TILE SHOP HOLDINGS, INC.
Form 10-Q
May 10, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2013

OR

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

For the transition period from – to –

Commission file number: 001-35629

TILE SHOP HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**45-5538095**
(State or other jurisdiction of incorporation)	**(I.R.S. Employer Identification No.)**

14000 Carlson Parkway	
Plymouth, Minnesota	**55441**
(Address of principal executive offices)	**(Zip Code)**

(763) 852-2901

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (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. S Yes ¨ No

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

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

Large accelerated filer £	Accelerated filer S
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

As of May 8, 2013, there were 52,988,057 shares of the registrant’s common stock, par value $0.0001 per share, outstanding.

TILE SHOP HOLDINGS, INC.

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PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

Tile Shop Holdings, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(in thousands, except per share amounts)

	March 31, 2013 (unaudited)	December 31, 2012 (audited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 15,763	$ 2,987
Trade receivables, net	1,281	1,009
Inventories	49,080	46,890
Prepaid inventory	6,875	6,051
Prepaid expenses	2,169	2,017
Income tax receivable	-	2,529
Deferred tax assets - current	9,364	9,364
Other current assets, net	3,862	966
Total Current Assets	88,394	71,813
Property, plant and equipment, net	91,588	82,080
Deferred tax assets	21,146	20,865
Other assets	1,313	1,316
TOTAL ASSETS	$ 202,441	$ 176,074
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Accounts payable	$ 16,868	$ 14,968
Current portion of long term debt	3,860	3,860
Accrued wages and salaries	3,672	2,912
Other accrued liabilities	10,719	7,734
Income tax payable	1,682	-
Current portion of capital lease obligation	245	234
Deferred compensation	6,171	6,171
Total Current Liabilities	43,217	35,879
Long-term debt, net	63,310	69,310
Capital lease obligation, net	1,352	1,420
Deferred rent	20,414	18,583
Warrant liability	37,489	95,645
TOTAL LIABILITIES	165,782	220,837

Stockholders' equity:		
Common stock, par value 0.0001; authorized: 100,000,000 shares; issued: 48,036,241, and 43,177,822 shares	5	4
Preferred stock, par value $.0001; authorized: 10,000,000 shares; issued: 0 shares	-	-
Additional paid-in-capital	135,572	9,434
Retained deficit	(98,918)	(54,201)
Total stockholders' equity	36,659	(44,763)
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 202,441	$ 176,074

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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Tile Shop Holdings, Inc. and Subsidiaries

Condensed Consolidated Statements of Income

(in thousands, except per share amounts)

(unaudited)

	Three months ended March 31, 2013	2012
Net sales	$ 56,835	$ 45,861
Cost of sales	16,462	12,173
Gross profit	40,373	33,688
Selling, general and administrative expenses	28,354	22,064
Deferred compensation expense	-	1,160
Income from operations	12,019	10,464
Interest expense	594	90
Change in fair value of warrants	51,845	-
Other (expense) income	(33)	7
(Loss) income before income taxes	(40,453)	10,381
Provision for income taxes	(4,264)	(248)
Net (loss) income	$ (44,717)	$ 10,133
Weighted average basic and diluted shares outstanding	44,854,988	32,000,000
Basic and diluted (loss) income earnings per share	$ (1.00)	$ 0.32
Pro forma computation related to conversion to C Corporation for income tax purposes		
Historical income before income taxes	$ -	$ 10,381
Pro forma provision for income taxes	-	(4,152)
Pro forma net income	$ -	$ 6,229
Pro forma weighted average basic and diluted shares outstanding	-	42,534,884
Pro forma basic and diluted income earnings per share	$ -	$ 0.15

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Tile Shop Holdings, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Three months ended March 31, 2013	2012
Cash Flows From Operating Activities		
Net (loss) income	$ (44,717)	$ 10,133
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Amortization of debt issuance costs	30	-
Depreciation and amortization	3,044	2,241
Loss on disposals of property, plant and equipment	45	-
Change in fair value of warrants	51,845	-
Deferred rent	1,831	1,578
Stock based compensation	1,092	-
Deferred income taxes	(281)	-
Changes in operating assets and liabilities:		
Trade receivables	(273)	(379)
Inventories	(2,190)	1,816
Prepaid expenses and other current assets	(568)	368
Accounts payable	446	2,930
Accrued interest	149	-
Income tax receivable/ payable	4,211	-
Accrued expenses and other liabilities	3,596	1,149
Net cash provided by operating activities	18,260	19,836
Cash Flows From Investing Activities		
Purchases of property, plant and equipment	(11,143)	(6,468)
Net cash used in investing activities	(11,143)	(6,468)
Cash Flows From Financing Activities		
Payments of long-term debt and capital lease obligations	(6,058)	(100)
Distributions to members		(4,193)
Repurchase of warrants	(30,108)	-
Proceeds from exercise of warrants	41,821	-
Security deposit	4	-
Net cash provided by (used in) financing activities	5,659	(4,293)
Net change in cash	12,776	9,075

Cash and cash equivalents beginning of period	2,987	6,283
Cash and cash equivalents end of period	$ 15,763	$ 15,358
Non cash items		
Reclassification of warrants from liability to equity	$ 110,002	$ -
Increase in other assets for exercise of warrants	3,332	-
Purchases of property, plant and equipment included in accounts payable and accrued expenses	1,455	-

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Tile Shop Holdings, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited)

Note 1: Organization and Nature of Business

The Tile Shop, LLC ("The Tile Shop") was formed on December 30, 2002, as a Delaware limited liability company (LLC) and began operations on January 1, 2003. Tile Shop Holdings, Inc. ("Holdings", and, together with its wholly owned subsidiaries, the "Company") was incorporated under the laws of the state of Delaware.

The Company is engaged in the sale of tile and flooring products. The Company also fabricates or manufactures certain products in Michigan, Wisconsin and Virginia. The Company's primary market is retail sales to consumers; however, the Company does have sales to contractors. As of March 31, 2013, the Company had 71 stores and an on-line retail operation. The retail stores are located in Minnesota, Wisconsin, Kansas, Illinois, Michigan, Ohio, Indiana, Maryland, Missouri, Kentucky, New York, Virginia, Iowa, North Carolina, New Jersey, Tennessee, Nebraska, Delaware, Georgia, Pennsylvania, Florida and Massachusetts. The Company also has distribution centers located in Wisconsin, Michigan, Virginia and Oklahoma.

The consolidated financial statements of the Company include the accounts of its wholly owned subsidiaries. All significant intercompany transactions have been eliminated in consolidation.

Note 2: Business Combination

On August 21, 2012, Holdings completed a business combination pursuant to the terms of the Contribution and Merger Agreement dated June 27, 2012 (the "Contribution and Merger Agreement"), whereby the former members of The Tile Shop, LLC ("The Tile Shop") directly or indirectly, contributed all of their membership interests in The Tile Shop to Holdings (the "Contribution"), in exchange for (i) a cash payment of $75 million, (ii) 32,000,000 shares of the common stock of Holdings valued at $320 million, and (iii) promissory notes issued by Holdings in the aggregate principal amount of $69.8 million. As a result of the Contribution, all ownership interests in The Tile Shop were contributed to Holdings. Concurrent with the Contribution, (i) all outstanding shares of JWC Acquisition Corp., a Delaware corporation ("JWCAC") common stock were exchanged for one share of common stock of Holdings and (ii) each outstanding JWCAC warrant, which was exercisable for one share of JWCAC common stock, became exercisable for one share of the Company's common stock. This transaction is referred to as the "Business Combination". Immediately following the Business Combination, the former members of The Tile Shop held 75.2% of the

42,534,884 issued and outstanding shares of common stock of Holdings.

The Tile Shop was considered the acquirer for accounting purposes because it obtained effective control of JWCAC. The Tile Shop did not have a change in control since The Tile Shop's operations comprise the ongoing operations of the combined entity, its senior management became the senior management of the combined entity, and its former owners own a majority voting interest in the combined entity and are able to elect a majority of the combined entity's board of directors. Accordingly, the Business Combination does not constitute the acquisition of a business for purposes of Financial Accounting Standards Board's Accounting Standard Codification 805, "Business Combinations," or ASC 805. As a result, the assets and liabilities of The Tile Shop and JWCAC are carried at historical cost and the Company has not recorded any step-up in basis or any intangible assets or goodwill as a result of the Business Combination. All direct costs of the Business Combination were offset to additional paid-in capital. The historical financial statements presented herein are that of The Tile Shop.

The recapitalization of the number of shares of common stock attributable to The Tile Shop members were reflected retroactive to January 1, 2010. Accordingly, the number of shares of common stock presented as outstanding as of January 1, 2010 totaled 32,329,897 consisting of 32,000,000 shares of common stock issued to The Tile Shop members as consideration for the Contribution, and 329,897 of common units held by the former owners of The Tile Shop, LLC which were fully redeemed in 2011. This number of shares was also used to calculate the Company's earnings per share for all periods prior to the Business Combination.

The cash flows related to the Business Combination, as reported in the Condensed Consolidated Statement of Cash Flow is summarized as follows:

	Amount (in thousands)		
Cash in trust at JWCAC	$	124,950	
Add: proceeds from issue of shares		15,000	
Less: redemption of JWCAC public shares		(54,960	)
Less: cash paid to The Tile Shop members		(75,000	)
Less: payment of deferred offering cost by JWCAC		(4,588	)
Less: payment of transaction expenses		(4,644	)
Remaining cash received by the Company in the merger	$	758	

Because the former members of The Tile Shop retained a significant ownership interest in Holdings following the Business Combination, a portion of the $69.8 million of notes payable issued to former members of The Tile Shop members as part of the Business Combination was treated as a leveraged dividend. Accordingly $52.5 million was reflected as a distribution of retained earnings. The remainder of the notes payable were deducted from additional paid in capital.

Pro Forma Information:

The pro forma computation related to the conversion to a C Corporation for income tax purposes assumes that such conversion occurred as of January 1, 2010. These amounts are not necessarily indicative of the consolidated results of income for future years or actual results that would have been realized had the change in tax status occurred as of the beginning of each such year.

Tile Shop Holdings, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited)

Note 3: Unaudited Consolidated Financial Statements

The information furnished in this report is unaudited and reflects all adjustments which are normal recurring adjustments that, in the opinion of management, are necessary to fairly present the operating results for the interim periods. The operating results for the interim periods presented are not necessarily indicative of the operating results to be expected for the full fiscal year. The unaudited interim condensed consolidated financial statements for the three months ended March 31, 2013, should be read in conjunction with the audited consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012, previously filed with the Securities and Exchange Commission on March 18, 2013.

Note 4: Summary of Selected Significant Accounting Polices

A detailed description of our significant accounting policies can be found in our most recent Annual Report filed on Form 10-K for the year ended December 31, 2012. There were no material changes in significant accounting policies during the quarter ended March 31, 2013.

Inventories:

Inventories are stated at the lower of cost (determined on the first-in, first-out method) or market. Inventories consist primarily of merchandise held for sale. Inventories comprised of the following as March 31, 2013 and December 31, 2012:

	(in thousands) March 31, 2013	December 31, 2012
Finished goods	$41,884	$ 39,353
Raw materials	1,270	858

Finished goods in transit	5,926	6,679
Total	$49,080	$ 46,890

Income taxes:

As a result of the Business Combination, beginning August 21, 2012, the Company's results of operations are taxed as a C Corporation. Prior to the Business Combination, The Tile Shop's operations were taxed as a limited liability company, whereby The Tile Shop elected to be taxed as a partnership and the income or loss was required to be reported by each respective member on their separate income tax returns. Therefore, no provision for federal income taxes has been provided in the accompanying condensed consolidated financial statements for the three months ended March 31, 2012. The provision recorded for the three months ended March 31, 2012, represents income taxes primarily payable by The Tile Shop, due to minimum fees in several states and income tax in the state of Michigan.

The change in status to a taxable entity and the transactions consummated as part of the Business Combination resulted in the recognition of deferred tax assets and liabilities based on the expected tax consequences of temporary differences between the book and tax basis of The Tile Shop's assets and liabilities at the date of the Business Combination including the following: (i) historical outside basis difference at August 21, 2012, and (ii) the tax basis increase of The Tile Shop membership interests directly held by the Company related to the Business Combination. The tax expense on income before income taxes for three months ended March 31, 2013 is $4.3 million, which is due to the significant non deductible expense added back for the change in warrant liability.

The Company recognizes deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Deferred tax liabilities and assets are determined based on the difference between the financial statement basis and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The Company estimates the degree to which tax assets and credit carryforwards will result in a benefit based on expected profitability by tax jurisdiction. A valuation allowance for such tax assets and loss carryforwards is provided when it is determined to be more likely than not that the benefit of such deferred tax asset will not be realized in future periods. If it becomes more likely than not that a tax asset will be used, the related valuation allowance on such assets would be reduced.

Tile Shop Holdings, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited)

Note 4: Summary of Selected Significant Accounting Polices (cont.)

Earnings Per Share:

Basic earnings per share is calculated by dividing net income (loss) by the weighted-average number of shares outstanding during the period. Diluted earnings (loss) per share is calculated by dividing net income (loss) by the weighted-average number of common shares outstanding, after giving effect to all dilutive potential common shares outstanding during the period. Common stock issued to The Tile Shop members in exchange for their direct or indirect ownership interests in The Tile Shop are retroactively reflected from January 1, 2011 as the number of shares outstanding in all periods prior to August 21, 2012 for the purpose of the earnings (loss) per share calculation. The additional shares issued as part of the Business Combination have been reflected as outstanding shares from August 21, 2012. For the three months ended March 31, 2013, diluted net loss per share is identical to basic net loss per share as all potentially dilutive securities have been excluded from the calculation of diluted net loss per common share because the inclusion of such securities would be anti-diultive. For the three months ended March 31, 2012, there were no potentially dilutive securities outstanding.

	(dollars in thousands)	
	For the Three months Ended March 31,	
	2013	2012
Net (loss) income	$ (44,717)	$ 10,133
Weighted-average shares outstanding – basic	44,854,988	32,000,000
Effect of diluted securities attributable to stock-based payments	-	-
Weighted-average shares outstanding – diluted	44,854,988	32,000,000
Earnings per share from continuing operations:		
Basic	$ (1.00)	$ 0.32
Diluted	$ (1.00)	$ 0.32

Potentially dilutive securities include 2,011,500 options, 7,359,018 warrants, and 295,000 restricted shares outstanding as of March 31, 2013.

Note 5: Other Accrued Liabilities

Other accrued liabilities consisted of the following at:

	(in thousands) March 31, 2013	December 31, 2012
Customer deposits	$5,387	$ 4,080
Taxes - other	2,134	1,490
Interest payable	498	349
Sales return reserve	2,700	1,815
	$10,719	$ 7,734

Note 6: Debt

On October 3, 2012, the Company and its operating subsidiary The Tile Shop, LLC entered into a credit agreement with Bank of America, N.A. (the "Credit Agreement"). The Credit Agreement, as amended, provides the Company with a $100 million senior secured credit facility, comprised of a five-year $25 million term loan and a $75 million revolving line of credit. Borrowings pursuant to the Credit Agreement bear interest at either a base rate or a LIBOR-based rate, at the option of the Company. The LIBOR-based rate will range from LIBOR plus 1.75% to 2.25%, depending on The Tile Shop's leverage ratio. The base rate is equal to the greatest of: (a) the Federal funds rate plus 0.50%, (b) the Bank of America "prime rate," and (c) the Eurodollar rate plus 1.00%, in each case plus 0.75% to 1.25% depending on The Tile Shop's leverage ratio. At March 31, 2013 and December 31, 2012 the interest rate was 2.615%. The term loan requires quarterly principal payments of $875,000. The Credit Agreement contains customary events of default, conditions to borrowings, and restrictive covenants, including restrictions on the Company's and The Tile Shop's ability to dispose of assets, make acquisitions, incur additional debt, incur liens, make investments, or enter into certain types of related party transactions. The credit facility also includes financial and other covenants including covenants to maintain certain fixed charge coverage ratios and rent adjusted leverage ratios. The Company was in compliance with the covenants during three months ended March 31, 2013, based on an amendment dated April 30, 2013 which excluded the impact of redemptions of warrants and capital stock, up to the amount of cash proceeds received from warrant exercises, from the calculation of certain financial covenants. The additional borrowings pursuant to the Credit Agreement may be used to support the Company's growth and for working capital purposes.

Tile Shop Holdings, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited)

Note 7: Fair Value of Financial Instruments

These condensed consolidated financial statements include the following financial instruments: cash and cash equivalents, trade receivables, accounts payable, accrued expenses, capital leases, notes payable, debt and warrant liability. At March 31, 2013 and December 31, 2012, the carrying amount of the Company's cash and cash equivalents and trade receivables, approximated their fair values due to their short maturities. The carrying value of the Company's borrowings and capital lease obligation approximates fair value based upon the market interest rates available to the Company for debt and capital lease obligations with similar risk and maturities.

Fair value is the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. To measure fair value, the Company uses a three-tier valuation hierarchy based upon observable and non-observable inputs:

Level 1 – Unadjusted quoted prices that are available in active markets for the identical assets or liabilities at the measurement date.

Level 2 – Significant other observable inputs available at the measurement date, other than quoted prices included in Level 1, either directly or indirectly, including:

- § Quoted prices for similar assets or liabilities in active markets;
- § Quoted prices for identical or similar assets in non-active markets;
- § Inputs other than quoted prices that are observable for the asset or liability; and
- § Inputs that are derived principally from or corroborated by other observable market data.

Level 3 – Significant unobservable inputs that cannot be corroborated by observable market data and reflect the use of significant management judgment. These values are generally determined using pricing models for which the assumptions utilize management's estimates of market participant assumptions.

Our common stock warrants are listed for trading on the OTC market. As of March 31, 2013 and December 31, 2012, we had approxi