in January 2015.

### **Government Investigation**

On September 26, 2013, sealed search warrants were executed at our corporate offices in Toano and Richmond, Virginia by the Department of Homeland Security's Immigration and Customs Enforcement and the U.S. Fish and Wildlife Service. The search warrants requested information, primarily documentation, related to the importation of certain of our wood flooring products. Since then, we have been cooperating with the federal authorities, including the Department of Justice ( DOJ ), in their investigation. In recent

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communications, the DOJ indicated that it is contemplating seeking criminal charges under the Lacey Act. We expect to continue to communicate with the DOJ regarding its intentions and possible courses of action in this matter. At this time, we do not have enough information to estimate a reasonably possible loss or range of loss that may result from actions by the DOJ as a result of its investigation.

### **Kiken Matter**

On or about November 26, 2013, Gregg Kiken ( Kiken ) filed a securities class action lawsuit, which was subsequently amended, in the United States District Court for the Eastern District of Virginia against us, our founder, our Chief Executive Officer and President, our Chief Financial Officer and our Chief Merchandising Officer (collectively, the Kiken Defendants ). In the amended complaint, Kiken and an additional plaintiff, Keith Foster (together with Kiken, the Plaintiffs ), allege that the Kiken Defendants made material false and/or misleading statements and failed to disclose material adverse facts about our business, operations and prospects. In particular, the Plaintiffs allege that the Kiken Defendants made material misstatements or omissions related to our compliance with the federal Lacey Act and the chemical content of certain of its wood products. In addition to attorneys' fees and costs, the Plaintiffs seek to recover damages on behalf of themselves and other persons who purchased or otherwise acquired our stock during the putative class period at allegedly inflated prices and purportedly suffered financial harm as a result. We dispute the Plaintiffs' claims and intend to defend the matter vigorously. Given the uncertainty of litigation, the preliminary stage of the case, insurance coverage issues and the legal standards that must be met for, among other things, class certification and success on the merits, we cannot estimate the reasonably possible loss or range of loss that may result from this action.

### **TCPA Matter**

On or about March 4, 2014, Richard Wade Architects, P.C. ( RWA ) filed a lawsuit in the United States District Court for the Northern District of Illinois (the RWA Lawsuit ), which was subsequently amended, alleging that we violated the Telephone Consumer Protection Act ( TCPA ), the Illinois Consumer Fraud Act and the common law by sending an unsolicited facsimile advertisement to RWA. RWA seeks recourse on its own behalf as well as other similarly situated parties that received unsolicited facsimile advertisements from us. The TCPA provides for recovery of actual damages or five hundred dollars for each violation, whichever is greater. If it is determined that a defendant acted willfully or knowingly in violating the TCPA, the amount of the award may be increased by up to three times the amount provided above. Although we believe we have valid defenses to the claims asserted, based upon the proceedings to date, at December 31, 2014, we have accrued \$300,000, including \$25,000 in the fourth quarter of 2014, as our best estimate of the probable loss that may result from this action.

### **Prop 65 Matter**

On or about July 23, 2014, Global Community Monitor and Sunshine Park LLC (together, the Prop 65 Plaintiffs ) filed a lawsuit, which was subsequently amended, in the Superior Court of the State of California, County of Alameda, against us. In the complaint, the Prop 65 Plaintiffs allege that we violated California's Safe Drinking Water and Toxic Enforcement Act of 1986, Health and Safety Code section 25249.5, et seq. ( Proposition 65 ). In particular, the Prop 65 Plaintiffs allege that we failed to warn consumers in California that certain of our products (collectively, the Products ) emit formaldehyde in excess of the applicable safe harbor limits. In addition to attorneys' fees and costs, the Prop 65 Plaintiffs seek (i) equitable relief involving the reformulation of the Products, additional warnings related to the Products, the issuance of notices to certain of the purchasers of the Products (the Customers ) and the waiver of restocking fees for Customers who return the Products and (ii) civil penalties in the amount of two thousand five hundred dollars per day for each violation of Proposition 65. We dispute the claims of the Prop 65 Plaintiffs and

intend to defend the matter vigorously. Further, we have filed a counterclaim against the Prop 65 Plaintiffs for trade libel, unfair business practices, intentional interference with a prospective business advantage, negligent interference with economic relations, and declaratory relief. Given the uncertainty of litigation, the preliminary stage of the case, and the legal standards that must be met for, among other things, success on the merits, we cannot estimate the reasonably possible loss or range of loss that may result from this action.

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### **Hallandale Matter**

On or about September 17, 2014, the City of Hallandale Beach Police Officers and Firefighters Personnel Retirement Trust ( Hallandale ) filed a securities class action lawsuit in the United States District Court for the Eastern District of Virginia against us, our Chief Executive Officer and President and our Chief Financial Officer (collectively, the Hallandale Defendants ). In the complaint, Hallandale alleges that the Hallandale Defendants made material false and/or misleading statements that caused losses to investors. In particular, Hallandale alleges that the Hallandale Defendants made material misstatements or omissions regarding our supply chain and inventory position. In addition to attorneys fees and costs, Hallandale seeks to recover damages on behalf of itself and other persons who purchased or otherwise acquired our stock during the putative class period at allegedly inflated prices and purportedly suffered financial harm as a result. We dispute Hallandale s claims and intend to defend the matter vigorously. Given the uncertainty of litigation, the preliminary stage of the case, insurance coverage issues and the legal standards that must be met for, among other things, class certification and success on the merits, we cannot estimate the reasonably possible loss or range of loss that may result from this action.

### **Gold Matter**

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 (the Bamboo Product ) that we sell is defective. On February 13, 2015, Gold filed an amended complaint, which added three additional plaintiffs (collectively with Gold, Gold Plaintiffs ). Gold Plaintiffs allege that we have engaged in unfair business practices and unfair competition by falsely representing the quality and characteristics of the Bamboo Product and by concealing the Bamboo Product s defective nature. Gold Plaintiffs seek the certification of two separate classes: (i) individuals in the United States who own homes or other structures where the Bamboo Product has been installed or where Bamboo Product has been removed and replaced; and (ii) the same description but for owners of California homes or structures only. In addition to attorneys fees and costs, Gold Plaintiffs seek (i) a declaration that we are financially responsible for notifying all purported class members, (ii) injunctive relief requiring us to replace and/or repair all of the Bamboo Product installed in structures owned by the purported class members, and (iii) a declaration that we must disgorge, for the benefit of the purported classes, all or part of its profits received from the sale of the defective Bamboo Product and/or to make full restitution to Gold Plaintiffs and the purported class members. We dispute the Gold Plaintiffs claims and intend to defend the matter vigorously. Given the uncertainty of litigation, the preliminary stage of the case, insurance coverage issues and the legal standards that must be met for, among other things, class certification and success on the merits, we cannot estimate the reasonably possible loss or range of loss that may result from this action.

### **Balero Matter**

On or about December 11, 2014, Joseph Michael Balero, Michael Ballerini and Lisa Miller (collectively, the Balero Plaintiffs ) filed a purported class action lawsuit in the Superior Court of the State of California for the County of Alameda alleging that we engaged in unlawful and fraudulent business practices by selling certain products in California that do not comply with California s Airborne Toxic Control Measure to Reduce Formaldehyde Emissions from Composite Wood Products (the CARB Standards ) and by falsely advertising and representing that such products meet the CARB standards. The purported class consists of all California consumers that purchased the subject products since 2011. In addition to attorneys fees and costs, the Balero Plaintiffs seek (i) declarations that our policies and practices of labeling, advertising, distributing and selling certain products it sells in California violate the CARB standards, (ii) injunctive relief prohibiting us from continuing to distribute and/or sell laminate flooring products that violate the CARB standards, (iii) restitution of all money and/or property that the Balero Plaintiffs and other purported

class members provided to us for the purchase and installation of certain products sold by us that allegedly violate the CARB Standards, and (iv) damages, including actual, compensatory and consequential, incurred by the Balero Plaintiffs and other purported class members in connection with our alleged breach of warranty. We dispute the claims of the Balero Plaintiffs and intend to defend the matter vigorously. Given the uncertainty of litigation, the preliminary stage of the case, insurance coverage issues and the legal standards that must be met for, among other things, class certification and success on the merits, we cannot estimate the reasonably possible loss or range of loss that may result from this action.

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**Antidumping and Countervailing Duties Investigation**

In October 2010, a conglomeration of domestic manufacturers of multilayered wood flooring 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 our engineered hardwood imported from China, which accounted for approximately 11% of our flooring purchases in 2014.

The DOC made preliminary determinations regarding CVD and AD rates in April 2011 and May 2011, respectively. In December 2011, after certain determinations were made by the ITC and DOC, orders were issued setting final AD and CVD rates at 3.3% and 1.5%, respectively. These rates became effective in the form of additional duty deposits, which we have paid, and applied retroactively to the DOC preliminary determinations of April 2011 and May 2011.

Following the issuance of the orders, a number of appeals were filed by several parties, including us, challenging various aspects of the determinations made by both the ITC and DOC, including certain aspects that may impact the validity of the AD and CVD orders and the applicable rates. The appeal of the CVD order is expected to be concluded by mid-2015. On January 23, 2015, the Court of International Trade issued a final decision rejecting the challenge of the AD rate for all but one Chinese exporter. This decision is expected to be appealed to the Court of Appeals for the Federal Circuit later in 2015 and may take a year to conclude.

As part of its processes in these proceedings, the DOC conducts annual reviews of the CVD and AD rates. In such cases, the DOC will issue preliminary rates that are not binding and 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, we adjust our payments prospectively based on the final rate.

In the first annual review in this matter, rates were modified for AD rates through November 2012 and for CVD rates through 2011. Specifically, the AD rate was set at 5.92% and the CVD rate was set at 0.83%. These rates are being appealed by several parties, including us. Nevertheless, at December 31, 2014, we were paying these rates on each applicable purchase.

In January 2015, pursuant to the second annual review, the DOC issued a preliminary AD rate of 18.27% for purchases from December 2012 through November 2013 and a preliminary CVD rate of 0.97% for purchases in fiscal year 2012. These rates are pending final determinations by the DOC which are currently planned to be finalized in May 2015. If these rates are confirmed, we would owe approximately \$5.7 million for shipments during the applicable time periods. If these rates remain in effect for shipments subsequent to November 2013 (AD) and shipments subsequent to December 2012 (CVD), we would owe an additional \$6.3 million for all shipments through December 31, 2014. As this is a preliminary rate, we have not recorded an accrual in our consolidated financial statements for the impact of higher rates for the applicable time periods covered in the second annual review.

Based on the information available, we believe there is at least a reasonable possibility that an additional loss may have been incurred in the range of \$0 to \$12.7 million.

The third annual review of the AD and CVD rates has been initiated in February 2015, with preliminary rates expected in late 2015 or early 2016. Any change in the applicable rates as a result of the third annual review would apply to imports occurring after the second period of review.

## **Other Matters**

We are 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, our ultimate liability in connection with these matters is not expected to have a material adverse effect on the results of operations, financial position or cash flows.

## **Item 4. Mine Safety Disclosures.**

None.

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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 February 23, 2015 were 27,069,307, and we had five stockholders of record.

The following table sets forth the range of high and low sales prices per share as reported by the NYSE for each quarter during the last two fiscal years.

	Price Range	
	High	Low
2014:		
Fourth Quarter	\$ 67.86	\$ 47.76
Third Quarter	77.27	52.76
Second Quarter	96.75	72.86
First Quarter	111.74	86.26
2013:		
Fourth Quarter	\$ 119.98	\$ 85.58
Third Quarter	115.59	77.88
Second Quarter	90.92	63.88
First Quarter	71.72	52.56

**Issuer Purchases of Equity Securities**

The following table presents our share repurchase activity for the quarter ended December 31, 2014 (dollars in thousands, except per share amounts):

Period	Total Number of Shares Purchased <sup>(1)</sup>	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Dollar Value that May Yet Be Purchased Under the Plans or Programs <sup>(2)</sup>
October 1, 2014 to October 31, 2014	68	\$ 49.46		\$ 14,728
November 1, 2014 to November 30, 2014	804	54.28		14,728
December 1, 2014 to December 31, 2014				14,728



Total	872	\$ 53.90	\$ 14,728
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(1) We repurchased 872 shares of our common stock in connection with the net settlement of shares issued as a result of the vesting of restricted shares during the quarter ended December 31, 2014.

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 (2) 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 have been publicly announced on November 15, 2012 and February 19, 2014, respectively.

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TABLE OF CONTENTS**Dividend Policy**

We have never paid any dividends on our common stock. Any future decision to pay cash dividends will be at the discretion of our board of directors and will be dependent on our results of operations, financial condition, contractual restrictions and other factors that the board of directors considers relevant.

**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, 2009 through December 31, 2014, to that of the total return index for the NYSE Composite, the Dow Jones US Furnishings Index and the S&P SmallCap 600 Index (which includes Lumber Liquidators) assuming an investment of \$100 on December 31, 2009. 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.

	12/31/2009	12/31/2010	12/31/2011	12/31/2012	12/31/2013	12/31/2014
Lumber Liquidators Holdings, Inc	\$ 100.00	\$ 92.95	\$ 65.90	\$ 197.13	\$ 383.92	\$ 247.43
Dow Jones US Furnishings Index	\$ 100.00	\$ 131.06	\$ 138.33	\$ 155.99	\$ 229.97	\$ 262.91
S&P Smallcap 600 Index	\$ 100.00	\$ 126.31	\$ 127.59	\$ 148.42	\$ 209.74	\$ 221.81
NYSE Composite	\$ 100.00	\$ 113.76	\$ 109.70	\$ 127.53	\$ 161.20	\$ 172.27

TABLE OF CONTENTS**Item 6. Selected Financial Data.**

The selected statements of income data for the years ended December 31, 2014, 2013 and 2012 and the balance sheet data as of December 31, 2014 and 2013 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, 2012, 2011 and 2010, and income data for the years ended December 31, 2011 and 2010 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,				
	2014	2013	2012	2011	2010
	(dollars in thousands, except per share amounts)				
Statement of Income Data					
Net sales	\$1,047,419	\$1,000,240	\$813,327	\$681,587	\$620,281
Comparable store net sales (decrease) increase <sup>(1)</sup>	(4.3)%	15.8%	11.4%	(2.0%)	2.1%
Cost of sales	629,252	589,257	504,542	440,912	404,451
Gross profit	418,167	410,983	308,785	240,675	215,830
Selling, general and administrative expenses	314,094	284,960	230,439	198,237	173,667
Operating income	104,073	126,023	78,346	42,438	42,163
Interest expense	84				
Other (income) expense <sup>(2)</sup>	406	(442)	(140)	(587)	(579)
Income before income taxes	103,583	126,465	78,486	43,025	42,742
Provision for income taxes	40,212	49,070	31,422	16,769	16,476
Net income	\$63,371	\$77,395	\$47,064	\$26,256	\$26,266
Net income per common share:					
Basic	\$2.32	\$2.82	\$1.71	\$0.95	\$0.96
Diluted	\$2.31	\$2.77	\$1.68	\$0.93	\$0.93
Weighted average common shares outstanding:					
Basic	27,264,882	27,484,790	27,448,333	27,706,629	27,384,095
Diluted	27,485,852	27,914,322	28,031,453	28,379,693	28,246,453

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

(2)

Includes interest income.

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	As of December 31,				
	2014	2013	2012	2011	2010
	(dollars in thousands, except average sale data)				
<b>Balance Sheet Data</b>					
Cash and cash equivalents	\$20,287	\$80,634	\$64,167	\$61,675	\$34,830
Merchandise inventories	314,371	252,428	206,704	164,139	155,131
Total assets	357,277	429,559	347,387	294,854	242,290
Customer deposits and store credits	34,943	22,377	25,747	18,120	12,039
Total debt and capital lease obligations, including current maturities					
Total stockholders' equity	332,054	309,329	234,541	215,084	180,505
Working capital <sup>(1)</sup>	213,030	245,207	187,118	167,248	146,118
<b>Other Data</b>					
Total stores in operation	352	318	288	263	223
Average sale <sup>(2)</sup>	\$1,675	\$1,705	\$1,600	\$1,560	\$1,520

(1) Working capital is defined as current assets minus current liabilities.

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

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

### **Overview and Trends**

Lumber Liquidators is the largest specialty retailer of hardwood flooring in North America. At December 31, 2014, we sold our products through 352 Lumber Liquidators stores in 46 states in the United States ( U.S. ) and in Canada, a call center, websites and catalogs. We offer an extensive selection of premium hardwood flooring products under multiple proprietary brands at low prices designed to appeal to a diverse customer base. We believe we have achieved a reputation for offering great value, superior service and a broad selection of high-quality hardwood flooring products.

With a balance of price, selection, quality, availability and service, we believe our value proposition is the most complete and the strongest within a highly-fragmented hardwood flooring market. Sourcing directly from the mill provides the foundation for this value proposition, further strengthened by our unique store model, the industry expertise of our people, our singular focus on hard-surface flooring and our aggressive expansion of our advertising reach and frequency.

Our 2014 net sales and financial results were generally below our expectations after two years of double-digit increases in comparable store net sales and 640 basis points of operating margin expansion. Our net sales throughout the year were adversely impacted by weakness in the number of customers invoiced, our measure of customer traffic , and in the second half of the year, our average sale decreased. We believe a combination of factors weakened customer demand for our flooring as well as our ability to convert that demand to invoiced sales in 2014. These adverse factors began with the unusually severe winter weather, the impact of which we believe extended into the second quarter, and a slowdown in the aggregate sales of single family homes, which were negative on a

year-over-year basis through September 2014. From May through August, constrained inventory levels in certain key merchandise categories significantly reduced our ability to convert consumer interest into invoiced sales. Our average sale decreased primarily due to changes in the sales mix of flooring, including clearance of products not a part of our continuing assortment, an increase in liquidation deals and greater ad-hoc discounting at the point of sale.

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Our 2014 quarterly trends in comparable store net sales and the portions attributed to the number of customers invoiced and average sale are as follows:

	Three Months Ended			
	March 31, 2014	June 30, 2014	September 30, 2014	December 31, 2014
Net sales at comparable stores <sup>(1)</sup>	(0.6 )%	(7.1 )%	(4.9 )%	(4.2 )%
Change attributed to:				
Number of customers invoiced <sup>(2)</sup>	(3.2 )%	(5.3 )%	(2.6 )%	1.1 %
Average sale <sup>(3)</sup>	2.6 %	(1.8 )%	(2.3 )%	(5.3 )%

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

(2) Change in number of customers invoiced which is calculated by applying our average sale to total net sales at comparable stores.

Average sale, calculated on a total company basis, is defined as the average invoiced sale per customer, measured (3) on a monthly basis and excluding transactions of less than \$250 (which are generally sample orders, or add-ons or fill-ins to previous orders) and of more than \$30,000 (which are usually contractor orders).

In late November 2014, we began implementing marketing changes to strengthen our value proposition toward improving the conversion rates of customer interest into invoiced sales. We experienced immediate benefit. In December 2014, we believe these changes were the primary driver of an 8.1% increase in the number of customers invoiced, though we believe both consumer sentiment and general demand for wood flooring were also stronger than in December 2013. Further, at December 31, 2014, open orders (customer orders awaiting pickup or delivery) had increased \$18 million, or 69.0% in comparison to December 31, 2013. The initial marketing changes featured modifications to our promotional focus, advertising cadence and outstanding advertised retail price points with limited point of sale discounting. In 2015, we plan to continue implementing marketing changes to strengthen each component of our value proposition.

As we had planned, 2014 was a year of infrastructure investment to facilitate our long-term growth plans, and our capital investments were the most significant in our history. During the year, we:

Completed a significant optimization of our supply chain, including implementation of product allocation intelligence, operation of our second major distribution center on the West Coast, and construction of a million square foot facility on the East Coast, which was fully operational in January 2015;

Improved the finish and expanded the assortment of our flagship brand Bellawood;

Expanded our finishing capacity by purchasing a second line, which we expect to be fully operational in the first quarter of 2015;

Invested in the initial steps to vertically integrate our supply of domestic hardwood;

Completed testing of structural alternatives to the national installation arrangement and significantly expanded stores in which our own associates perform certain customer-facing, consultative services and coordinate the actual installation services provided by third-party professional installers; and

Opened 34 new store locations in the expanded showroom format and remodeled 17 existing stores, including 13 relocated within the primary trade area.

We enter 2015 focused on our core business and our value proposition to once again capture share in our highly fragmented market. We expect to lever our 2014 investments and once again drive operating margin expansion.

We have continued implementing marketing changes to strengthen our value proposition. We expect net sales to increase in 2015, which we believe will be driven by the number of customers invoiced, partially

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offset by a lower average sale. We expect moderate improvement in the marketplace for residential wood flooring, marked by periods of volatility when our customer may be cautious and price sensitive. We expect an increase in unit flow, primarily measured in square feet of flooring, greater than our net sales increase due to both projected changes in our sales mix and a lower average retail price per unit received from our customers. We plan to open 30 to 35 new store locations, remodel 15 to 20 existing stores and increase the number of stores where we provide installation services to approximately 150 by the end of 2015. Though our gross margin will be pressured by additional sales mix of installation services, we expect those services to be accretive to operating margin.

We expect full year 2015 gross margin to be pressured in comparison to 2014, with gross margin in the second half of the year generally stronger than the first half. Gross margin pressures are expected to be caused by lower average selling prices due to net changes in retail pricing and modifications in our promotional plan, net shifts in our sales mix and greater transportation costs due to higher unit flow, partially offset by higher attachment of moldings and accessories, a reduction in ad-hoc discounting at the point of sale, efficiencies due to supply chain optimization and generally lower transportation rates.

Net SG&A expenses are expected to increase over 2014 due to store base expansion, transition and full implementation of our East Coast distribution operations, legal and professional fees which continue at elevated levels, higher incentive compensation and greater depreciation including recent infrastructure investments. In the first quarter of 2015, we expect approximately \$2.7 million of incremental costs to transition and fully implement the expanded East Coast distribution operations, including \$1.5 million in transportation costs.

## Other External Factors Impacting Our Business

*Antidumping and Countervailing Duties Investigation.* As discussed in Section 3 *Legal Proceedings*, we are subject to antidumping and countervailing duties on imports of engineered hardwood from China. If the outcome of ongoing litigation with the United States Department of Commerce and the United States International Trade Commission is adverse, our results of operations may be materially adversely impacted. Additionally, the outcome may impact from where we source our engineered hardwood in the future. We currently source a portion of our engineered hardwood from locations outside of China, and we have the ability to increase our purchases from these suppliers if the need arises, although at a potentially higher cost of product than our current engineered hardwood cost. Additionally, we are expanding our assortment of engineered hardwood which we believe is constructed in such a way as to not be subject to antidumping and countervailing duties.

## Results of Operations

### Net Sales

	Year Ended December 31,					
	2014		2013		2012	
	(dollars in thousands)					
Net sales	\$1,047,419		\$1,000,240		\$813,327	
Percentage increase	4.7	%	23.0	%	19.3	%
Number of stores open at end of period	352		318		288	
Number of stores opened in period	34		30		25	
	percentage increase (decrease)					
Average sale	(1.8	)%	6.6	%	2.5	%



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Average retail price per unit sold <sup>(1)</sup>	(1.9	)%	5.7	%	0.2	%
Comparable stores:						
Net sales	(4.3	)%	15.8	%	11.4	%
Customers invoiced	(2.5	)%	9.2	%	8.9	%
Net sales of stores operating for 13 to 36 months	4.2	%	21.8	%	23.3	%
Net sales of stores operating for more than 36 months	(5.1	)%	14.9	%	9.1	%
Net sales in markets with all stores comparable (no cannibalization)	(0.3	)%	18.2	%	13.3	%
Net sales in cannibalized markets <sup>(2)</sup>	17.2	%	45.2	%	33.3	%

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(1) Average retail price per unit sold is calculated on a total company basis and excludes non-merchandise revenue.

(2) A cannibalized market has at least one comparable store and one non-comparable store.

Net sales for 2014 increased \$47.2 million, or 4.7%, over 2013 as net sales in comparable stores decreased \$42.9 million and net sales in non-comparable stores increased \$90.1 million. Net sales in 2014 were impacted by the following factors:

Net sales in comparable stores decreased 4.3% comparing 2014 to 2013 as a result of a decrease of 2.5% attributable to the number of customers invoiced and a decrease of 1.8% in the average sale.

We believe the number of customers invoiced decreased primarily due to the net effect of constrained inventory in certain key product categories, overall weakness in customer demand for wood flooring and the adverse impact of winter weather, unusual in severity, geographic scale and duration.

We believe up to \$24 million of net sales were lost due to constrained inventory levels of certain key

- merchandise categories, primarily laminate, vinyl plank and engineered hardwood, as customer demand was either lost or converted to substitute products at lower retail prices.

We believe the severity of the weather required a number of customers to reprioritize home improvement projects, including flooring, and a portion of that demand was either delayed to 2015 or indefinitely suspended. We estimated approximately 650 basis points of underperformance in comparing the net sales in 131 of our stores operating in areas most severely impacted and net sales in the remainder of our stores.

A lower average sale in 2014 was due to a 1.9% net decrease in the average retail price per unit sold, partially offset by an increase in the number of units sold. Changes in the sales mix of flooring, including clearance of products not a part of our continuing assortment, an increase in liquidation deals and greater ad-hoc discounting at the point of sale drove down the average retail price per unit sold. Partially offsetting this decrease were increases in sales mix of moldings and accessories, non-merchandise services and Bellawood products.

Seven store locations serving communities recovering from the effects of Hurricane Sandy reduced total comparable store net sales by 35 to 45 basis points in 2014. Comparable store net sales benefited 40 to 50 basis points in 2013 from these locations.

Store base expansion drove the increase in non-comparable store net sales as we expanded our store base unit count by 10.7%, 10.4% and 9.5% in 2014, 2013 and 2012, respectively, with 34, 30 and 25 locations, respectively, opened in existing markets where brand awareness tends to increase first year net sales per unit relative to a new market.

Net sales of delivery and installation services were \$32.3 million in 2014, up from \$16.1 million in 2013.

Net sales for 2013 increased \$186.9 million, or 23.0%, over 2012 as net sales in comparable stores increased \$128.2 million and net sales in non-comparable stores increased \$58.7 million. In addition to the factors noted above, net sales were impacted by the following factors:

Net sales in comparable stores increased 15.8% comparing 2013 to 2012 with an increase of 9.2% attributable to the increase in the number of customers invoiced and an increase of 6.6% in the average sale.

We believe the number of customers invoiced in comparable stores benefited from greater recognition of our value proposition due to our efforts to expand our advertising reach and frequency.

We believe the average sale benefited from increases in the average retail price per unit sold due primarily to changes in the sales mix of flooring products, stronger retail price discipline at the point of sale and increases in the sales mix of moldings and accessories.

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	Year Ended December 31,		
	2014	2013	2012
	(dollars in thousands)		
Net Sales	\$ 1,047,419	\$ 1,000,240	\$ 813,327
Cost of Sales	629,252	589,257	504,542
Gross Profit	\$ 418,167	\$ 410,983	\$ 308,785
Gross Margin	39.9 %	41.1 %	38.0 %

We believe that the significant drivers within gross margin and their estimated impact compared to the prior year are as follows:

Driver	Description	Year Ended December 31,		
		2014	2013 <sup>(1)</sup>	2012 <sup>(1)</sup>
		expansion (contraction) in basis points		
Product	Cost of acquiring the products we sell from our suppliers, including the impact of our sourcing initiatives; Customs and duty charges; Changes in the mix of products sold; Changes in the average retail price per unit sold; Changes in the average retail price and related cost of services, including installation and delivery; Changes in finishing costs to produce a unit of our proprietary brands. International and domestic transportation costs, including the impact of international container rates; Fuel and fuel surcharges;	(130)	300	250
Transportation	Impact of vendor shipments received directly by our stores; Transportation charges from our distribution centers to our stores and between stores.	10	20	10
All Other	Investments in our quality control procedures; Warranty and customer satisfaction costs; Inventory shrink; Net costs of producing samples.		(10 )	10
	<b>Total Change in Gross Margin from the prior year</b>	<b>(120)</b>	<b>310</b>	<b>270</b>

(1) The cost of delivery to our customers has been reclassified from Transportation to Product.

*Product:* Gross margin was impacted by the following:

In 2014, gross margin was adversely impacted by net shifts in our sales mix of flooring products, including sales of substitute product while inventories of certain key products were constrained, clearance of Bellawood products which would not be a part of our continuing assortment, and the marketing changes implemented to strengthen our value proposition.

In 2014, greater ad-hoc discounting at the point of sale, reversing 2013 and 2012 trends of improving retail price discipline at the point of sale.

- Moldings and accessories, which generally produce a gross margin higher than flooring, increased within our total merchandise sales mix to 20.1% in 2014 from 18.9% in 2013 and 16.7% in 2012.
- Increases in customers choosing installation and delivery services, which have average gross margins less than our average merchandise transaction.
- Sourcing initiatives, including line reviews and the percentage of product we source direct from the mill, generally lowered net costs from our suppliers and increased vendor allowances.

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*Transportation:* Gross margin was impacted by changes in our supply chain structure, changes in international and domestic transportation rates and certain operational efficiencies.

Gross margin benefited in 2014 and 2013 from generally lower average international transportation rates. In 2014, lower international rates were primarily driven by shipments to our West Coast distribution center, which were significantly less than rates to the East Coast.

Gross margin in 2014 was not materially impacted by domestic costs other than delivery, as the increase in domestic miles traveled due to increasing inventory levels was offset by a net lower average cost per domestic mile. In 2013, gross margin benefited from lower aggregate domestic costs as the impact of the reduction in the average cost per mile traveled was greater than the impact of increased domestic miles.

*All Other Costs:* Gross margin was impacted in 2014 due to greater costs of merchandise obsolescence and shrink, including increased inventory reserves, and our increased investment in quality control and assurance, offset by lower sample and customer satisfaction costs.

Higher total inventory levels carried throughout 2014 and the significant product transitions due to the Bellawood transition and efforts to mitigate the adverse impact of constrained inventory with substitute product resulted in higher 2014 shrink and an increase in the inventory reserve for loss or obsolescence. Inventory obsolescence and shrink increased 24.3% in comparing 2014 to 2013, and the reserve at December 31, 2014 was \$3.2 million, up from \$1.3 million at the end of 2013.

In 2013 and 2012, gross margin benefitted from supply chain initiatives to improve the accuracy and visibility of product movement within the distribution centers and the stores, thereby lowering inventory shrink.

Improvements to production efficiency lowered the cost per sample, more than offsetting an increase in sample requests.

Investments in quality control and customer support training, combined with improved control over installation, resulted in lower aggregate customer satisfaction costs.

Operating Income and Operating Margin

	Year Ended December 31,		
	2014	2013	2012
	(dollars in thousands)		
Gross Profit	\$ 418,167	\$ 410,983	\$ 308,785
SG&A Expenses	314,094	284,960	230,439
Operating Income	\$ 104,073	\$ 126,023	\$ 78,346
Operating Margin	9.9 %	12.6 %	9.6 %

The following table sets forth components of our SG&A expenses for the periods indicated, as a percentage of net sales. Individual line items include the impact of our finishing operations, with a credit for these expenses included in other SG&A expenses.

	Year Ended December 31,			
	2014	2013	2012	
Total SG&A Expenses	<b>30.0 %</b>	<b>28.5 %</b>	<b>28.3 %</b>	
Salaries, Commissions and Benefits	11.8 %	12.1 %	12.1 %	
Advertising	7.9 %	7.6 %	7.2 %	
Occupancy	4.2 %	3.5 %	3.7 %	
Depreciation and Amortization	1.4 %	1.1 %	1.2 %	
Stock-based Compensation	0.5 %	0.6 %	0.5 %	
Other SG&A Expenses	4.2 %	3.6 %	3.6 %	



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Operating income for 2014 decreased \$21.9 million over 2013 as the \$7.2 million increase in gross profit was more than fully offset by a \$29.1 million increase in SG&A expenses. Operating income for 2013 increased \$47.7 million over 2012 as the \$102.2 million increase in gross profit was partially offset by a \$54.5 million increase in SG&A expenses. The net increase in SG&A expenses included the following:

Salaries, commissions and benefits increased in both 2014 and 2013 primarily due to store base growth, corporate support, including global compliance, our test of installation services management, the start-up and operations of the West Coast distribution center and higher net cost of benefits. These expenses were partially offset in 2014 by lower commission rates earned by our store management and lower accruals related to our management bonus plan, as compared to 2013.

Advertising expenses increased as a percentage of net sales as we continued to broaden our reach and frequency, partially offset by leverage of our national advertising campaigns over a larger store base.

Occupancy costs increased primarily due to store base expansion and incremental expense related to the West Coast distribution center, which became fully operational during the first quarter of 2014.

Depreciation and amortization increased primarily due to store base expansion, remodeling existing stores and the West Coast distribution center.

Stock-based compensation in 2013 included a special grant of restricted stock to certain members of management in March 2013 which fully vested in March 2014. In addition, our chief executive officer, who does not participate in our regular annual grant of equity, was awarded a grant of stock options and restricted stock in March 2013 which resulted in approximately \$0.8 million and \$0.6 million of expense in 2014 and 2013, respectively.

Other SG&A expenses included lower reimbursements under our national installation arrangement, incremental costs related to the West Coast distribution center and approximately \$13.6 million and \$10.6 million of legal and professional fees in 2014 and 2013, respectively.

Total incremental SG&A expenses related to the West Coast distribution center, primarily occupancy and wages, were approximately \$5.9 million in 2014. We incurred incremental transition expenses related to the East Coast distribution center of approximately \$0.5 million in the fourth quarter of 2014.

**Provision for Income Taxes**

	Year Ended December 31,		
	2014	2013	2012
	(dollars in thousands)		
Provision for Income Taxes	\$ 40,212	\$ 49,070	\$ 31,422
Effective Tax Rate	38.8 %	38.8 %	40.0 %

The effective tax rate may vary due to changes in state taxes and certain reserves. The increase in the 2012 effective tax rate was due to a \$1.3 million valuation allowance recorded in the fourth quarter. Our Canadian operations, which included the first stores opening in March 2011, had produced a cumulative net loss through 2012. Management determined that the positive evidence supporting future realization of the deferred tax asset was outweighed by the more objectively verifiable negative evidence, and a full valuation allowance was recorded. As the Canadian operations have remained in a cumulative loss position in both 2013 and 2014, a full valuation allowance has continued to be recorded with incremental adjustments each year due to an increase in the net operating loss. Absent the change in the valuation allowance, the effective tax rate for 2014, 2013 and 2012 would have approximated 38.1%, 38.2% and 38.5%, respectively.

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	Year Ended December 31,		
	2014	2013	2012
	(dollars in thousands)		
Net Income	\$ 63,371	\$ 77,395	\$ 47,064
As a percentage of net sales	6.1 %	7.7 %	5.8 %

Net income for the year ended December 31, 2014 decreased 18.1% over the year ended December 31, 2013. Net income for the year ended December 31, 2013 increased 64.4% over the year ended December 31, 2012.

**Liquidity and Capital Resources**

Our principal liquidity and capital requirements are for capital expenditures to maintain and grow our business, working capital and general corporate purposes. We periodically use excess cash flow to repurchase shares of our common stock under our stock repurchase program. Our principal sources of liquidity are \$20.3 million of cash and cash equivalents at December 31, 2014, our cash flow from operations, and \$47.3 million of availability under our revolving credit facility. We believe that cash flow from operations, together with existing liquidity sources, will be sufficient to fund our operations and anticipated capital expenditures for the foreseeable future.

In 2015, we expect capital expenditures to total between \$25 million and \$35 million. In addition to general capital requirements, we intend to:

- open between 30 and 35 new store locations, using up to \$10 million of cash;
- remodel or relocate 15 to 20 existing stores, using up to \$5 million of cash;
- complete our East Coast distribution center and new finishing line;
- continue to invest in vertical integration initiatives;
- continue to invest in integrated information technology systems; and
- continue to improve the effectiveness of our marketing programs.

**Cash and Cash Equivalents**

In 2014, cash and cash equivalents decreased \$60.3 million to \$20.3 million. The decrease of cash and cash equivalents was primarily due to \$53.3 million of net cash used to repurchase common stock and \$71.1 million for capital expenditures partially offset by net cash provided by operating activities of \$57.1 million.

In 2013, cash and cash equivalents increased \$16.5 million to \$80.6 million. The increase of cash and cash equivalents was primarily due to \$53.0 million of net cash provided by operating activities and \$27.4 million of proceeds received from stock option exercises which was partially offset by the use of \$34.8 million to repurchase common stock and \$28.6 million for capital expenditures.

In 2012, cash and cash equivalents increased \$2.5 million to \$64.2 million. The increase of cash and cash equivalents was primarily due to \$47.3 million of net cash provided by operating activities and \$17.6 million of proceeds received from stock option exercises which was partially offset by the use of \$49.4 million to repurchase common stock and \$13.4 million for capital expenditures.



## **Merchandise Inventories**

Merchandise inventory is our most significant asset, and is considered either available for sale or inbound in-transit, based on whether we have physically received and inspected the products at an individual store location, in our distribution centers or in another facility where we control and monitor inspection.

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Merchandise inventories and available inventory per store in operation on December 31 were as follows:

	2014	2013	2012
	(in thousands)		
Inventory Available for Sale	\$ 265,949	\$ 212,617	\$ 168,409
Inventory Inbound In-Transit	48,422	39,811	38,295
Total Merchandise Inventories	<b>\$ 314,371</b>	<b>\$ 252,428</b>	<b>\$ 206,704</b>
Available Inventory Per Store	<b>\$ 756</b>	<b>\$ 669</b>	<b>\$ 585</b>

Available inventory per store at December 31, 2014 was higher than both December 31, 2013 and December 31, 2012 due to weaker than expected net sales, increases in merchandise categories previously constrained and increases in moldings and accessories. In addition, inventory levels were higher as we prepared for transition and consolidation of our East Coast distribution operations in the first quarter of 2015, and in anticipation of Chinese New Year which was later in February than most years. Further, inventory within our Californian distribution facility was elevated to provide a measure of safety stock while a new labor contract was negotiated for west coast ports. We expect 2015 inventory levels to decrease in comparison to 2014 by the end of June and normalize in the range of \$640,000 to \$690,000 per store throughout the second half of 2015.

Inbound in-transit inventory generally varies due to the timing of certain international shipments and certain seasonal factors, including international holidays, rainy seasons and specific merchandise category planning.

## Cash Flows

**Operating Activities.** Net cash provided by operating activities was \$57.1 million for 2014, \$53.0 million for 2013, and \$47.3 million for 2012. The \$4.1 million increase in net cash comparing 2014 to 2013 is primarily due to an increase in customer deposits and store credits and a reduction in merchandise inventories, net of the change in accounts payable. These increases were offset by less profitable operations. The \$5.7 million increase in net cash comparing 2013 to 2012 is primarily due to more profitable operations which were partially offset by a larger and earlier build in merchandise inventories net of the change in accounts payable.

**Investing Activities.** Net cash used in investing activities was \$71.1 million for 2014, \$28.6 million for 2013, and \$13.4 million for 2012. Net cash used in investing activities in each year included capital purchases for store base expansion, and investments in and maintenance of forklifts, our integrated information technology solution, our finishing lines and our Corporate Headquarters. In 2014 and 2013, capital expenditures also included remodeling of existing stores to our expanded showroom format and \$37.6 million and \$8.4 million, respectively, for land, buildings and equipment for the East Coast distribution facility and \$1.2 million and \$2.1 million, respectively, for equipment and leasehold improvements for the West Coast distribution facility.

**Financing Activities.** Net cash used by financing activities was \$46.2 million in 2014, \$7.4 million in 2013 and \$31.9 million in 2012. We used cash of \$53.3 million, \$34.8 million and \$49.4 million in 2014, 2013 and 2012, respectively, to repurchase our common stock, primarily under our stock repurchase program initiated in February 2012. Stock option exercises provided \$7.2 million, \$27.3 million and \$17.5 million in 2014, 2013 and 2012, respectively. During 2014, we borrowed \$53.0 million under our revolving credit facility to fund capital expenditures and inventory purchases, however, this amount was fully repaid by year-end.

## Revolving Credit Agreement

A revolving credit agreement (the Revolver ) providing for borrowings up to \$50.0 million is available to us through expiration on February 21, 2017. During 2014, we borrowed and repaid a total of \$53.0 million against the Revolver, and during 2013 and 2012, we did not borrow against the Revolver. The Revolver supported \$2.7 million and \$2.3 million of letters of credit at December 31, 2014 and 2013, respectively. At December 31, 2012, there were no outstanding commitments under letters of credit. The Revolver is primarily available to fund inventory purchases, including the support of up to \$10.0 million for letters of credit, and for

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general operations. The Revolver is secured by our inventory, has no mandated payment provisions and we pay a fee of 0.1% per annum, subject to adjustment based on certain financial performance criteria, on any unused portion of the

Revolver. Amounts outstanding under the Revolver would be subject to an interest rate of LIBOR plus 1.125%, subject to adjustment based on certain financial performance criteria. The Revolver has certain defined covenants and restrictions, including the maintenance of certain defined financial ratios. We were in compliance with these financial covenants at December 31, 2014.

## Related Party Transactions

See the discussion of related party transactions in Note 4 and Note 9 to the consolidated financial statements included in Item 8 of this report and within Certain Relationships and Related Transactions, and Director Independence in Item 13 of this report.

## Contractual Commitments and Contingencies

Our significant contractual obligations and commitments as of December 31, 2014 are summarized in the following table:

	Payments Due by Period				
	Total	Less Than 1 Year	1 to 3 Years	3 to 5 Years	5+ Years
	(in thousands)				
Contractual obligations					
Operating lease obligations <sup>(1)</sup>	\$ 125,027	\$ 27,391	\$ 44,763	\$ 28,535	\$ 24,338
Purchase obligations <sup>(2)</sup>	4,041	4,041			
Total contractual obligations	\$ 129,068	\$ 31,432	\$ 44,763	\$ 28,535	\$ 24,338

(1) Included in this table is the base period or current renewal period for our operating leases. The operating leases generally contain varying renewal provisions.

(2) Purchase obligations represent capital expenditure commitments for the completion of the East Coast distribution center and new finishing line.

## Off-Balance Sheet Arrangements

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

## Inflation

Inflationary factors such as increases in the cost of our product and overhead costs may adversely affect our operating results. Although we do not believe that inflation has had a material impact on our financial position or results of operations to date, a high rate of inflation in the future may have an adverse effect on our ability to maintain current levels of gross profit and SG&A expenses as a percentage of net sales if the selling prices of our products do not increase with these increased costs.

## **Critical Accounting Policies and Estimates**

Critical accounting policies are those that we believe are both significant and that require us to make difficult, subjective or complex judgments, often because we need to estimate the effect of inherently uncertain matters. We base our estimates and judgments on historical experiences and various other factors that we believe to be appropriate under the circumstances. Actual results may differ from these estimates, and we might obtain different estimates if we used different assumptions or conditions. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our financial statements:

### **Recognition of Net Sales**

We recognize net sales for products purchased at the time the customer takes possession of the merchandise. We recognize service revenue, which consists primarily of installation revenue and freight charges for in-home delivery, when the service has been rendered. We report sales exclusive of sales taxes

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collected from customers and remitted to governmental taxing authorities. Net sales are reduced by an allowance for anticipated sales returns that we estimate based on historical and current sales trends and experience. We believe that our estimate for sales returns is an accurate reflection of future returns. Any reasonably likely changes that may occur in the assumptions underlying our allowance estimates would not be expected to have a material impact on our financial condition or operating performance. Actual sales returns did not vary materially from estimated amounts for 2014, 2013 or 2012.

In addition, customers who do not take immediate delivery of their purchases are generally required to pay a deposit, equal to approximately half of the retail sales value, with the balance payable when the customer takes possession of the merchandise. These customer deposits benefit our cash flow and return on investment capital, because we receive partial payment for our customers' purchases immediately. We record these deposits as a liability on our balance sheet in customer deposits and store credits until the customer takes possession of the merchandise.

### **Merchandise Inventories**

We value our merchandise inventories at the lower of merchandise cost or market value. We determine merchandise cost using the average cost method. All of the hardwood flooring we purchase from suppliers is either prefinished or unfinished, and in immediate saleable form. To the extent that we finish and box unfinished products, we include those costs in the average unit cost of related merchandise inventory. In determining market value, we make judgments and estimates as to the market value of our products, based on factors such as historical results and current sales trends. Any reasonably likely changes that may occur in those assumptions in the future may require us to record charges for losses or obsolescence against these assets, but would not be expected to have a material impact on our financial condition or operating performance. Actual losses and obsolescence charges did not vary materially from estimated amounts for 2014, 2013 or 2012.

### **Stock-Based Compensation**

We currently utilize a single equity incentive plan under which we may grant non-qualified stock options, restricted shares, stock appreciation rights and other equity awards to employees, non-employee directors and other service providers. We recognize expense for our stock-based compensation based on the fair value of the awards that are granted. Compensation expense is recognized only for those awards expected to vest, with forfeitures estimated at the date of grant based on our historical experience and future expectations. Measured compensation cost is recognized ratably over the service period of the entire related stock-based compensation award.

The fair value of stock options was estimated at the date of grant using the Black-Scholes-Merton valuation model. In order to determine the related stock-based compensation expense, we used the following assumptions for stock options granted during 2014:

Expected life of 5.5 years;  
Expected stock price volatility of 45%;  
Risk-free interest rate of 1.8%; and  
Dividends are not expected to be paid in any year.

The expected stock price volatility is based on the historical volatility of our stock price. The volatility is estimated for a period of time equal to the expected term of the related option. The risk-free interest rate is based on the implied yield of U.S. Treasury zero-coupon issues with an equivalent remaining term. The expected term of the options represents the estimated period of time until exercise and is determined by considering the contractual terms, vesting schedule and expectations of future employee behavior. Had we arrived at different assumptions of stock price

volatility or expected terms of our options, our stock-based compensation expense and results of operations could have been different.

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## **Item 7A. Quantitative and Qualitative Disclosures About Market Risk.**

### **Interest Rate Risk.**

We are exposed to interest rate risk through the investment of our cash and cash equivalents. We invest our cash in short-term investments with maturities of three months or less. Changes in interest rates affect the interest income we earn, and therefore impact our cash flows and results of operations. In addition, borrowings under our revolving credit agreement are exposed to interest rate risk due to the variable rate of the facility. As of December 31, 2014, no amounts were outstanding under the Revolver.

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

### **Exchange Rate Risk.**

Less than two percent of our revenue, expense and capital purchasing activities are transacted in currencies other than the U.S. dollar, including the Euro, Canadian dollar, Chinese yuan and Brazilian real.

We currently do not engage in any exchange rate hedging activity and currently have no intention to do so in the foreseeable future. However, in the future, in an effort to mitigate losses associated with these risks, we may at times engage in transactions involving various derivative instruments to hedge revenues, inventory purchases, assets and liabilities denominated in foreign currencies.



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# Report of Ernst & Young LLP, Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of Lumber Liquidators Holdings, Inc.

We have audited the accompanying consolidated balance sheets of Lumber Liquidators Holdings, Inc. as of December 31, 2014 and 2013, and the related consolidated statements of income, other comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2014. Our audits also included Financial Statement Schedule II Analysis of Valuation and Qualifying Accounts for each of the three years in the period ended December 31, 2014. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Lumber Liquidators Holdings, Inc. at December 31, 2014 and 2013, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2014, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Lumber Liquidators Holdings, Inc.'s internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated February 25, 2015 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Richmond, Virginia  
February 25, 2015

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# Report of Ernst & Young LLP, Independent Registered Public Accounting Firm, on Internal Control over Financial Reporting

The Board of Directors and Stockholders of Lumber Liquidators Holdings, Inc.

We have audited Lumber Liquidators Holdings, Inc.'s internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). Lumber Liquidators Holdings, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

In our opinion, Lumber Liquidators Holdings, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Lumber Liquidators Holdings, Inc. as of December 31, 2014 and 2013, and the related consolidated statements of income, other comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2014 and our report dated February 25, 2015 expressed an

unqualified opinion thereon.

/s/ Ernst & Young LLP

Richmond, Virginia  
February 25, 2015

TABLE OF CONTENTS**Lumber Liquidators Holdings, Inc.****Consolidated Balance Sheets  
(in thousands, except share data)**

	December 31,	
	2014	2013
Assets		
Current Assets:		
Cash and Cash Equivalents	\$20,287	\$ 80,634
Merchandise Inventories	314,371	252,428
Prepaid Expenses	5,575	6,229
Other Current Assets	17,044	12,916
Total Current Assets	<b>357,277</b>	<b>352,207</b>
Property and Equipment, net	124,867	65,947
Goodwill	9,693	9,693
Other Assets	1,625	1,712
Total Assets	<b>\$493,462</b>	<b>\$ 429,559</b>
Liabilities and Stockholders' Equity		
Current Liabilities:		
Accounts Payable	\$80,303	\$ 56,327
Customer Deposits and Store Credits	34,943	22,377
Accrued Compensation	3,693	11,709
Sales and Income Tax Liabilities	7,472	4,878
Other Current Liabilities	17,836	11,709
Total Current Liabilities	<b>144,247</b>	<b>107,000</b>
Deferred Rent	6,603	4,169
Deferred Tax Liability	10,558	9,061
Stockholders' Equity:		
Common Stock (\$0.001 par value; 35,000,000 shares authorized; 27,069,307 and 27,557,570 shares outstanding, respectively)	30	30
Treasury Stock, at cost (2,816,780 and 2,133,307 shares, respectively)	(138,692)	(85,382 )
Additional Capital	177,479	164,581
Retained Earnings	294,033	230,662
Accumulated Other Comprehensive Loss	(796 )	(562 )
Total Stockholders' Equity	<b>332,054</b>	<b>309,329</b>
Total Liabilities and Stockholders' Equity	<b>\$493,462</b>	<b>\$ 429,559</b>

*See accompanying notes to consolidated financial statements*



TABLE OF CONTENTS**Lumber Liquidators Holdings, Inc.****Consolidated Statements of Income  
(in thousands, except share data and per share  
amounts)**

	Year Ended December 31,		
	2014	2013	2012
Net Sales	<b>\$1,047,419</b>	<b>\$1,000,240</b>	<b>\$813,327</b>
Cost of Sales	629,252	589,257	504,542
Gross Profit	418,167	410,983	308,785
Selling, General and Administrative Expenses	314,094	284,960	230,439
Operating Income	104,073	126,023	78,346
Other (Income) Expense	490	(442)	(140)
Income Before Income Taxes	103,583	126,465	78,486
Provision for Income Taxes	40,212	49,070	31,422
Net Income	<b>\$63,371</b>	<b>\$77,395</b>	<b>\$47,064</b>
Net Income per Common Share Basic	<b>\$2.32</b>	<b>\$2.82</b>	<b>\$1.71</b>
Net Income per Common Share Diluted	<b>\$2.31</b>	<b>\$2.77</b>	<b>\$1.68</b>
Weighted Average Common Shares Outstanding:			
Basic	27,264,882	27,484,790	27,448,333
Diluted	27,485,852	27,914,322	28,031,453

*See accompanying notes to consolidated financial statements*

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**Lumber Liquidators Holdings, Inc.**

**Consolidated Statements of Other Comprehensive  
Income  
(in thousands)**

	Year Ended December 31,		
	2014	2013	2012
Net Income	<b>\$ 63,371</b>	<b>\$ 77,395</b>	<b>\$ 47,064</b>
Foreign Currency Translation Adjustments	(234 )	(635 )	267
Comprehensive Income	<b>\$ 63,137</b>	<b>\$ 76,760</b>	<b>\$ 47,331</b>

*See accompanying notes to consolidated financial statements*



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**Lumber Liquidators Holdings, Inc.**

**Consolidated Statements of Stockholders Equity  
(in thousands, except share data)**

*See accompanying notes to consolidated financial statements*

TABLE OF CONTENTS**Lumber Liquidators Holdings, Inc.****Consolidated Statements of Cash Flows  
(in thousands)**

	Year Ended December 31,		
	2014	2013	2012
Cash Flows from Operating Activities:			
Net Income	\$63,371	\$77,395	\$47,064
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:			
Depreciation and Amortization	14,714	11,666	9,957
Deferred Income Taxes	(152 )	(846 )	160
Stock-Based Compensation Expense	5,593	5,974	3,997
Changes in Operating Assets and Liabilities:			
Merchandise Inventories	(62,140)	(45,834)	(42,712 )
Accounts Payable	21,478	(15 )	16,756
Customer Deposits and Store Credits	12,623	(3,354 )	7,626
Prepaid Expenses and Other Current Assets	(1,836 )	(257 )	(2,835 )
Other Assets and Liabilities	3,436	8,271	7,256
Net Cash Provided by Operating Activities	<b>57,087</b>	<b>53,000</b>	<b>47,269</b>
Cash Flows from Investing Activities:			
Purchases of Property and Equipment	(71,138)	(28,585)	(13,376 )
Net Cash Used in Investing Activities	<b>(71,138)</b>	<b>(28,585)</b>	<b>(13,376 )</b>
Cash Flows from Financing Activities:			
Payments for Stock Repurchases	(53,310)	(34,830)	(49,436 )
Proceeds from the Exercise of Stock Options	3,150	10,255	10,454
Excess Tax Benefit from Stock-Based Compensation	4,004	17,132	7,131
Borrowings on Revolving Credit Facility	53,000		
Payments on Revolving Credit Facility	(53,000)		
Net Cash Used in Financing Activities	<b>(46,156)</b>	<b>(7,443 )</b>	<b>(31,851 )</b>
Effect of Exchange Rates on Cash and Cash Equivalents	(140 )	(505 )	450
Net (Decrease) Increase in Cash and Cash Equivalents	<b>(60,347)</b>	<b>16,467</b>	<b>2,492</b>
Cash and Cash Equivalents, Beginning of Year	<b>80,634</b>	<b>64,167</b>	<b>61,675</b>
Cash and Cash Equivalents, End of Year	<b>\$20,287</b>	<b>\$80,634</b>	<b>\$64,167</b>

*See accompanying notes to consolidated financial statements*

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## **Lumber Liquidators Holdings, Inc.**

### **Notes to Consolidated Financial Statements (amounts in thousands, except share data and per share amounts)**

#### **Note 1. Summary of Significant Accounting Policies**

##### **Nature of Business**

Lumber Liquidators Holdings, Inc. and its direct and indirect subsidiaries (collectively and, where applicable, individually, the Company) engage in business as a multi-channel specialty retailer of hardwood flooring, and hardwood flooring enhancements and accessories, operating as a single business segment. The Company offers an extensive assortment of exotic and domestic hardwood species, engineered hardwood, laminate and vinyl plank flooring direct to the consumer. The Company also features the renewable flooring products, bamboo and cork, and provides a wide selection of flooring enhancements and accessories, including moldings, noise-reducing underlay, adhesives and flooring tools. In a limited number of its stores, the Company also offers ceramic and mosaic tile, stone and porcelain. These products are primarily sold under the Company's private label brands, including the premium Bellawood brand floors. The Company also provides in-home delivery and installation services to certain of its customers. The Company sells primarily to homeowners or to contractors on behalf of homeowners through a network of 343 store locations in primary or secondary metropolitan areas in 46 states and nine store locations in Canada at December 31, 2014. In addition to the store locations, the Company's products may be ordered, and customer questions/concerns addressed, through both its call center in Toano, Virginia, and its website, [www.lumberliquidators.com](http://www.lumberliquidators.com). The Company finishes the majority of the Bellawood products on its finishing lines in Toano, Virginia, which along with the call center, corporate offices, and a distribution center, represent the Corporate Headquarters.

##### **Organization and Basis of Financial Statement Presentation**

The consolidated financial statements of Lumber Liquidators Holdings, Inc., a Delaware corporation, include the accounts of its wholly owned subsidiaries. All significant intercompany transactions have been eliminated in consolidation. Certain reclassifications have been made to prior year amounts to conform to the current year presentation.

##### **Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

## **Cash and Cash Equivalents**

The Company had cash equivalents of \$12,700 and \$9,333 at December 31, 2014 and 2013, respectively. The Company considers all highly liquid investments with a maturity date of three months or less when purchased to be cash equivalents, of which there was nil and \$170 at December 31, 2014 and 2013, respectively. The Company accepts a range of debit and credit cards, and these transactions are generally transmitted to a bank for reimbursement within 24 hours. The payments due from the banks for these debit and credit card transactions are generally received, or settle, within 24 to 48 hours of the transmission date. The Company considers all debit and credit card transactions that settle in less than seven days to be cash and cash equivalents. Amounts due from the banks for these transactions classified as cash and cash equivalents totaled \$12,700 and \$9,163 at December 31, 2014 and 2013, respectively.

## **Credit Programs**

Credit is offered to the Company's customers through a proprietary credit card, the Lumber Liquidators credit card, underwritten by a third party financial institution and at no recourse to the Company. A credit line is offered to the Company's professional customers through the Lumber Liquidators Commercial Credit Program. This commercial credit program is underwritten by a third party financial institution, generally with no recourse to the Company.

As part of the credit program, the Company's customers may use their Lumber Liquidators credit card to tender installation services provided by the Company's third party installation provider, who is responsible for

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## **Lumber Liquidators Holdings, Inc.**

### **Notes to Consolidated Financial Statements (amounts in thousands, except share data and per share amounts)**

#### **Note 1. Summary of Significant Accounting Policies (continued)**

all credits and program fees for the related transactions. The Company has agreed to indemnify the financial institution against any losses related to these credits or fees. There are no maximum potential future payments under the guarantee. The Company is able to seek recovery from the installation provider of any amounts paid on its behalf. The Company believes that the risk of significant loss from the guarantee of these obligations is remote.

#### **Fair Value of Financial Instruments**

The carrying amounts of financial instruments such as cash and cash equivalents, accounts payable and other liabilities approximate fair value because of the short-term nature of these items. Of these financial instruments, the cash equivalents are classified as Level 1 as defined in the Financial Accounting Standards Board Accounting Standards Codification ( FASB ASC ) 820 fair value hierarchy.

#### **Merchandise Inventories**

The Company values merchandise inventories at the lower of cost or market value. Merchandise cost is determined using the average cost method. All of the hardwood flooring purchased from vendors is either prefinished or unfinished, and in immediate saleable form. The Company adds the finish to, and boxes, various species of unfinished product, to produce certain proprietary products, primarily Bellawood, at its finishing facility. These finishing and boxing costs are included in the average unit cost of related merchandise inventory. The Company maintains an inventory reserve for loss or obsolescence based on historical results and current sales trends. This reserve was \$3,242 and \$1,275 at December 31, 2014 and 2013, respectively.

#### **Impairment of Long-Lived Assets**

The Company evaluates potential impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets may be impaired, and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amounts of those assets. If impairment exists and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amount of those assets, an impairment loss is recorded based on the difference between the carrying value and fair value of the assets. No impairment charges were recognized in 2014, 2013 or 2012.

## **Goodwill and Other Indefinite-Lived Intangibles**

Goodwill represents the costs in excess of the fair value of net assets acquired associated with acquisitions by the Company. Other assets include \$800 for an indefinite-lived intangible asset for the phone number 1-800-HARDWOOD and related internet domain names. The Company evaluates these assets for impairment on an annual basis, or whenever events or changes in circumstance indicate that the asset carrying value exceeds its fair value. Based on the analysis performed, the Company has concluded that no impairment in the value of these assets has occurred.

### **Self Insurance**

The Company is self-insured for certain employee health benefit claims and for certain workers' compensation claims.

The Company estimates a liability for aggregate losses below stop-loss coverage limits based on estimates of the ultimate costs to be incurred to settle known claims and claims incurred but not reported as of the balance sheet date. The estimated liability is not discounted and is based on a number of assumptions and factors including historical and industry trends and economic conditions. This liability could be affected if future occurrences and claims differ from these assumptions and historical trends. As of December 31, 2014 and 2013, an accrual of \$1,585 and \$1,305 related to estimated claims was included in other current liabilities, respectively.

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## **Lumber Liquidators Holdings, Inc.**

### **Notes to Consolidated Financial Statements (amounts in thousands, except share data and per share amounts)**

#### **Note 1. Summary of Significant Accounting Policies (continued)**

##### **Recognition of Net Sales**

The Company recognizes net sales for products purchased at the time the customer takes possession of the merchandise. Service revenue, primarily installation revenue and freight charges for in-home delivery, is included in net sales and recognized when the service has been rendered. The Company reports sales exclusive of sales taxes collected from customers and remitted to governmental taxing authorities, and net of an allowance for anticipated sales returns based on historical and current sales trends and experience. The sales returns allowance and related changes were not significant for 2014, 2013 or 2012.

The Company generally requires customers to pay a deposit, equal to approximately half of the retail sales value, when purchasing merchandise inventories not regularly carried in a given store location, or not currently in stock.

These deposits are included in customer deposits and store credits until the customer takes possession of the merchandise.

##### **Cost of Sales**

Cost of sales includes the cost of the product sold, cost of installation services, transportation costs from vendor to the Company's distribution centers or store locations, any applicable finishing costs related to production of the Company's proprietary brands, transportation costs from distribution centers to store locations, transportation costs for the delivery of products from store locations to customers, certain costs of quality control procedures, inventory adjustments including shrinkage, and costs to produce samples, reduced by vendor allowances.

The Company offers a range of limited warranties from the durability of the finish on its prefinished products to its services provided. These limited warranties range from one to 100 years. Warranty reserves are based primarily on claims experience, sales history and other considerations, including payments made to satisfy customers for claims not directly related to the warranty on the Company's products. Warranty costs are recorded in cost of sales. This reserve was \$1,568 and \$1,009 at December 31, 2014 and 2013, respectively. The Company is able to seek recovery from its vendors and installation providers for certain amounts paid.

Vendor allowances primarily consist of volume rebates that are earned as a result of attaining certain purchase levels and reimbursement for the cost of producing samples. Vendor allowances are accrued as earned, with those allowances received as a result of attaining certain purchase levels accrued over the incentive period based on estimates of purchases. Volume rebates earned are initially recorded as a reduction in merchandise inventories and a

subsequent reduction in cost of sales when the related product is sold. Reimbursement received for the cost of producing samples is recorded as an offset against cost of sales.

### **Advertising Costs**

Advertising costs charged to selling, general and administrative ( SG&A ) expenses, net of vendor allowances, were \$82,604, \$75,506 and \$58,548 in 2014, 2013 and 2012, respectively. The Company uses various types of media to brand its name and advertise its products. Media production costs are generally expensed as incurred, except for direct mail, which is expensed when the finished piece enters the postal system. Media placement costs are generally expensed in the month the advertising occurs, except for contracted endorsements and sports agreements, which are generally expensed ratably over the contract period. Amounts paid in advance are included in prepaid expenses and totaled \$1,549 and \$2,893 at December 31, 2014 and 2013, respectively.

### **Store Opening Costs**

Costs to open new store locations are charged to SG&A expenses as incurred, net of any vendor support.



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## **Lumber Liquidators Holdings, Inc.**

### **Notes to Consolidated Financial Statements (amounts in thousands, except share data and per share amounts)**

#### **Note 1. Summary of Significant Accounting Policies (continued)**

##### **Other Vendor Consideration**

Consideration from non-merchandise vendors, including royalties and rebates, are generally recorded as an offset to SG&A expenses when earned.

##### **Depreciation and Amortization**

Property and equipment is carried at cost and depreciated on the straight-line method over the estimated useful lives. The estimated useful lives for leasehold improvements are the shorter of the estimated useful lives or the remainder of the lease terms. For leases with optional renewal periods, the Company uses the original lease term, excluding optional renewal periods, to determine the appropriate estimated useful lives. Capitalized software costs are capitalized from the time that technological feasibility is established until the software is ready for use. The estimated useful lives are generally as follows:

	Years
Buildings and Building Improvements	15 to 40
Property and Equipment	5 to 25
Computer Software and Hardware	3 to 10
Leasehold Improvements	1 to 15

##### **Operating Leases**

The Company has operating leases for its stores, Corporate Headquarters, certain of its distribution facilities, supplemental office facilities and certain equipment. The lease agreements for certain stores and distribution facilities contain rent escalation clauses, rent holidays and tenant improvement allowances. For scheduled rent escalation clauses during the lease terms or for rental payments commencing at a date other than the date of initial occupancy, the Company records minimum rental expenses in SG&A expenses on a straight-line basis over the terms of the leases. The difference between the rental expense and rent paid is recorded as deferred rent on the consolidated balance sheets. For tenant improvement allowances, the Company records deferred rent on the consolidated balance sheets and amortizes the deferred rent over the terms of the leases as reductions to rental expense.

## **Stock-Based Compensation**

The Company records compensation expense associated with stock options and other forms of equity compensation in accordance with FASB ASC 718. The Company may issue incentive awards in the form of stock options, restricted shares and other equity awards to employees, non-employee directors and other service providers. The Company recognizes expense for its stock-based compensation based on the fair value of the awards that are granted. Compensation expense is recognized only for those awards expected to vest, with forfeitures estimated at the date of grant based on historical experience and future expectations. Measured compensation cost is recognized ratably over the requisite service period of the entire related stock-based compensation award.

## **Foreign Currency Translation**

The Company's Canadian operations use the Canadian dollar as the functional currency. Assets and liabilities are translated at exchange rates in effect at the balance sheet date. Revenues and expenses are translated at the average monthly exchange rates during the year. Resulting translation adjustments are recorded as a component of accumulated other comprehensive income on the consolidated balance sheets.

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## **Lumber Liquidators Holdings, Inc.**

### **Notes to Consolidated Financial Statements (amounts in thousands, except share data and per share amounts)**

#### **Note 1. Summary of Significant Accounting Policies (continued)**

##### **Income Taxes**

Income taxes are accounted for in accordance with FASB ASC 740 ( ASC 740 ). Income taxes are provided for under the asset and liability method and consider differences between the tax and financial accounting bases. The tax effects of these differences are reflected on the consolidated balance sheets as deferred income taxes and measured using the effective tax rate expected to be in effect when the differences reverse. ASC 740 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion of the deferred tax asset will not be realized. In evaluating the need for a valuation allowance, the Company takes into account various factors, including the nature, frequency and severity of current and cumulative losses, expected level of future taxable income, the duration of statutory carryforward periods and tax planning alternatives. In future periods, any valuation allowance will be re-evaluated in accordance with ASC 740, and a change, if required, will be recorded through income tax expense in the period such determination is made.

The Company recognizes the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the relevant taxing authorities, based on the technical merits of its position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The Company classifies interest and penalties related to income tax matters as a component of income tax expense.

##### **Net Income per Common Share**

Basic net income per common share is determined by dividing net income by the weighted average number of common shares outstanding during the year. Diluted net income per common share is determined by dividing net income by the weighted average number of common shares outstanding during the year, plus the dilutive effect of common stock equivalents, including stock options and restricted shares. Common stock and common stock equivalents included in the computation represent shares issuable upon assumed exercise of outstanding stock options and release of restricted shares, except when the effect of their inclusion would be antidilutive.

##### **Recent Accounting Pronouncements**

In May 2014, the FASB issued Accounting Standards Update No. 2014-09 ( ASU 2014-09 ), which creates ASC Topic 606, *Revenue from Contracts with Customers*, and supersedes the revenue recognition requirements in Topic 605, *Revenue Recognition*, including most industry-specific revenue recognition guidance throughout the Industry Topics

of the Codification. In addition, ASU 2014-09 supersedes the cost guidance in Subtopic 605-35, *Revenue Recognition – Construction-Type and Production-Type Contracts*, and creates new Subtopic 340-40, *Other Assets and Deferred Costs – Contracts with Customers*. In summary, the core principle of Topic 606 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The amendments in ASU 2014-09 are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, and early application is not permitted. Therefore, the amendments in ASU 2014-09 will become effective for the Company at the beginning of its 2017 fiscal year. The Company is currently assessing the impact of implementing the new guidance on its consolidated financial statements.

TABLE OF CONTENTS**Lumber Liquidators Holdings, Inc.****Notes to Consolidated Financial Statements  
(amounts in thousands, except share data and per  
share amounts)****Note 2. Property and Equipment**

Property and equipment consisted of:

	December 31,	
	2014	2013
Land	\$ 4,937	\$ 4,937
Property and Equipment	51,409	38,401
Computer Software and Hardware	40,071	38,317
Leasehold Improvements	30,715	22,230
Assets under Construction	51,097	8,095
	178,229	111,980
Less: Accumulated Depreciation and Amortization	53,362	46,033
Property and Equipment, net	\$ 124,867	\$ 65,947

As of December 31, 2014 and 2013, the Company had capitalized \$31,230 and \$28,391 of computer software costs, respectively. Amortization expense related to these assets was \$3,212, \$2,659 and \$2,388 for 2014, 2013 and 2012, respectively.

**Note 3. Revolving Credit Agreement**

A revolving credit agreement (the Revolver) providing for borrowings up to \$50,000 is available to the Company through expiration on February 21, 2017. The Revolver is primarily available to fund inventory purchases, including the support of up to \$10,000 for letters of credit, and for general operations. During 2014, a total of \$53,000 was borrowed against the Revolver, however, there were no outstanding borrowings against the Revolver at December 31, 2014. As of December 31, 2013 and 2012, there were no outstanding borrowings against the Revolver. As of December 31, 2014 and 2013, the Revolver supported \$2,685 and \$2,289 of letters of credit, respectively. Interest paid was \$84 in 2014 and nil in 2013 and 2012. The Revolver is secured by the Company's inventory, has no mandated payment provisions and a fee of 0.1% per annum, subject to adjustment based on certain financial performance criteria, on any unused portion of the Revolver. Amounts outstanding under the Revolver would be subject to an interest rate of LIBOR plus 1.125%, subject to adjustment based on certain financial performance criteria. The Revolver has certain defined covenants and restrictions, including the maintenance of certain defined financial ratios.

The Company was in compliance with these financial covenants at December 31, 2014.

## Note 4. Leases

The Company has operating leases for its stores, Corporate Headquarters, Hampton Roads and West Coast distribution centers, supplemental office facilities and certain equipment. The store location leases are operating leases and generally have five-year base periods with one or more five-year renewal periods. The Corporate Headquarters has an operating lease with a base term running through December 31, 2019. The Hampton Roads distribution centers have operating leases with varied expiration dates ending by March 31, 2015. The West Coast distribution center is an operating lease with a base term running through October 31, 2024.

As of December 31, 2014, 2013 and 2012, the Company leased the Corporate Headquarters, which includes a store location, and 30, 29 and 27 of its locations, representing 8.8%, 9.4% and 9.7% of the total number of store leases in operation, respectively, from entities controlled by the Company's founder and current chairman of the Board of Directors ( Controlled Companies ).

TABLE OF CONTENTS**Lumber Liquidators Holdings, Inc.****Notes to Consolidated Financial Statements  
(amounts in thousands, except share data and per  
share amounts)****Note 4. Leases (continued)**

Rental expense is as follows:

	Year Ended December 31,		
	2014	2013	2012
Rental expense	\$ 27,995	\$ 21,874	\$ 18,826
Rental expense related to Controlled Companies	2,837	2,895	2,725

The future minimum rental payments under non-cancellable operating leases, segregating Controlled Companies leases from all other operating leases, were as follows at December 31, 2014:

	Operating Leases		Store Leases	Distribution Centers & Other Leases	Total Operating Leases
	Store Leases	Headquarters Lease			
2015	\$ 1,635	\$ 1,234	\$ 21,988	\$ 2,534	\$ 27,391
2016	1,172	1,271	19,483	2,230	24,156
2017	887	1,309	16,236	2,175	20,607
2018	809	1,348	12,126	2,047	16,330
2019	455	1,388	8,382	1,980	12,205
Thereafter	923		12,932	10,483	24,338
Total minimum lease payments	\$ 5,881	\$ 6,550	\$ 91,147	\$ 21,449	\$ 125,027

**Note 5. Stockholders Equity****Net Income per Common Share**

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

	Year Ended December 31,		
	2014	2013	2012
Net Income	\$63,371	\$77,395	\$47,064
Weighted Average Common Shares Outstanding	27,264,882	27,484,790	27,448,333
Basic			

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Effect of Dilutive Securities:				
Common Stock Equivalents		220,970	429,532	583,120
Weighted Average Common Shares Outstanding		27,485,852	27,914,322	28,031,453
Diluted				
Net Income per Common Share	Basic	\$2.32	\$2.82	\$1.71
Net Income per Common Share	Diluted	\$2.31	\$2.77	\$1.68

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(amounts in thousands, except share data and per  
share amounts)****Note 5. Stockholders Equity (continued)**

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

	As of December 31,		
	2014	2013	2012
Stock Options	184,252	103,329	16,969
Restricted Shares	16,699	176	4,261

**Stock Repurchase Program**

In 2012, the Company's Board of Directors ( Board ) authorized the repurchase of up to \$100,000 of the Company's common stock from time to time on the open market or in privately negotiated transactions. In January 2014, the Company's Board authorized the repurchase of up to an additional \$50,000 of the Company's common stock, bringing the total authorization to \$150,000 and at December 31, 2014, the Company had \$14,728 remaining under this authorization. The Company has not purchased any stock through privately negotiated transactions. Purchases under this program were as follows:

	Year Ended December 31,		
	2014	2013	2012
Shares Repurchased	671,200	403,630	1,648,777
Average Price per Share	\$ 77.68	\$ 84.40	\$ 29.74
Total Aggregate Costs	\$ 52,138	\$ 34,066	\$ 49,068

**Note 6. Stock-Based Compensation**

Stock-based compensation expense included in SG&A expenses consisted of:

	Year Ended December 31,		
	2014	2013	2012
Stock Options, Restricted Shares and Stock Appreciation Rights	\$5,593	\$ 5,974	\$ 3,997

## Overview

On May 6, 2011, the Company's stockholders approved the Lumber Liquidators Holdings, Inc. 2011 Equity Compensation Plan (the 2011 Plan), which succeeded the Lumber Liquidators Holdings, Inc. 2007 Equity Compensation Plan. The 2011 Plan is an equity incentive plan for employees, non-employee directors and other service providers from which the Company may grant stock options, restricted shares, stock appreciation rights (SARs) and other equity awards. The total number of shares of common stock authorized for issuance under the 2011 Plan is 5.3 million. As of December 31, 2014, 1.4 million shares of common stock were available for future grants. Stock options granted under the 2011 Plan expire no later than ten years from the date of grant and the exercise price shall not be less than the fair market value of the shares on the date of grant. Vesting periods are assigned to stock options and restricted shares on a grant by grant basis at the discretion of the Board. The Company issues new shares of common stock upon exercise of stock options and vesting of restricted shares.

The Company also maintains the Lumber Liquidators Holdings, Inc. Outside Directors Deferral Plan under which each of the Company's non-employee directors has the opportunity to elect annually to defer certain fees until departure from the Board. A non-employee director may elect to defer up to 100% of his or her fees and have such fees invested in deferred stock units. Deferred stock units must be settled in common stock upon the director's departure from the Board. There were 63,279 and 57,724 deferred stock units outstanding at December 31, 2014 and 2013, respectively.

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(amounts in thousands, except share data and per  
share amounts)****Note 6. Stock-Based Compensation (continued)****Stock Options**

The following table summarizes activity related to stock options:

	Shares	Weighted Average Exercise Price	Remaining Average Contractual Term (Years)	Aggregate Intrinsic Value
Balance, December 31, 2011	2,194,347	\$ 14.42	6.6	\$ 12,746
Granted	182,281	25.73		
Exercised	(937,048 )	11.16		
Forfeited	(128,203 )	19.94		
Balance, December 31, 2012	1,311,377	\$ 17.79	6.5	\$ 45,954
Granted	214,966	62.52		
Exercised	(718,665 )	14.35		
Forfeited	(58,188 )	29.04		
Balance, December 31, 2013	749,490	\$ 33.04	7.3	\$ 52,358
Granted	79,126	100.05		
Exercised	(149,707 )	21.04		
Forfeited	(26,101 )	60.71		
Balance, December 31, 2014	652,808	\$ 42.81	6.9	\$ 18,113
Exercisable at December 31, 2014	181,834	\$ 22.90	5.3	\$ 7,974
Vested and expected to vest, December 31, 2014	652,808	\$ 42.81	6.9	\$ 18,113

The aggregate intrinsic value is the difference between the exercise price and the closing price of the Company's common stock on December 31. The intrinsic value of the stock options exercised during 2014, 2013 and 2012 was \$10,278, \$49,137 and \$22,881, respectively.

As of December 31, 2014, total unrecognized compensation cost related to unvested options was approximately \$6,487, net of estimated forfeitures, which is expected to be recognized over a weighted average period of approximately 2.3 years.

The fair value of each stock option award is estimated by management on the date of the grant using the Black-Scholes-Merton option pricing model. The weighted average fair value of options granted during 2014, 2013

and 2012 was \$43.21, \$29.66 and \$12.68, respectively.

The following are the ranges of assumptions for the periods noted:

	Year Ended December 31,					
	2014	2013		2012		
Expected dividend rate	0%	0%		0%		
Expected stock price volatility	45%	45%		45%		
Risk-free interest rate	1.8%	1.3	2.0%	1.0	1.6%	
Expected term of options	5.5 years	6.0	7.5 years	6.5	7.5 years	

The expected stock price volatility is based on the historical volatility of the Company's stock price and in 2013 and 2012, also included the historical volatilities of companies included in a peer group that was selected by management whose shares or options are publicly available. The volatilities are estimated for a period of time equal to the expected term of the related option. The risk-free interest rate is based on the implied yield of U.S. Treasury zero-coupon issues with an equivalent remaining term. The expected term of

TABLE OF CONTENTS**Lumber Liquidators Holdings, Inc.****Notes to Consolidated Financial Statements  
(amounts in thousands, except share data and per  
share amounts)****Note 6. Stock-Based Compensation (continued)**

the options represents the estimated period of time until exercise and is determined by considering the contractual terms, vesting schedule and expectations of future employee behavior.

**Restricted Shares**

The following table summarizes activity related to restricted shares:

	Shares	Weighted Average Grant Date Fair Value
Nonvested, December 31, 2011	142,120	\$ 15.08
Granted	66,425	27.62
Released	(43,529 )	29.41
Forfeited	(12,611 )	21.58
Nonvested, December 31, 2012	152,405	\$ 15.19
Granted	80,814	66.11
Released	(38,362 )	75.73
Forfeited	(16,522 )	37.51
Nonvested, December 31, 2013	178,335	\$ 22.82
Granted	38,260	89.46
Released	(45,503 )	95.02
Forfeited	(14,003 )	54.90
Nonvested, December 31, 2014	157,089	\$ 15.00

The fair value of restricted shares released during 2014, 2013 and 2012 was \$4,371, \$3,060 and \$1,391, respectively.

As of December 31, 2014, total unrecognized compensation cost related to unvested restricted shares was approximately \$2,834, net of estimated forfeitures, which is expected to be recognized over a weighted average period of approximately 1.9 years.

**Stock Appreciation Rights**

The following table summarizes activity related to SARs:

	Shares	Weighted Average Exercise Price	Remaining Average Contractual Term (Years)	Aggregate Intrinsic Value
Balance, December 31, 2011		\$		\$
Granted	9,796	24.71		
Forfeited	(495 )	24.35		
Balance, December 31, 2012	9,301	\$ 24.72	8.9	\$ 261
Granted	7,533	71.84		
Forfeited	(678 )	57.95		
Balance, December 31, 2013	16,156	\$ 45.30	8.7	\$ 938
Granted	1,941	107.28		
Forfeited	(1,870 )	92.97		
Balance, December 31, 2014	16,227	\$ 48.16	7.8	\$ 389
Exercisable at December 31, 2014	6,707	\$ 39.13	7.6	\$ 192

The fair value method, estimated by management using the Black-Scholes-Merton option pricing model, is used to recognize compensation cost associated with SARs.

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(amounts in thousands, except share data and per  
share amounts)****Note 7. Income Taxes**

The components of income before income taxes were as follows:

	Year Ended December 31,		
	2014	2013	2012
United States	\$ 105,447	\$ 128,482	\$ 80,565
Foreign	(1,864 )	(2,017 )	(2,079 )
Total Income before Income Taxes	\$ 103,583	\$ 126,465	\$ 78,486

The provision for income taxes consisted of the following:

	Year Ended December 31,		
	2014	2013	2012
Current			
Federal	\$ 34,615	\$ 43,159	\$ 26,949
State	5,614	6,637	4,195
Foreign	135	120	118
Total Current	40,364	49,916	31,262
Deferred			
Federal	(22 )	(745 )	(387 )
State	(130 )	(101 )	(164 )
Foreign			711
Total Deferred	(152 )	(846 )	160
Total Provision for Income Taxes	\$ 40,212	\$ 49,070	\$ 31,422

The reconciliation of significant differences between income tax expense applying the federal statutory rate and the actual income tax expense at the effective rate are as follows:

	Year Ended December 31,					
	2014		2013		2012	
Income Tax Expense at Federal Statutory Rate	\$36,254	35.0 %	\$44,263	35.0 %	\$27,470	35.0 %
Increases (Decreases):						
State Income Taxes, Net of Federal Income Tax Benefit	3,711	3.6 %	4,146	3.3 %	2,542	3.2 %

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Valuation Allowance	458	0.4 %	498	0.4 %	1,267	1.6 %
Foreign Operations	329	0.3 %	328	0.2 %	283	0.4 %
Other	(540 )	(0.5 )%	(165 )	(0.1 )%	(140 )	(0.2 )%
Total	\$40,212	38.8%	\$49,070	38.8%	\$31,422	40.0%

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(amounts in thousands, except share data and per  
share amounts)****Note 7. Income Taxes (continued)**

The tax effects of temporary differences that result in significant portions of the deferred tax accounts are as follows:

	December 31,	
	2014	2013
Deferred Tax Liabilities:		
Prepaid Expenses	\$ (77 )	\$ (72 )
Depreciation and Amortization	(16,900 )	(13,763 )
Other		(1,325 )
Total Gross Deferred Tax Liabilities	(16,977 )	(15,160 )
Deferred Tax Assets:		
Stock-Based Compensation Expense	3,785	3,104
Reserves	4,296	2,697
Employee Benefits	15	2,663
Inventory Capitalization	7,188	4,887
Foreign Operations	2,223	1,765
Other	37	
Total Gross Deferred Tax Assets	17,544	15,116
Less Valuation Allowance	(2,223 )	(1,765 )
Total Net Deferred Tax Assets	15,321	13,351
Net Deferred Tax Liability	\$ (1,656 )	\$ (1,809 )

In both 2014 and 2013, the Canadian operations were in a cumulative loss position. As such, the Company has recorded a full valuation allowance on the net deferred tax assets in Canada. For the year ended December 31, 2014, the valuation allowance increased by \$458 primarily as a result of an increase in the Canadian net operating loss. In future periods, the allowance could be reduced if sufficient evidence exists indicating that it is more likely than not that a portion or all of these deferred tax assets will be realized.

As of December 31, 2014 and 2013, the Company had Canadian net operating loss carryforwards of \$8,577 and \$7,069, respectively, which begin to expire in 2030. These net operating losses may be carried forward up to 20 years to offset future taxable income.

The Company made income tax payments of \$33,281, \$30,154 and \$29,035 in 2014, 2013 and 2012, respectively.

The reconciliation of unrecognized tax benefits was as follows:

	Year Ended December 31,		
	2014	2013	2012
Balance at beginning of year	\$ 915	\$ 574	\$ 294
Increases based on tax positions related to the current year	430	341	280
Increases for tax positions of prior years	161		
Lapse of statute	(274 )		
Balance at end of year	\$ 1,232	\$ 915	\$ 574

As of December 31, 2014, the Company had \$1.2 million of gross unrecognized tax benefits, \$0.8 million of which, if recognized, would affect the effective tax rate. It is reasonably possible that the amount of the unrecognized tax benefit with respect to certain of the uncertain tax positions will increase or decrease during the next 12 months; however, the Company does not expect the change to have a significant

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## **Lumber Liquidators Holdings, Inc.**

### **Notes to Consolidated Financial Statements (amounts in thousands, except share data and per share amounts)**

#### **Note 7. Income Taxes (continued)**

effect on its results of operations, financial position or cash flows. As of December 31, 2013, the Company had \$0.9 million of gross unrecognized tax benefits, \$0.6 million of which, if recognized, would affect the effective tax rate. As of December 31, 2012, the Company had \$0.6 million of gross unrecognized tax benefits, \$0.4 million of which, if recognized, would affect the effective tax rate.

The Company files income tax returns with the U.S. federal government and various state and foreign jurisdictions. In the normal course of business, the Company is subject to examination by taxing authorities. The Internal Revenue Service has completed audits of the Company's federal income tax returns for years through 2009.

#### **Note 8. Profit-sharing Plan**

The Company maintains a profit-sharing plan, qualified under Section 401(k) of the Internal Revenue Code, for all eligible employees. Employees are eligible to participate following the completion of three months of service and attainment of age 21. In 2013, the Company amended the plan to a safe harbor plan, and began matching 100% of the first 3% of employee contributions and 50% of the next 2% of employee contributions. Additionally, employees are now immediately 100% vested in the Company's matching contributions. Prior to 2013, the Company matched 50% of employee contributions up to 6% of eligible compensation. The Company's matching contributions, included in SG&A expenses, totaled \$1,937, \$1,590 and \$749 in 2014, 2013 and 2012, respectively.

#### **Note 9. Related Party Transactions**

The Company is party to an agreement dated June 1, 2010 with Designers Surplus, LLC t/a Cabinets to Go (CTG). The Company's founder is the sole member of an entity that owns a significant interest in CTG. Pursuant to the terms of the agreement, the Company provides certain advertising, marketing and other services. The Company charges CTG for its services at rates believed to be at fair market value. The revenue recognized by the Company from this agreement was nil in 2014 and 2013 and \$55 in 2012.

As described in Note 4, the Company leases a number of its store locations and Corporate Headquarters from Controlled Companies.

#### **Note 10. Commitments and Contingencies**

## **Prusak Matter**

On August 30, 2012, Jaroslaw Prusak, a purported customer ( Prusak ), filed a putative class action lawsuit, which was subsequently amended, against the Company in the United States District Court for the Northern District of Illinois (the Prusak Lawsuit ). Prusak alleged that the Company willfully violated the Fair and Accurate Credit Transactions Act amendments to the Fair Credit Reporting Act in connection with electronically printed credit card receipts provided to certain of its customers. In the operative complaint, Prusak, for himself and the putative class, sought statutory and punitive damages, attorneys fees and costs, and other relief. Although the Company believed it has valid defenses to the claims asserted, the Company agreed to a settlement of the claims in the lawsuit for approximately \$705, which was previously accrued. At December 31, 2014, the Company had a remaining accrual of \$468, which was subsequently paid in January 2015.

## **Government Investigation**

On September 26, 2013, sealed search warrants were executed at the Company s corporate offices in Toano and Richmond, Virginia by the Department of Homeland Security s Immigration and Customs Enforcement and the U.S. Fish and Wildlife Service. The search warrants requested information, primarily documentation, related to the importation of certain of the Company s wood flooring products. Since then, the Company has been cooperating with the federal authorities, including the Department of Justice ( DOJ ), in

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## **Lumber Liquidators Holdings, Inc.**

### **Notes to Consolidated Financial Statements (amounts in thousands, except share data and per share amounts)**

#### **Note 10. Commitments and Contingencies (continued)**

their investigation. In recent communications, the DOJ indicated that it is contemplating seeking criminal charges under the Lacey Act. The Company expects to continue to communicate with the DOJ regarding its intentions and possible courses of action in this matter. At this time, the Company does not have enough information to estimate a reasonably possible loss or range of loss that may result from actions by the DOJ as a result of its investigation.

#### **Kiken Matter**

On or about November 26, 2013, Gregg Kiken ( Kiken ) filed a securities class action lawsuit, which was subsequently amended, in the United States District Court for the Eastern District of Virginia against the Company, its founder, Chief Executive Officer and President, Chief Financial Officer and Chief Merchandising Officer (collectively, the Kiken Defendants ). In the amended complaint, Kiken and an additional plaintiff, Keith Foster (together with Kiken, the Plaintiffs ), allege that the Kiken Defendants made material false and/or misleading statements and failed to disclose material adverse facts about the Company s business, operations and prospects. In particular, the Plaintiffs allege that the Kiken Defendants made material misstatements or omissions related to the Company s compliance with the federal Lacey Act and the chemical content of certain of its wood products. In addition to attorneys fees and costs, the Plaintiffs seek to recover damages on behalf of themselves and other persons who purchased or otherwise acquired the Company s stock during the putative class period at allegedly inflated prices and purportedly suffered financial harm as a result. The Company disputes the Plaintiffs claims and intends to defend the matter vigorously. Given the uncertainty of litigation, the preliminary stage of the case, insurance coverage issues 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 of loss that may result from this action.

#### **TCPA Matter**

On or about March 4, 2014, Richard Wade Architects, P.C. ( RWA ) filed a lawsuit in the United States District Court for the Northern District of Illinois (the RWA Lawsuit ), which was subsequently amended, alleging that Lumber Liquidators violated the Telephone Consumer Protection Act ( TCPA ), the Illinois Consumer Fraud Act and the common law by sending an unsolicited facsimile advertisement to RWA. RWA seeks recourse on its own behalf as well as other similarly situated parties that received unsolicited facsimile advertisements from the Company. The TCPA provides for recovery of actual damages or five hundred dollars for each violation, whichever is greater. If it is determined that a defendant acted willfully or knowingly in violating the TCPA, the amount of the award may be increased by up to three times the amount provided above. Although the Company believes it has valid defenses to the claims asserted, based upon the proceedings to date, at December 31, 2014, the Company has accrued \$300, including \$25 in the fourth quarter of 2014, as its best estimate of the probable loss that may result from this action.

## Prop 65 Matter

On or about July 23, 2014, Global Community Monitor and Sunshine Park LLC (together, the Prop 65 Plaintiffs ) filed a lawsuit, which was subsequently amended, in the Superior Court of the State of California, County of Alameda, against the Company. In the complaint, the Prop 65 Plaintiffs allege that the Company violated California's Safe Drinking Water and Toxic Enforcement Act of 1986, Health and Safety Code section 25249.5, et seq. ( Proposition 65 ). In particular, the Prop 65 Plaintiffs allege that the Company failed to warn consumers in California that certain of the Company's products (collectively, the Products ) emit formaldehyde in excess of the applicable safe harbor limits. In addition to attorneys' fees and costs, the Prop 65 Plaintiffs seek (i) equitable relief involving the reformulation of the Products, additional warnings related to the Products, the issuance of notices to certain of the purchasers of the Products (the Customers ) and the waiver of restocking fees for Customers who return the Products and (ii) civil penalties in the amount of two thousand five hundred dollars per day for each violation of Proposition 65. The Company disputes the claims of the Prop 65 Plaintiffs and intends to defend the matter vigorously. Further, the Company has filed a

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## **Lumber Liquidators Holdings, Inc.**

### **Notes to Consolidated Financial Statements (amounts in thousands, except share data and per share amounts)**

#### **Note 10. Commitments and Contingencies (continued)**

counterclaim against the Prop 65 Plaintiffs for trade libel, unfair business practices, intentional interference with a prospective business advantage, negligent interference with economic relations, and declaratory relief. Given the uncertainty of litigation, the preliminary stage of the case, and the legal standards that must be met for, among other things, success on the merits, the Company cannot estimate the reasonably possible loss or range of loss that may result from this action.

#### **Hallandale Matter**

On or about September 17, 2014, the City of Hallandale Beach Police Officers and Firefighters Personnel Retirement Trust ( Hallandale ) filed a securities class action lawsuit in the United States District Court for the Eastern District of Virginia against the Company, its Chief Executive Officer and President and its Chief Financial Officer (collectively, the Hallandale Defendants ). In the complaint, Hallandale alleges that the Hallandale Defendants made material false and/or misleading statements that caused losses to investors. In particular, Hallandale alleges that the Hallandale Defendants made material misstatements or omissions regarding the Company's supply chain and inventory position. In addition to attorneys' fees and costs, Hallandale seeks to recover damages on behalf of itself and other persons who purchased or otherwise acquired the Company's stock during the putative class period at allegedly inflated prices and purportedly suffered financial harm as a result. The Company disputes Hallandale's claims and intends to defend the matter vigorously. Given the uncertainty of litigation, the preliminary stage of the case, insurance coverage issues 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 of loss that may result from this action.

#### **Gold Matter**

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 (the Bamboo Product ) that the Company sells is defective. On February 13, 2015, Gold filed an amended complaint, which added three additional plaintiffs (collectively with Gold, Gold Plaintiffs ). Gold Plaintiffs allege that the Company has engaged in unfair business practices and unfair competition by falsely representing the quality and characteristics of the Bamboo Product and by concealing the Bamboo Product's defective nature. Gold Plaintiffs seek the certification of two separate classes: (i) individuals in the United States who own homes or other structures where the Bamboo Product has been installed or where Bamboo Product has been removed and replaced; and (ii) the same description but for owners of California homes or structures only. In addition to attorneys' fees and costs, Gold Plaintiffs seek (i) a declaration that the Company is financially responsible for notifying all purported class members, (ii) injunctive relief requiring the Company to replace and/or repair all of the Bamboo Product installed in structures owned by the purported class members, and (iii) a declaration that the Company must disgorge, for the benefit of the purported classes, all or part of

its profits received from the sale of the defective Bamboo Product and/or to make full restitution to Gold Plaintiffs and the purported class members. The Company disputes the Gold Plaintiffs' claims and intends to defend the matter vigorously. Given the uncertainty of litigation, the preliminary stage of the case, insurance coverage issues 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 of loss that may result from this action.

### **Balero Matter**

On or about December 11, 2014, Joseph Michael Balero, Michael Ballerini and Lisa Miller (collectively, the Balero Plaintiffs) filed a purported class action lawsuit in the Superior Court of the State of California for the County of Alameda alleging that the Company engaged in unlawful and fraudulent business practices by selling certain products in California that do not comply with California's Airborne Toxic Control Measure to Reduce Formaldehyde Emissions from Composite Wood Products (the CARB Standards) and by falsely



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## **Lumber Liquidators Holdings, Inc.**

### **Notes to Consolidated Financial Statements (amounts in thousands, except share data and per share amounts)**

#### **Note 10. Commitments and Contingencies (continued)**

advertising and representing that such products meet the CARB standards. The purported class consists of all California consumers that purchased the subject products since 2011. In addition to attorneys' fees and costs, the Balero Plaintiffs seek (i) declarations that the Company's policies and practices of labeling, advertising, distributing and selling certain products it sells in California violate the CARB standards, (ii) injunctive relief prohibiting the Company from continuing to distribute and/or sell laminate flooring products that violate the CARB standards, (iii) restitution of all money and/or property that the Balero Plaintiffs and other purported class members provided to the Company for the purchase and installation of certain products sold by the Company that allegedly violate the CARB Standards, and (iv) damages, including actual, compensatory and consequential, incurred by the Balero Plaintiffs and other purported class members in connection with the Company's alleged breach of warranty. The Company disputes the claims of the Balero Plaintiffs and intends to defend the matter vigorously. Given the uncertainty of litigation, the preliminary stage of the case, insurance coverage issues 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 of loss that may result from this action.

#### **Antidumping and Countervailing Duties Investigation**

In October 2010, a conglomeration of domestic manufacturers of multilayered wood flooring 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 the Company's engineered hardwood imported from China, which accounted for approximately 11% of its flooring purchases in 2014.

The DOC made preliminary determinations regarding CVD and AD rates in April 2011 and May 2011, respectively. In December 2011, after certain determinations were made by the ITC and DOC, orders were issued setting final AD and CVD rates at 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 preliminary determinations of April 2011 and May 2011.

Following the issuance of the orders, a number of appeals were filed by several parties, including the Company, challenging various aspects of the determinations made by both the ITC and DOC, including certain aspects that may impact the validity of the AD and CVD orders and the applicable rates. The appeal of the CVD order is expected to be concluded by mid-2015. On January 23, 2015, the Court of International Trade issued a final decision rejecting the challenge of the AD rate for all but one Chinese exporter. This decision is expected to be appealed to the Court of Appeals for the Federal Circuit later in 2015 and may take a year to conclude.

As part of its processes in these proceedings, the DOC conducts annual reviews of the CVD and AD rates. In such cases, the DOC issues preliminary rates that are not binding and 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.

In the first annual review in this matter, rates were modified for AD rates through November 2012 and for CVD rates through 2011. Specifically, the AD rate was set at 5.92% and the CVD rate was set at 0.83%. These rates are being appealed by several parties, including the Company. Nevertheless, at December 31, 2014, the Company was paying these rates on each applicable purchase.

In January 2015, pursuant to the second annual review, the DOC issued a preliminary AD rate of 18.27% for purchases from December 2012 through November 2013 and a preliminary CVD rate of 0.97% for purchases in fiscal year 2012. These rates are pending final determinations by the DOC which are currently

TABLE OF CONTENTS**Lumber Liquidators Holdings, Inc.****Notes to Consolidated Financial Statements  
(amounts in thousands, except share data and per  
share amounts)****Note 10. Commitments and Contingencies (continued)**

planned to be finalized in May 2015. If these rates are confirmed, the Company would owe approximately \$5,700 for shipments during the applicable time periods. If these rates remain in effect for shipments subsequent to November 2013 (AD) and shipments subsequent to December 2012 (CVD), the Company would owe an additional \$6,300 for all shipments through December 31, 2014. As this is a preliminary rate, the Company has not recorded an accrual in its consolidated financial statements for the impact of higher rates for the applicable time periods covered in the second annual review.

Based on the information available, the Company believes there is at least a reasonable possibility that an additional loss may have been incurred in the range of \$0 to \$12,700.

The third annual review of the AD and CVD rates has been initiated in February 2015, with preliminary rates expected in late 2015 or early 2016. Any change in the applicable rates as a result of the third annual review would apply to imports occurring after the second period of review.

**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, the Company's ultimate liability in connection with these matters is not expected to have a material adverse effect on the results of operations, financial position or cash flows.

**Note 11. Condensed Quarterly Financial Information (unaudited)**

The following tables present the Company's unaudited quarterly results for 2014 and 2013.

	Quarter Ended			
	March 31, 2014	June 30, 2014	September 30, 2014	December 31, 2014
Net Sales	\$246,291	\$263,085	\$266,067	\$271,976
Gross Profit	101,287	106,238	104,158	106,484
Selling, General and Administrative Expenses	78,866	79,066	78,377	77,805
Operating Income	22,421	27,172	25,781	28,679
Net Income	\$13,694	\$16,607	\$15,725	\$17,345

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Net Income per Common Share Basic	\$0.50	\$0.61	\$0.58	\$0.64
Net Income per Common Share Diluted	\$0.49	\$0.60	\$0.58	\$0.64
Number of Stores Opened in Quarter	13	13	5	3
Comparable Store Net Sales Decrease	(0.6 )%	(7.1 )%	(4.9 )%	(4.2 )%

	Quarter Ended			
	March 31, 2013	June 30, 2013	September 30, 2013	December 31, 2013
Net Sales	\$ 230,418	\$ 257,111	\$ 254,278	\$ 258,433
Gross Profit	92,997	106,079	106,375	105,531
Selling, General and Administrative Expenses	67,589	72,992	73,109	71,270
Operating Income	25,408	33,087	33,266	34,262
Net Income	\$ 15,781	\$ 20,422	\$ 20,397	\$ 20,795
Net Income per Common Share Basic	\$ 0.58	\$ 0.74	\$ 0.74	\$ 0.75
Net Income per Common Share Diluted	\$ 0.57	\$ 0.73	\$ 0.73	\$ 0.74
Number of Stores Opened in Quarter	5	7	7	11
Comparable Store Net Sales Increase	15.2 %	14.9 %	17.4 %	15.6 %

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## **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.**

None.

### **Item 9A. Controls and Procedures.**

An evaluation was performed under the supervision and with the participation of our management, including our Chief Executive Officer (principal executive officer) and Chief Financial Officer (principal financial officer), of the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (Exchange Act), as of the end of the period covered by this report.

Based on that evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective as of December 31, 2014 and designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

## **Management's Annual Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance of achieving their control objectives.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2014. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control – Integrated Framework* (2013 framework). Based on our assessment and those criteria, management believes that we maintained effective internal control over financial reporting as of December 31, 2014.

Our independent registered public accounting firm, Ernst & Young LLP, has issued a report on our internal controls over financial reporting as of December 31, 2014. See Item 8. Consolidated Financial Statements and Supplementary Data.

### **Changes in Internal Control over Financial Reporting**

There have not been any changes in our internal control over financial reporting during the quarter ended December 31, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial

reporting.

## **Item 9B. Other Information.**

None.

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**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance.**

The information required by this Item is incorporated by reference from the definitive proxy statement for our 2015 annual meeting of shareholders, which will be filed no later than 120 days after December 31, 2014.

**Code of Ethics**

We have a Code of Business Conduct and Ethics, which applies to all employees, officers and directors of Lumber Liquidators Holdings, Inc. and its direct and indirect subsidiaries. Our Code of Business Conduct and Ethics meets the requirements of a code of ethics as defined by Item 406 of Regulation S-K, and applies to our Chief Executive Officer, Chief Financial Officer (who is both our principal financial and principal accounting officer), as well as all other employees. Our Code of Business Conduct and Ethics also meets the requirements of a code of conduct under Rule 303A.10 of the NYSE Listed Company Manual. Our Code of Business Conduct and Ethics is posted on our website at [www.lumberliquidators.com](http://www.lumberliquidators.com) in the Corporate Governance section of our Investor Relations home page.

We intend to provide any required disclosure of an amendment to or waiver from our Code of Business Conduct and Ethics on our website at [www.lumberliquidators.com](http://www.lumberliquidators.com) in the Corporate Governance section of our Investor Relations home page promptly following the amendment or waiver. We may elect to disclose any such amendment or waiver in a report on Form 8-K filed with the SEC either in addition to or in lieu of the website disclosure. The information contained on or connected to our website is not incorporated by reference in this report and should not be considered part of this or any other report that we file with or furnish to the SEC.

**Item 11. Executive Compensation.**

The information required by this Item is incorporated by reference from the definitive proxy statement for our 2015 annual meeting of shareholders, which will be filed no later than 120 days after December 31, 2014.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

The information required by this Item is incorporated by reference from the definitive proxy statement for our 2015 annual meeting of shareholders, which will be filed no later than 120 days after December 31, 2014.

**Item 13. Certain Relationships and Related Transactions, and Director Independence.**

The information required by this Item is incorporated by reference from the definitive proxy statement for our 2015 annual meeting of shareholders, which will be filed no later than 120 days after December 31, 2014.

## **Item 14. Principal Accountant Fees and Services.**

The information required by this Item is incorporated by reference from the definitive proxy statement for our 2015 annual meeting of shareholders, which will be filed no later than 120 days after December 31, 2014.

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## **PART IV**

### **Item 15. Exhibits, Financial Statement Schedules.**

(a) The following documents are filed as part of this annual report:

#### **Consolidated Financial Statements**

Refer to the financial statements filed as part of this annual report in Part II, Item 8.

#### **1. Financial Statement Schedules.**

The following financial statement schedule is filed as part of this annual report under Schedule II – Analysis of Valuation and Qualifying Accounts for the years ended December 31, 2014, 2013 and 2012. All other financial statement schedules have been omitted because the required information is either included in the financial statements or the notes thereto or is not applicable.

#### **2. Exhibits.**

The exhibits listed on the accompanying Exhibit Index are filed or incorporated by reference as part of this report.

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**Lumber Liquidators Holdings, Inc.**  
**Schedule II Analysis of Valuation and Qualifying**  
**Accounts**  
**For the Years Ended December 31, 2014, 2013 and**  
**2012**  
**(in thousands)**

	Balance	Additions	Deductions <sup>(1)</sup>	Other	Balance
	Beginning	Charged			End
	of Year	to Cost			of Year
		and			
		Expenses			
For the Year Ended December 31, 2012:					
Reserve deducted from assets to which it applies					
Inventory reserve for loss or obsolescence	\$ 500	\$2,150	\$ (1,615 )	\$	\$ 1,035
Income tax valuation allowance	\$	\$1,267	\$	\$	\$ 1,267
For the Year Ended December 31, 2013:					
Reserve deducted from assets to which it applies					
Inventory reserve for loss or obsolescence	\$ 1,035	\$1,465	\$ (1,225 )	\$	\$ 1,275
Income tax valuation allowance	\$ 1,267	\$498	\$	\$	\$ 1,765
For the Year Ended December 31, 2014:					
Reserve deducted from assets to which it applies					
Inventory reserve for loss or obsolescence	\$ 1,275	\$3,198 <sup>(2)</sup>	\$ (1,231 )	\$	\$ 3,242
Income tax valuation allowance	\$ 1,765	\$458	\$	\$	\$ 2,223

(1) Deductions are for the purposes for which the reserve was created.

(2) Addition of \$1,200 for reserves related to the Company's Bellawood transition.

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## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on February 25, 2015.

LUMBER LIQUIDATORS HOLDINGS, INC.

/s/ Robert M. Lynch

By:

Robert M. Lynch  
President and Chief Executive Officer

Pursuant to the requirements of the Securities and Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on February 25, 2015.

Signature	Title
/s/ Robert M. Lynch Robert M. Lynch	President, Chief Executive Officer and Director (Principal Executive Officer)
/s/ Daniel E. Terrell  Daniel E. Terrell	Chief Financial Officer (Principal Financial and Principal Accounting Officer)
/s/ Thomas D. Sullivan  Thomas D. Sullivan	Chairman of the Board
/s/ Macon F. Brock, Jr.  Macon F. Brock, Jr.	Director
/s/ Douglas T. Moore  Douglas T. Moore	Director
/s/ John M. Presley  John M. Presley	Director
/s/ Peter B. Robinson  Peter B. Robinson	Director
/s/ Martin F. Roper  Martin F. Roper	Director
/s/ Nancy M. Taylor  Nancy M. Taylor	Director
/s/ Jimmie L. Wade  Jimmie L. Wade	Director



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**EXHIBIT INDEX**

Exhibit Number	Exhibit Description
3.01	Certificate of Incorporation of Lumber Liquidators Holdings, Inc. (filed as Exhibit 3.1 to the Company's current report on Form 8-K, filed on January 4, 2010 (File No. 001-33767), and incorporated by reference)
3.02	By-Laws of Lumber Liquidators Holdings, Inc. (filed as Exhibit 3.2 to the Company's current report on Form 8-K, filed on January 4, 2010 (File No. 001-33767), and incorporated by reference)
4.01	Form of Certificate of Common Stock of Lumber Liquidators Holdings, Inc. (filed as Exhibit 4.1 to the Company's current report on Form 8-K, filed on January 4, 2010 (File No. 001-33767), and incorporated by reference)
10.01*	Lumber Liquidators Holdings, Inc. 2011 Equity Compensation Plan (filed as Exhibit 10.1 to the Company's Registration Statement on Form S-8, filed May 6, 2011 (File No. 333-173981), and incorporated by reference)
10.02*	Lumber Liquidators 2007 Equity Compensation Plan (filed as Exhibit 10.1 to the Company's Post-effective Amendment No. 1 to its Registration Statement on Form S-8, filed January 4, 2010 (File No. 333-147247), and incorporated by reference)
10.03*	Lumber Liquidators 2006 Equity Plan for Non-Employee Directors (filed as Exhibit 10.2 to the Company's Post-effective Amendment No. 1 to its Registration Statement on Form S-8, filed January 4, 2010 (File No. 333-147247), and incorporated by reference)
10.04*	Lumber Liquidators 2004 Stock Option and Grant Plan (filed as Exhibit 10.3 to the Company's Post-effective Amendment No. 1 to its Registration Statement on Form S-8, filed January 4, 2010 (File No. 333-147247), and incorporated by reference)
10.05*	Offer Letter Agreement with Marco Pescara (filed as Exhibit 10.06 to the Company's Registration Statement on Form S-1, filed April 23, 2007 (File No. 333-142309), and incorporated by reference)
10.06*	Form of Non-Qualified Employee Stock Option Agreement, effective October 18, 2006 (filed as Exhibit 10.07 to the Company's Registration Statement on Form S-1, filed April 23, 2007 (File No. 333-142309), and incorporated by reference)
10.07	Lease by and between ANO LLC and Lumber Liquidators (relating to Toano facility) (filed as Exhibit 10.08 to the Company's Amendment No. 1 to its Registration Statement on Form S-1, filed May 30, 2007 (File No. 333-142309), and incorporated by reference)
10.08*	Form of Option Award Agreement, effective November 16, 2007 (filed as Exhibit 10.10 to the Company's annual report on Form 10-K, filed on March 12, 2008 (File No. 001-33767), and incorporated by reference)
10.09*	Form of Restricted Stock Agreement, effective November 16, 2007 (filed as Exhibit 10.11 to the Company's annual report on Form 10-K, filed on March 12, 2008 (File No. 001-33767), and incorporated by reference)
10.10*	Form of Option Award Agreement, effective December 31, 2010 (filed as Exhibit 10.13 to the Company's annual report on Form 10-K, filed on February 23, 2010 (File No. 001-33767), and incorporated by reference)
10.11*	Form of Restricted Stock Agreement, effective December 31, 2010 (filed as Exhibit 10.14 to the Company's annual report on Form 10-K, filed on February 23, 2010 (File No. 001-33767), and incorporated by reference)

10.12\* Form of Option Award Agreement, effective May 6, 2011 (filed as Exhibit 10.2 to the Company's current report on Form 8-K, filed May 6, 2011 (File No. 001-33767), and incorporated by reference)

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Exhibit Number	Exhibit Description
10.13*	Form of Restricted Stock Agreement, effective May 6, 2011 (filed as Exhibit 10.1 to the Company's current report on Form 8-K, filed May 6, 2011 (File No. 001-33767), and incorporated by reference)
10.14*	Employment Agreement with Robert M. Lynch (filed as Exhibit 10.1 to the Company's current report on Form 8-K, filed December 21, 2010 (File No. 005-83765), and incorporated by reference)
10.15*	Amendment to Employment Agreement with Robert M. Lynch (filed as Exhibit 10.1 to the Company's current report on Form 8-K, filed December 21, 2011 (File No. 005-83765), and incorporated by reference)
10.16	Amended and Restated Revolving Credit Agreement, dated as of February 21, 2012, by and between Lumber Liquidators, Inc. and Bank of America, N.A. and the related Amended and Restated Revolving Credit Note, dated as of February 21, 2012 (filed as Exhibit 10.24 to the Company's annual report on Form 10-K, filed on March 22, 2012 (File No. 001-33767), and incorporated by reference)
10.17*	Amended and Restated Annual Bonus Plan (filed as Exhibit 10.17 to the Company's annual report on Form 10-K, filed on February 20, 2013 (File No. 001-33767), and incorporated by reference)
10.18*	Form of Option Award Agreement, effective January 24, 2013 (filed as Exhibit 10.18 to the Company's annual report on Form 10-K, filed on February 20, 2013 (File No. 001-33767), and incorporated by reference)
10.19*	Form of Restricted Stock Agreement, effective January 24, 2013 (filed as Exhibit 10.19 to the Company's annual report on Form 10-K, filed on February 20, 2013 (File No. 001-33767), and incorporated by reference)
10.20*	Form of Stock Appreciation Right Agreement, effective January 24, 2013 (filed as Exhibit 10.20 to the Company's annual report on Form 10-K, filed on February 20, 2013 (File No. 001-33767), and incorporated by reference)
10.21*	Relocation Agreement with Robert M. Lynch, dated February 5, 2014 (filed as Exhibit 10.1 to the Company's current report on Form 8-K, filed February 5, 2014 (File No. 005-83765) and incorporated by reference)
21.01	Subsidiaries of Lumber Liquidators Holdings, Inc.
23.01	Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm
31.01	Certification of Principal Executive Officer of Lumber Liquidators Holdings, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.02	Certification of Principal Financial Officer of Lumber Liquidators Holdings, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.01	Certification of Principal Executive Officer and Principal Financial Officer of Lumber Liquidators Holdings, Inc. pursuant to Section 906 of the Sarbanes-Oxley act of 2002
101	The following financial statements from the Company's Form 10-K for the year ended December 31, 2014, formatted in XBRL: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Other Comprehensive Income, (iv) Consolidated Statements of Stockholders' Equity, (v) Consolidated Statements of Cash Flows, (vi) Notes to Consolidated Financial Statements

\* Indicates a management contract or compensation plan, contract or agreement.

