

Lumber Liquidators Holdings, Inc.
Form 10-K
February 29, 2016

**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, 2015
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	New York Stock Exchange

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically 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

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As of June 30, 2015, the last business day of the registrant's most recent second quarter, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was \$542.6 million based on the closing sale price as reported on the New York Stock Exchange.

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of February 25, 2016:

Title of Class	Number of Shares
Common Stock, \$0.001 par value	27,088,460

DOCUMENTS INCORPORATED BY REFERENCE

Part III incorporates certain information by reference from the registrant's proxy statement for the 2016 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, 2015.

TABLE OF CONTENTS

LUMBER LIQUIDATORS HOLDINGS, INC.
ANNUAL REPORT ON FORM 10-K

TABLE OF CONTENTS

	Page
<u>Cautionary note regarding forward-looking statements</u>	1
PART I	
<u>Item 1.</u>	2
<u>Business</u>	
<u>Item 1A.</u>	7
<u>Risk Factors</u>	
<u>Item 1B.</u>	19
<u>Unresolved Staff Comments</u>	
<u>Item 2.</u>	19
<u>Properties</u>	
<u>Item 3.</u>	20
<u>Legal Proceedings</u>	
<u>Item 4.</u>	29
<u>Mine Safety Disclosures</u>	
PART II	
<u>Item 5.</u>	30
<u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	
<u>Item 6.</u>	32
<u>Selected Financial Data</u>	
<u>Item 7.</u>	33
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	
<u>Item 7A.</u>	45
<u>Quantitative and Qualitative Disclosures About Market Risk</u>	
<u>Item 8.</u>	46
<u>Consolidated Financial Statements and Supplementary Data</u>	
<u>Item 9.</u>	82
<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	
<u>Item 9A.</u>	82

Controls and Procedures

Item 9B.

84

Other Information

PART III

Item 10.

85

Directors, Executive Officers and Corporate Governance

Item 11.

85

Executive Compensation

Item 12.

85

Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Item 13.

85

Certain Relationships and Related Transactions, and Director Independence

Item 14.

85

Principal Accountant Fees and Services

PART IV

Item 15.

86

Exhibits, Financial Statement Schedules

Signatures

88

i

TABLE OF CONTENTS

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENT

This report includes statements of the Company's expectations, intentions, plans and beliefs that constitute forward-looking statements within the meanings of the Private Securities Litigation Reform Act of 1995. These statements, which may be identified by words such as may, will, should, expects, intends, plans, anticipates, thinks, estimates, seeks, predicts, could, projects, potential and other similar terms and phrases, are based on the beliefs of the Company's management, as well as assumptions made by, and information currently available to, the Company's management as of the date of such statements. These statements are subject to risks and uncertainties, all of which are difficult to predict and many of which are beyond the Company's control. Forward-looking statements in this report may include, without limitation, statements regarding legal matters and settlement discussions, the terms of and compliance with the Plea Agreement with the Department of Justice (the Plea Agreement) and the associated environmental compliance plan (the Compliance Plan), the Company's ability to borrow under its asset-backed revolving credit facility, elevated levels of legal and professional fees, elevated levels of payroll and stock-based compensation expense, sales growth, comparable store net sales, number of stores providing installation services, impact of cannibalization, impact of inflation, price changes, inventory availability and inventory per store, inventory valuation, earnings performance, stock-based compensation expense, margins, return on invested capital, advertising costs, costs to administer the Company's indoor air quality testing program, intention to conduct additional investigation and reviews in connection with certain consumers' indoor air quality tests, strategic direction, the scale of the expansion of and transition to the Company's laminate products sourced from Europe and North America, supply chain, the demand for the Company's products, benefits from an improving housing market, construction of engineered hardwood as to not be subject to anti-dumping and countervailing duties, ultimate resolution of governmental investigations, and store openings and remodels.

The Company's 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 the Company's suppliers; the ability to retain and motivate Company employees; the availability of sufficient suitable hardwood; the impact on the Company if the Company is unable to maintain quality control over its products; the cost and effect on the Company's reputation of, and consumers' purchasing decisions in connection with, unfavorable allegations surrounding the product quality of the Company's laminates sourced from China; the Company's suppliers' ability to meet its quality assurance requirements; disruption in the Company's suppliers' abilities to supply needed inventory; the impact on the Company's business of its expansion of laminate products sourced from Europe and North America and the flooring industry's demand for product from these regions; disruptions or delays in the production, shipment, delivery or processing through ports of entry; the strength of the Company's competitors and their ability to increase their market share; slower growth in personal income; the number of customers requesting and cost associated with addressing the Company's indoor air quality testing program; the ability to collect necessary additional information from applicable customers in connection with indoor air quality test results; changes in business and consumer spending and the demand for the Company's products; changes in transportation costs; the rate of growth of residential remodeling and new home construction; the Company's ability to offset the effects of the rate of inflation, if higher than expected; the demand for and profitability of installation services; changes in the scope or rates of any antidumping or countervailing duty rates applicable to the Company's products; the duration, costs and outcome of pending or potential litigation or governmental investigations; ability to successfully and timely implement the Compliance Plan; ability to make timely payments pursuant to the terms of the Plea Agreement; ability to borrow under its asset-backed revolving credit facility; ability to reach an appropriate resolution in connection with the

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

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

1

TABLE OF CONTENTS

PART I

Item 1. Business.

Overview

Lumber Liquidators is the largest specialty retailer of hardwood flooring in North America, offering a complete purchasing solution across an extensive assortment of exotic and domestic hardwood species, engineered hardwood, laminate, resilient vinyl, bamboo and cork. We operate as a single operating segment, with our call center, website and customer service network supporting retail store operations.

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 within a highly-fragmented hardwood flooring market. The foundation for our value proposition is strengthened by our unique store model, the industry expertise of our people, our singular focus on hard-surface flooring and our expansion of our advertising reach and frequency.

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

Our Business

Market

According to the July 2015 Issue of Floor Covering Weekly, U.S. installed floor covering product sales in 2014 were \$35.6 billion, excluding installation. Within this market, U.S. hardwood and laminate flooring sales accounted for 19.1% of the total. Flooring sales are driven by a number of factors including discretionary income and the housing market. Including installation, the overall flooring industry has grown at a compound annual growth rate of 5.1% from 2009 through 2014. Over the same period, hardwood and laminate flooring sales, including the cost of installation grew at a compound annual growth rate of 5.5%. 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 in the future.

Competition

We compete for 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. Although the market includes the national home improvement warehouse chains, warehouse clubs and online retailers, we believe the majority of the industry 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. Catalina Research, Inc., a company providing market research on various flooring types, estimates there are approximately 9,000 specialty floor coverings stores in the U.S.

Customers

We target several distinct customer groups who each have varied needs with respect to their flooring purchase, including do-it-yourself (DIY) customers, do-it-for-me (DIFM) customers, and commercial customers. Each of the customer groups we serve are passionate about their flooring purchase and value our wide assortment of flooring products, availability, and the quality of those products. Each of these customer groups require a unique customer service approach based on the ability of our associates to share detailed product knowledge and preferred installation methods. We offer DIFM customers installation services, while our DIY and commercial customers receive additional support throughout their purchase, including dedicated call center resources. All customer groups are offered delivery services.

TABLE OF CONTENTS

Products and Services

Product Selection

We offer an extensive assortment of wood flooring under 19 proprietary brand names, led by our flagship, Bellawood.

We have invested significant resources developing these national brand names, as well as the Lumber Liquidators name. Our hardwood flooring products are available in various widths and lengths and are generally differentiated in terms of quality and price based on the species, wood grade, warranty and durability of finish. Prefinished floors are the dominant choice for residential customers over unfinished wood planks that have a finish applied after installation. We also offer an assortment of flooring enhancements, installation and accessories, including moldings, underlays and tools. Our revenue by major product category is included in Note 1 of our consolidated financial statements in Item 8 of this report.

Direct Sourcing

Sourcing directly from mills and other vendors enables us to offer a broad assortment of high-quality, proprietary products to our customers at a consistently low cost. We seek to establish strong, long-term relationships with our vendor partners around the world. In doing so, we look for vendors that have demonstrated an ability to meet our demanding specifications and the capability to provide sustainable and growing supplies of high-quality and innovative products.

Supply Chain

Our supply chain is focused on delivering a complete assortment of products to our customers in an efficient manner. 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 our western stores. In 2014, we completed construction of a million square foot distribution center on 110 acres of land we own in Henrico County, Virginia to consolidate the 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 those facilities to the new facility in 2014, and the facility was fully operational in 2015.

During 2015, we leased third party consolidation services to break bulk shipments from mills into quantities and assortments that can be sent directly to our store locations. We terminated these services at the end of the second quarter of 2015 as we enhanced our utilization of our distribution centers. Additionally, a number of our vendors maintain certain inventory levels for shipment directly to our stores or our customers. Our product is generally transported boxed and palletized, and the weight of our product generally is correlated with our supply chain costs.

Compliance and Quality Control

The Company's compliance programs are designed to ensure the products we sell are safe, responsibly sourced, and meet all regulatory and statutory requirements, including without limitation requirements associated with the Lacey Act and the California Air Resources Board (CARB). We utilize a variety of due diligence processes and controls, including supplier audits, periodic on site visits, and product testing. The Company utilizes a risk-based approach to implement and operate the various aspects of its compliance program. Our compliance program considers, among other things, product risk, the level of vertical integration at our mills, legality concerns noted by both private and government parties, and the results of on-site audits performed by, or on behalf of, the Company. Our evaluation of

risk is a key component in our allocation of resources to ensure the Company meets its standards for product compliance and safety. We believe our Lacey Act Compliance program is one of the most stringent programs in the industry. Compliance and Quality Control teams located in the United States and in China are supplemented with external resources that provide independent analyses which are incorporated into our review processes and monitor our sourcing efforts across all areas from which we source product. Compliance programs are continually under review, updated and enhanced as appropriate to stay current with statutory and regulatory requirements.

Additionally, we began operating a 1,500 square foot lab within our new East Coast distribution facility during the first quarter of 2015. The lab features two temperature and humidity controlled conditioning rooms and two emission chambers correlated to a CARB-approved Third Party Certifier standard. We believe this equipment mirrors the capabilities of CARB and other state-of-the-art emission testing facilities. We believe

TABLE OF CONTENTS

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 to help ensure compliance with CARB requirements.

Installation

Historically, 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, 2015, we utilized a network of associates to perform certain customer-facing, consultative services and coordinated the installation of our flooring products by third-party professional installers in 186 of our stores. Service revenue for installation transactions we control is included in net sales, with the corresponding costs in cost of sales. We believe our greater interaction with the customer and greater control over the third party services provided will ultimately result in a better customer experience and higher utilization by the customer. Installation services are offered in our remaining stores through a national arrangement with a third-party. Under this national arrangement, we receive certain reimbursements based on volume, which offset other expenses.

Store Model

As of December 31, 2015, we operated 374 retail stores, with 366 located throughout the United States and eight in Ontario, Canada, after closing one of our Canadian stores at the end of its lease term during the fourth quarter.

We generally seek locations with lower rent than retailers requiring high traffic or impulse purchases and are able to adapt a range of existing buildings to our format, from free-standing buildings to strip centers to small shopping centers. Generally, our stores are approximately 6,500 to 7,500 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 routinely evaluate our store site selection criteria and are currently targeting retail corridors within a market over the more industrial locations we historically sought. We consistently monitor performance of current stores as well as the market opportunity for new locations, adjusting as needed to optimize the profitability and growth potential of our network.

Sales Approach

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 length of a hardwood flooring purchase can vary significantly from initial interest to final sale, but averages approximately 100 days.

Our objective is to help the consumer through the entire purchase cycle from aspiration to installation, whether in our store or in their home. Our goal is to provide our customers with everything needed to complete their flooring

project to remove the existing floor, install the new floor with complementary moldings and accessories, and finally, maintain the floor for its lifetime.

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

We are committed to responding to our potential and existing customers in a timely manner. Our call center is staffed by flooring experts cross-trained in sales, customer service and product support. In addition to

4

TABLE OF CONTENTS

receiving telephone calls, our call center associates chat online with visitors to our website, respond to emails from our customers and engage in telemarketing activities. Customers can contact our call center to place an order, to make an inquiry or to order a catalog.

Knowledgeable Salespeople

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

We place an emphasis on identifying, hiring and empowering employees who share a passion for our business philosophy. Many of our store managers have previous experience with the home improvement, retail flooring or flooring installation industries. We provide continuous training for our store associates, ranging from topic-specific modules offered through our online learning management system to participation in our Lumber Liquidators University (LLU) program. LLU is a training event for all of our regional and store managers that focuses on selling techniques and in-depth product training.

Digital

Our website contains a broad range of information on our products and services, including a comprehensive knowledge base of tools on wood flooring, product reviews, before and after photos from previous customers, product information and how-to installation videos. A consumer also has the ability to chat live with a flooring expert regarding questions about a flooring purchase or installation, either online or over the phone.

We continue to develop several new and responsive mobile, tablet and website functions to assist consumers with their flooring choice. We also have an active presence on Facebook, Pinterest, YouTube and Twitter.

Advertising and Financing

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

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

Employees

As of December 31, 2015, we had 1,842 employees, 96% of whom were full-time and none of whom were represented by a union. Of these employees, 71% work in our stores, 17% work in corporate store support infrastructure or similar functions (including our call center employees) and 12% work either on our finishing line or in one of our distribution centers. We believe that we have good relations with our employees.

Seasonality and Quarterly Results

Our quarterly results of operations can fluctuate depending on the timing of our advertising expenses and the timing of, and income contributed by, our new stores. Our net sales fluctuate slightly as a result of seasonal factors, and we adjust merchandise inventories in anticipation of those factors, causing variations in

TABLE OF CONTENTS

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 colder winter months and during the hottest summer months.

Intellectual Property and Trademarks

We have a number of marks registered in the United States, including Lumber Liquidators®, Hardwood Floors For Less!®, Bellawood®, 1-800-HARDWOOD®, 1-800-FLOORING®, Quickclic®, Virginia Mill Works Co. Hand Scraped and Distressed Floors®, Morning Star Bamboo Flooring®, Dream Home Laminate Floors®, Builders 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 warranted, the filing of lawsuits and administrative actions to enforce our rights.

Government Regulation

We are subject to extensive and varied federal, provincial, state and local government regulations in the jurisdictions in which we operate, including laws and regulations relating to our relationships with our employees and customers, public health and safety, zoning, accommodations for persons 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. Certain of our operations and properties are also subject to federal, provincial, state and local laws and regulations relating to the use, storage, handling, generation, transportation, treatment, emission, release, discharge and disposal of hazardous materials, substances and wastes and relating to the investigation and cleanup of contaminated properties, including off-site disposal locations. We do not currently incur significant costs complying with the laws and regulations related to hazardous materials. However, we could be subject to material costs, liabilities or claims relating to compliance in the future, especially in the event of changes in existing laws and regulations or in their interpretation, as well as the passage of new laws and regulations.

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

Products that we import into the United States and Canada are subject to laws and regulations imposed in conjunction with such importation, including those issued and/or enforced by U.S. Customs and Border Protection and the Canadian Border Services Agency. In addition, certain of our products are subject to laws and regulations relating to the importation, acquisition or sale of illegally harvested plants and plant products and the emissions of hazardous materials. We work closely with our suppliers to address the applicable laws and regulations in these areas.

Available Information

We maintain a website at *www.lumberliquidators.com*. The information on or available through our website is not, and should not be considered, a part of this 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.

TABLE OF CONTENTS

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 Our Operations

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

We rely on our reputation for offering great value, superior service and a broad selection of high-quality, safe flooring products. We are currently involved in a number of government investigations and legal actions, many of which have resulted from unfavorable allegations regarding our products and us. Negative publicity surrounding these government investigations and legal actions could continue to harm our reputation and the demand for our products. Additional unfavorable allegations, government investigations and legal actions involving our products and us could also affect our perception in the market and our brands and negatively impact our business and financial condition. For instance, unfavorable allegations surrounding the product quality of our laminates sourced from China has and could continue to negatively affect our operations. If this negative impact is significant, our ability to maintain our liquidity and grow or sustain our business could be jeopardized.

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 and financial condition.

We are, or may become, involved in legal proceedings, government and agency investigations, and consumer, employment, tort and other litigation (see discussion of Legal Proceedings in Item 3 of this Annual Report and Note 10 to the consolidated financial statements included in Item 8 of this Annual 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 be costly to implement or otherwise negatively affect our operations or could require us to pay substantial amounts of money that could have a material adverse effect on our liquidity, financial condition and results of operations and could affect our ability to obtain capital or access our revolving line of credit and continue as a going concern. Additionally, defending against lawsuits and legal proceedings may involve significant expense and diversion of management's attention and resources.

Implementing our Environmental Compliance Plan will be costly to implement and the failure to implement the plan could adversely affect our ability to import and, therefore, our results of operations.

As disclosed on October 7, 2015, we reached a settlement with the United States Department of Justice (DOJ) regarding our compliance with the Lacey Act. In connection with that settlement, we agreed to implement an

environmental compliance plan (the Compliance Plan) and we will be subject to a probation period of five years. The implementation of the Compliance Plan will be costly and, if the implementation costs are more than we anticipate, it could adversely impact our operating results. Further, in the event we fail to implement the Compliance Plan as required and in accordance with set deadlines, the government may require us to cease the importation of hardwood flooring from China until the DOJ determines that the Compliance Plan has been satisfactorily implemented. If we have to cease the importation of hardwood flooring, our ability to operate would be substantially harmed and our business, including our results of operations, would be adversely affected.

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, the environment, foreign operations (such as the Foreign Corrupt Practices Act), truth-in-advertising, consumer

TABLE OF CONTENTS

protection, privacy, zoning and occupancy matters as well as the operation of retail stores and warehouse, production and distribution facilities and provision of installation services. In addition, various federal, provincial and state laws govern our relationship with and other matters pertaining to our employees, including wage and hour 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, including labor laws that impact exempt status and overtime eligibility, 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 comply with, extend or renew a material approval, license or permit required by such laws, or if there is a delay in renewing any material approval, license or permit, our net sales and operating results could deteriorate or otherwise cause harm to our business.

With regard to our products, we 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, penalties, criminal charges, or other legal risks, be liable for costs and damages, or suffer reputational harm, which could reduce demand for our merchandise and hurt our business and results of operations. Further, if such laws and regulations should change, we may experience increased costs or incur decreased efficiency in order to adhere to the new standards.

Our growth strategy is impacted by our ability to open new stores and is subject to many unpredictable factors.

As of December 31, 2015, we had 374 stores throughout the United States and Canada, 152 of which we opened after January 1, 2011. Assuming the continued success of our store model and satisfaction of our internal criteria, we plan to open a significant number of new stores over the next several years. This growth strategy and the investment associated with the development of each new store may cause our operating results to fluctuate and be unpredictable or decrease our profits. Our future results and ability to implement our growth strategy will depend on various factors, including the following:

- our ability to maintain our reputation of providing safe, compliant products;
- consumer recognition of the quality of our products;
- the successful resolution of the various pending government investigations and legal proceedings;
- 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;

Federal, provincial, state or local laws and regulations, or our failure to comply with such laws and regulations, could