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ETD.N - Q2 2026 Ethan Allen Interiors Inc Earnings Call

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CONFERENCE CALL PARTICIPANTS

Taylor Zick *KeyBanc Capital Markets Inc - Analyst*

Cristina Fernandez *Telsey Advisory Group LLC - Analyst*

PRESENTATION

Operator

Good afternoon, and welcome to the Ethan Allen fiscal 2026 second-quarter analyst conference call. (Operator Instructions) Please note, this conference is being recorded.

It is now my pleasure to introduce you to our host, Matt McNulty, Senior Vice President, Chief Financial Officer and Treasurer. Thank you. You may begin.

Matthew McNulty - *Ethan Allen Interiors Inc - Chief Financial Officer, Senior Vice President, Treasurer*

Thank you, operator. Good afternoon, and thank you all for joining us today to discuss Ethan Allen's fiscal 2026 second-quarter results. With me today is Farooq Kathwari, our Chairman, President and CEO. Mr. Kathwari will open and close our prepared remarks, while I will speak to our financial performance midway through. After our prepared remarks, we will then open the call up for your questions.

Before I begin, I'd like to remind the audience that this call is being webcast live under the News & Events tab within our Investor Relations website. A replay and transcript of today's call will also be made available on our Investor Relations website. There, you'll find a copy of today's press release, which contains reconciliations of the non-GAAP financial measures referred to on this call and in the press release.

Our comments today may include forward-looking statements that are subject to risks and uncertainties that could cause actual results to differ materially. The most significant risk factors that could affect our future results are described in our most recent quarterly report on Form 10-Q. Please refer to our SEC filings for a complete review of those risks. The company assumes no obligation to update or revise any forward-looking matters discussed during this call.

With that, I'm pleased to now turn the call over to Mr. Kathwari.

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Well, thank you, Matt, and thank you for joining our second quarter ending December 31, 2025, earnings call and our initiatives to grow our business.

The second-quarter results were strongly impacted by the government shutdown, resulting in lower consumer confidence, lower traffic to our design centers and lower orders at retail and especially from the US government contract, also impacted by a very strong previous year comparison. The good news is that we have started the third quarter with stronger traffic and positive written sales in January, as we mentioned in our press release.

During the last few years, we have made major changes to our vertically integrated structure, including our retail network, manufacturing, marketing, logistics and are positioned well. After Matt provides a brief overview of our second-quarter financial results, I will provide more details of our business -- of our initiatives to grow our business, and then we'll open up for any questions or comments.

Matt, please proceed.

Matthew McNulty - *Ethan Allen Interiors Inc - Chief Financial Officer, Senior Vice President, Treasurer*

Thank you, Mr. Kathwari. Our financial performance in the just-completed second quarter was highlighted by a robust balance sheet and strong margins despite a challenging environment. Our consolidated net sales of \$149.9 million benefited from a higher starting retail backlog, a higher average ticket price, incremental clearance sales, and fewer returns. These increases were offset by fewer contract sales and lower demand.

Retail written orders declined 17.9%, while wholesale orders were 19.3% lower than a year ago, with both metrics declining sequentially throughout the quarter as our prior-year comparables got tougher. Our demand trends reflect the combination of macroeconomic challenges and a difficult prior-year comparison as well as an 11% decline in design center traffic. With that said, we are pleased to see positive written order growth in January.

We ended the quarter with wholesale backlog of \$49.8 million. A lower volume of contract orders combined with improved customer lead times helped reduce our backlog. Our consolidated gross margin was 60.9%, up 60 basis points from a year ago due to a change in sales mix, reduced headcount, a higher average ticket price and lower inbound freight, partially offset by increased promotional activity, incremental tariffs and elevated clearance sales.

Our adjusted operating income was \$13.5 million with an operating margin of 9%. For historical context, adjusted operating margin during the pre-pandemic 2019 second quarter was 5.4% or 360 basis points lower than it is today. Our current year operating margin was impacted by fixed cost deleveraging from lower sales, combined with delivering out orders with higher promotions, additional marketing, higher occupancy costs from new design centers, increased employee benefit costs as well as incremental tariffs. These increases were partially offset by disciplined approach to controlling operating expenses, including reduced headcount.

At quarter end, we had 3,149 total associates, a decrease of 5.1% from a year ago. Adjusted diluted EPS was \$0.44. Our effective tax rate was 25.3%, which varies from the 21% federal statutory rate primarily due to state taxes.

Now turning to our liquidity. We ended the quarter with a robust balance sheet, including total cash and investments of \$179.3 million with no debt. Our liquidity position remains strong, although we generated an operating cash flow deficit of \$1.8 million during the quarter due to changes in working capital, including lower customer deposits and the timing of our biweekly payroll.

In November, we paid a regular quarterly cash dividend of \$10 million or \$0.39 per share. Also, as just announced in our earnings release, our Board declared a regular quarterly cash dividend of \$0.39 per share, which we paid in February. We are pleased to continue to pay cash dividends while maintaining a strong cash position.

Before closing, I'd like to spend a few moments on tariffs. We are exposed to tariffs assessed on raw materials and finished goods we import into the US. Recently enacted Section 232 tariffs made effective in mid-October have resulted in manufactured upholstered wood products being subject to a 25% tariff. Our non-US manufactured case goods are currently subject to a 10% tariff that is partially reduced based on the consumption of US-sourced materials.

With regards to imports, our exposure is primarily concentrated on imported case goods from Indonesia, select fabrics from Asia, and imported accents consisting of lighting and area rugs. To help offset some of the tariff impact, we worked with our vendors on cost sharing, performed additional sourcing diversification, and recently pushed through selective retail price increases, which averaged 5%.

These carefully measured price increases were applied strategically across select SKUs rather than broadly. We will continue to review pricing and we'll respond quickly and thoughtfully as conditions evolve.

We believe our North American manufacturing, which represents approximately 75% of the furniture we sell, provides us with a strategic advantage. By controlling more aspects of the production process within North America, we believe we can mitigate some of our tariff exposure.

As I conclude my prepared remarks, we are pleased that our disciplined investments and strong expense management are helpful -- are helping to build a fundamentally stronger company. We delivered another strong quarter and entered the 2026 calendar year with a debt-free balance sheet, strong liquidity, and a proven ability to provide clients with custom furniture and complementary design services.

With that, I will now turn the call back over to Mr. Kathwari.

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Thank you, Matt. I'm pleased to share our initiatives to help us to grow our business as we move forward. Our key focus remains to continue to strengthen our unique vertically integrated structure, including continued strengthening our product programs. Our design centers have started to receive our new products introduced in the fall of last year. Our products continue to be developed under the umbrella of classics with a modern perspective.

About 75% of our furniture is made in our manufacturing workshops in North America, and all products are custom-made. All products made in North America, I'm talking of furniture, are custom-made on receipt of models. This is possible because of our North American manufacturing and provides a strong competitive advantage.

Strengthening our marketing programs, in our second quarter, we continue to utilize various mediums, including direct mail and digital advertising. We increased our advertising by 25%, mostly in digital mediums. While we did not get the full benefit in our second quarter of this increased marketing spend due to economic slowdown, we feel it will benefit us in the future.

Our retail network, today, we operate 172 design centers in North America and reflects our current projection under the umbrella of, we say, classics with a modern projection. The design centers reflect the reduction of the size due to strong interior design talent and digital technology.

Continued strengthening our manufacturing. As I mentioned, about 75% of our furniture is made in our North American facilities. Combination of strong talent and technology is key to our productivity. Again, I repeat that all our manufacturing in North America is based on custom-made furniture. 20 years back, 80% was in stock that we sold furniture, especially what we call case goods.

Strengthening our national and retail logistics continues to be a very important initiative. We deliver our products to our clients all across North America at one delivered price with what we call white glove service, very unique. If a customer is in Seattle or in Florida or in Texas, it's exactly the same delivered price, and it took us a long time to do this, and it reflects the investments we have made to have a very strong logistics network.

And again, very, very important, the focus on continued strengthening of talent combined with technology, combined with technology is key to future.

With this, happy to take any questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Taylor Zick, KeyBanc Capital Markets.

Taylor Zick - KeyBanc Capital Markets Inc - Analyst

I just wanted to ask about the retail written orders during the quarter. You noted that the monthly trends decelerated during the quarter just due to difficult comparisons. But as you kind of look through that, do you have any sense of what the underlying trends were during the second quarter?

Farooq Kathwari - Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer

Yes, I think Matt can give you the exact numbers of the retail, I mean, our retail business in the quarter was somewhat impacted. But Matt, what are the numbers?

Matthew McNulty - Ethan Allen Interiors Inc - Chief Financial Officer, Senior Vice President, Treasurer

Yes. Each sequential month during Q2 decreased by a higher percentage. We don't typically disclose the breakdown on a month-to-month basis, but it did blend to an average decrease of 18%. But we started out stronger in October, and it decelerated more so for the government shutdown combined with the prior year comparison.

If you recall, November, December last year were very strong. So it was a difficult prior-year comparison. If we go back two years to fiscal '24, that calendar year '23, we were only down very low-single digits compared to this past -- a year ago was much higher written.

Taylor Zick - KeyBanc Capital Markets Inc - Analyst

Got it. Yes. And certainly good to see the positive retail comps here in January. That's great.

And Farooq, maybe for my second question, can you touch a bit on the contract side of the business? You have obviously cited the government shutdown as sort of a headwind here. But since the government has reopened, have you seen any improvement in the orders? Or does those remain relatively soft?

Farooq Kathwari - Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer

Well, during the last quarter, the orders stopped. That, of course, had a major impact on our results last quarter because of the fact that the government being closed, they were not sending any orders. The good news is the orders are coming in, and they are coming in reasonably high, but not as strong as we had last year because it is now taking the government, all the embassies all over the world, a little time to get back on.

So, yes, we are seeing new orders. It's a little bit lower than last year, but every week, it's growing.

Taylor Zick - KeyBanc Capital Markets Inc - Analyst

Understood. And then maybe one last question for me before I turn it over to others. The company continues to put up very strong gross margins here despite the difficult environment and tariffs and all that. So how should we think about the sustainability of these margins as we look to 3Q and 4Q ahead?

Farooq Kathwari - Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer

I think we have a good opportunity of maintaining them because of the fact that a lot of work has been done at all levels in terms of combining great talent and technology. That has really impacted all elements, especially our retail network, our manufacturing, our logistics. So I believe that, obviously, the volumes have an important factor, but we have an opportunity of maintaining them.

Operator

Cristina Fernandez, Telsey Advisory Group.

Cristina Fernandez - Telsey Advisory Group LLC - Analyst

I appreciate all the color on the tariffs, Matt, that you gave. I wanted to see if you could give more detail as far as, I guess, what the total impact is. And you mentioned that you were mitigating some of it. So I want to see if you can give some color on what the unmitigated amount is?

And how should we think about that impact as we move forward? Do you think with the price increase and some of the changes you've made, you can mitigate the costs? Or we're going to see some impact flowing through the cost base?

Farooq Kathwari - Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer

Yes. Go ahead, Matt.

Matthew McNulty - Ethan Allen Interiors Inc - Chief Financial Officer, Senior Vice President, Treasurer

Sure. Yes, I'm happy to answer that one. So there's a couple of strategies we took. It's really a three-pronged approach to trying to mitigate some of the tariff impact. One is vendor cost sharing or partner cost sharing, reaching out to partners to help negotiate and sharing some of the costs that we did over the last several months and was very successful.

Another strategy that we've employed is supplier sourcing diversification, trying to source from other countries, which we've done to some extent.

And then the third prong is really the retail price increases, which I mentioned we pushed through a select -- about a blended average of 5% in October this past quarter increase. Those did help mitigate some of the tariff impact. It did not do all of it.

Now price increases were in the beginning of October, but late from a delivered perspective. A lot of those orders did not get delivered out fully in the quarter. So we'll see a little bit more of a benefit from price increases moving forward.

With that said, there will still be some more headwinds. You mentioned the Section 232 tariffs that came into play mid-October. So we hadn't really experienced a full quarter worth of those. That's probably the largest. That's about 40% of our overall tariff exposure is there.

And then the IEEPA tariffs, which are currently under review by the Supreme Court is about 40% and the remainder is Section 301 tariffs. I would say, all in, we're still seeing a headwind. We don't disclose the actual percentage of the headwind overall, but I think the steps we've taken will help mitigate a significant amount of that, plus our current structure of being 75% in North America does help mitigate it naturally that way.

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Yes, Cristina. And also, of course, we are not counting on it, but the US Supreme Court has still not decided on the validity of the IEEPA tariffs. And it's possible that it goes away and which will -- and that will impact 40% of our exposure if they take it down completely with an annual savings of approximately \$8 million.

But again, as I said, we are hoping that happens, but our plans are to keep them on the side while making all changes so that we are able to maintain strong margins.

Cristina Fernandez - *Telsey Advisory Group LLC - Analyst*

I had a question on the January trend relative to the second quarter, I guess what would you attribute it? Do you think it's marketing? I mean, promotions seem pretty similar to last year. What would you attribute the improved trend?

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

I think the most important one is that the consumers came back. I think in the last quarter, with all the uncertainty, government shutdowns, all people were scared. People are not coming in. What we have seen in January, people are coming back.

Now the good news is because of our structure, because of our interior design network, and we have most likely the strongest interior design network, they have maintained good contacts with their clients. And what we've seen is our traffic has increased. People are coming back.

Again, there's still some concerns, but the concerns we had in the last quarter about all the uncertainty in the marketplace that created issues. We see in January, the government shutdown was not there, somewhat of a better consumer attitude. So people -- also the people or designers worked with clients. And as in last quarter, the ones who did not close, they are closing the business now.

Cristina Fernandez - *Telsey Advisory Group LLC - Analyst*

And the last question I had was on marketing. The 25% increase. I mean, do you expect that level to continue as we move through the year? And where are you mostly seeing the benefit of this marketing? Is it better traffic? Is it new customer acquisition? How are you measuring the efficiency of that marketing spend?

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Yes. That's a very important issue. Now if we knew that the government shutdown and all of those were going to take place, we would not have increased our marketing by 25%. That's what we did. But the reason it is mostly on digital marketing. The digital marketing is where clients today, it used to be that our designers had to spend a tremendous amount of time working with the clients physically.

Today, consumers and our clients and our designers are able to work virtually with the amount of technology that we have. So all this was to help bring more people through our virtual advertising and also help them close business. And that, we'll continue to do.

But having said this, we are going to reduce some of our advertising expense in some other mediums. Look at 10 years back, we spent a lot of money on national advertising, zero. Then in the last year or so, we spent a fair amount of money on sending magazines, digital magazines, and printed magazine.

So one of the things we looked at was the impact of our digital magazine, where we're sending close to, I think, close to 18 million a month. We decided that we'll take it down to 9 million or 10 million and still make an impact and especially spending this more money on the digital marketing will help us. So those are the areas where we are looking at.

Operator

And with that, there are no further questions at this time. I'd like to turn the floor back over to Farooq Kathwari for any closing remarks.

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Well, thank you for joining. I would say that we are stronger today. We have spent a fair amount of time. First, we've got -- as you know, every week, I get about 40 reports. They don't all report to me, but they have to write on five things.

First is talent. What have they done to improve talent. The good news is we've got strong talent. We have less people, but strong talent. And as I said, our headcount today is about 30% less than what was only five or six years back. Now that is due to high talent, and it's also due to technology. So we're going to continue to have technology. That's tremendously important.

Second, third thing is marketing. And marketing, again, is tremendously important, but the means of marketing are constantly changing. And this also reflected what we did last quarter in terms of spending more money on digital mediums. We'll continue to do that.

And service is critical. That's our fourth tremendously important area. And the services provided by interior designers, services provided by our logistics teams, as I said, that we today deliver our products at one price nationally to our consumer with service.

And then finally, social responsibility is tremendously important, and we'll continue to do that. So thanks very much for joining and look forward to our continued discussions next quarter.

Operator

Thank you. And with that, ladies and gentlemen, this does conclude today's teleconference. We thank you for your participation. You may disconnect your lines at this time, and have a wonderful day.

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Thank you.

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