

Lumber Liquidators, Inc.
Form 10-K
March 12, 2008
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2007

OR

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

For the transition period from _____ to _____

Commission file number: 001-33767

Lumber Liquidators, Inc.

(Exact Name of Registrant as Specified in its Charter)

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Delaware
(State of Incorporation)

043229199
(IRS Employer Identification No.)

3000 John Deere Road

Toano, VA 23168

(Address of principal executive offices, including, 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 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, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer 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 December 31, 2007, the last business day of the Registrant's most recently completed fiscal quarter, the aggregate market value of such shares held by non-affiliates of the Registrant (based upon the closing sale price of such shares on New York Stock Exchange on December 31, 2007) was approximately \$71.6 million. 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 5% or more of Registrant's outstanding common stock as of December 31, 2007 have been excluded in

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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 29, 2008:

Title of Class	Number of Shares
Common Stock, \$0.001 par value	26,746,702

DOCUMENTS INCORPORATED BY REFERENCE

Part III incorporates certain information by reference from the Registrant's proxy statement for the 2008 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, 2007.

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PART I

**Item 1. Business.
Overview**

Lumber Liquidators is the largest specialty retailer of hardwood flooring in the United States, based on industry sources and our experience. We believe we have achieved a reputation for offering great value, superior service and a broad selection of high-quality hardwood flooring products. We offer an extensive selection of premium hardwood flooring products under multiple proprietary brands at everyday low prices designed to appeal to a diverse customer base. We believe that our vertically integrated business model enables us to offer a broad assortment of high-quality products to our customers at a lower cost than our competitors. As of December 31, 2007, we sold our products through 116 Lumber Liquidators stores in 43 states, a call center, our website and a catalog.

Our company was founded in 1994 by Tom Sullivan, the current chairman of our board of directors, and in 1996, he opened the first Lumber Liquidators store near Boston, Massachusetts. Tom believed that traditional home improvement and flooring retailers underserved the homeowner in terms of selection, quality, price and product availability, presenting an opportunity to sell hardwood flooring at liquidator prices. Tom established relationships directly with vendors and mills to provide customers with broad, high-quality assortments at everyday low prices. He also identified the opportunity to better serve customers by employing knowledgeable sales staff to educate the customer about the product and provide advice on self-installation or working with contractors. In August 1996, Tom opened the second Lumber Liquidators store in Hartford, Connecticut, starting our company's national expansion. In 2000, we relocated to Colonial Heights, Virginia and in 2004, we moved into our current location in Toano, Virginia. The Toano facility includes our call center, corporate offices, and distribution and finishing facility, where we currently finish approximately 70% of our Bellawood products. In August 2007, we reincorporated from Massachusetts to Delaware. On November 9, 2007, we completed our initial public offering and our common stock now trades on the New York Stock Exchange under the symbol LL.

We expect to remain committed to our value proposition as we grow through new stores and increased comparable store net sales. We have invested significant resources developing our national brands, including our name and proprietary products, which include our flagship Bellawood brand. We believe Lumber Liquidators is now recognized across the United States as a destination for high-quality hardwood flooring at everyday low prices, while our Bellawood brand is known as a premium flooring brand within the industry. We expect to continue to invest resources in our advertising and marketing at a percentage of net sales greater than our competitors. We drive net sales growth through new store openings and increases in comparable store net sales, and we drive profitability through our store model and corporate cost controls. We have substantially completed a significant investment in our store support infrastructure, primarily our senior management team, and we believe this investment should support our continuing growth.

Our Value Proposition

Our value proposition to the customer is a key driver of our business. Important components include:

Price. A fundamental part of our founding philosophy is to provide quality hardwood flooring brands at everyday low prices. We are able to maintain these prices across our product range because we purchase flooring directly from mills and brokers. In addition, we operate a low-cost store model with a no frills showroom, limited in-store inventory and locations in industrial or commercial areas that carry lower rent expense than many retail stores.

Selection. We have developed a broad product assortment of domestic and exotic hardwoods sold under proprietary brands that help us to differentiate our products from those of our competitors. We offer products across a range of price points and quality levels that allow us both to target discrete market segments and to appeal to diverse groups of customers.

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Quality. We believe that we have achieved a reputation for quality, and that our proprietary brands are recognized for excellence by our customers. We work directly with our supplier mills and brokers to source and produce flooring that will meet our high quality standards and we also currently finish approximately 70% of our premium Bellawood products at our state-of-the-art Toano facility. We maintain an in-house inspection and quality control function and enforce strict certification requirements for Bellawood supplier mills.

Availability. Since our founding, we have made it a priority to build long-term relationships with our key supplier mills and brokers. As we have grown, we believe our relationships with our suppliers have strengthened, which we believe helps us ensure our continued access to a broad selection of domestic and exotic hardwood products at attractive prices. We believe that these direct supplier relationships are relatively unique in our industry. In addition, we believe our supply chain and centralized inventory at our Toano facility allow us to meet the delivery needs of our customers better than our competitors.

Our Strategy

We intend to continue to increase revenues and profitability by strengthening our position as a leading provider of hardwood flooring. Specific elements of our strategy for continued growth include the following:

Expand Our Store Base. The hardwood flooring market is highly fragmented, and we believe there is a significant opportunity to expand our store base. Because of the low capital investment to open our new stores and the attractive returns on investment that our stores generate, we intend to continue to expand our store base. We opened 25 new stores in 2007 and plan to open between 30 and 40 new stores during each of the next several years.

Improve Existing Store Net Sales Growth. We seek to drive productivity through strong comparable store net sales performance and by improving operational efficiencies. We expect net sales growth will be driven by our investment in our proprietary brands, targeted marketing campaigns and more efficient net sales and inventory planning and forecasting, as well as favorable long-term industry trends. In addition, we continue to build on what we believe is our strong track record of consistent store-level execution.

Expand Operating Margins. We attribute our success to our focus on and our ability to deliver on our value proposition to the customer, which results from leveraging our strength as a vertically-integrated, low-cost operator. As we continue to increase our revenues by opening new stores and marketing our proprietary brands, we also plan to decrease marginal costs by taking advantage of improving economies of scale in purchasing, leveraging our existing infrastructure and other fixed expenses and optimizing our finishing, distribution and supply chain management.

Leverage Brand Marketing Across Multiple Channels. We use our advertising and marketing activities and our multiple sales channels to help educate potential customers about hardwood flooring. As customers learn more about hardwood flooring and how best to shop for it, they also learn more about our products and value proposition, which we believe drives customer store visits and purchases of our products. We believe that as we continue to leverage our multi-channel strategy, we will drive repeat customer traffic. We have also made a significant advertising and marketing investment to link our brands to quality and value, as well as to establish ourselves as the hardwood flooring experts. As we continue to grow and open more stores, we believe that our marketing and branding activities will become more efficient and targeted. We also believe that our customer acquisition costs will decline on both a per-customer and per-store basis.

Our Brands

We offer a large selection of hardwood flooring year-round at everyday low prices, ranging in quality from our premium Bellawood brand to our more economical brands. We believe both Lumber Liquidators and Bellawood are well-known national brands. We have positioned Lumber Liquidators to represent an attractive

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value proposition to the customer, and believe we offer superior service and hardwood flooring expertise. Based on our market research, we believe that Bellawood, which accounted for approximately one-third of our 2007 net sales, is among the most-recognized brands in our industry. We are committed to supporting our brands and products through diverse national marketing campaigns that reach a wide variety of potential customers. Our objective is to sell high-quality products at an attractive value.

Our Integrated Multi-Channel Sales Model

We have an integrated multi-channel sales model that enables our national store network, call center, website and catalog to work together in a coordinated manner. We believe that due to the average size of the sale, many of our customers conduct extensive research before making a purchase decision. Our average sale was approximately \$1,800 in 2007. 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 sales strategy emphasizes customer service by providing superior convenience and education tools for our customers to learn about our products and the installation process. Customers can view our complete assortment of products through each channel. We believe that potential new customers generally first come to know about us through our national advertising and other marketing efforts. For many of them, the next stop is our website, which provides an informational tool where they can start to learn about our wide variety of products. Our website also allows new customers to see before and after examples from previous customers, explains the installation process and provides product reviews and endorsements. Some customers contact our call center, which is staffed by more than 50 flooring experts who are also available for online chat and email. Customers can order samples or a catalog through any of our sales channels. We hire store associates who often have relevant industry experience, are able to guide customers through the purchasing process and can provide advice on installation, the selection of a contractor and maintenance. Once an order is placed, customers can either have purchases delivered or can pick them up at a nearby store location. We strive to use our various sales channels to make our customers' transactions easy and efficient.

Our approach is based on our belief that customers prefer to shop for flooring using multiple channels. Because hardwood flooring is an infrequent purchase for many of our customers, we believe that we increase our chances of making a sale if we are the consumer's choice for expert service at each step of their purchasing decision, from initial education about hardwood flooring to guidance on best maintenance practices for their installed flooring. Our national advertising strategy is designed to raise awareness of our brand and to establish Lumber Liquidators as the first destination for customers who are in the early stages of a purchase decision. Our other marketing efforts, our website and our catalog are similarly designed both to sell products and to provide customers with information throughout the purchasing process. Our research indicates that by the time a customer enters one of our stores, he or she has generally researched our offerings on our website or in our catalog and is ready to make a purchase.

Customers can purchase our products in our stores, or through our call center or website. The prices available on our website and from our call center are the same as the prices in our stores.

Our Marketing and Advertising

Our marketing strategy emphasizes product credibility, value, brand awareness, customer education and direct selling. We have structured our marketing and advertising strategy to correspond with our understanding of the hardwood flooring purchase/cycle. We increase brand awareness in a variety of ways, including advertising and demonstration of our value proposition to customers. We have invested significantly to build awareness and demand for all of our proprietary brands.

We believe that our Lumber Liquidators brand is positioned based on selection, price and service, while our Bellawood brand is known as a premium flooring brand within the industry. We believe that we establish product

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credibility primarily through the strength of our product and the attractiveness of our pricing. We believe that we have achieved a reputation for quality and low prices, and that our proprietary brands are recognized for excellence by our customers. Our objective is to sell high-quality products at an attractive value, and we offer a large selection of hardwood flooring year-round at everyday low prices, ranging in quality from our premium Bellawood brand to our more economical brands. We try to avoid being perceived as a volume-driven discounter, so while our promotional cycle focuses on particular buying cycles, we generally try to hold our sales around events where we can create some excitement among customers. For example, we hold sales when we acquire bulk amounts of inexpensive inventory where we can pass along the savings, during three-day weekends when a customer has more time to consider (and possibly even install) a new flooring purchase, and during our annual odd lot sidewalk sale in April.

Our product credibility also benefits from celebrity endorsements and product placement opportunities. We have long-term relationships with respected, well-known home improvement celebrities Bob Vila and Ty Pennington. Bob Vila in particular has been associated specifically with our Bellawood proprietary brand for several years. Ty Pennington has a long-term endorsement arrangement and his own hardwood flooring collection, the Ty Pennington Collection.

To increase brand awareness, we conduct ad campaigns on both a national and local level using both traditional and new media. We co-sponsor various television shows such as *Extreme Makeover: Home Edition* and HGTV's *Dream Home*, 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. In addition, we use targeted television advertising on cable networks such as Discovery Channel, HGTV, TLC, DIY Network and A&E Network. We engage in sports marketing by participating in opportunities with, among others, Major League Baseball and the National Basketball Association and sponsoring a truck in the NASCAR Craftsman Truck Series.

We believe our national advertising campaigns have been successful, and we expect to see greater returns on our investment in national advertising as more stores open near people who have already been introduced to our brands. We expect to place a greater focus on local advertising to support targeted store growth while maintaining appropriate levels of national advertising.

We also engage in marketing and advertising using the Internet and our catalogs. 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. Our direct mail strategy focuses on regular contact with our customers and the targeting of prospective purchasers. We distribute our catalog, as well as other direct mailings, to key consumer and commercial segments around specific store locations.

Our Stores and Store Model

Our stores are designed to emphasize our products in a visually appealing showroom format, yet reflect our low-cost approach to doing business. The average size of our stores is approximately 6,400 square feet, of which approximately 800 square feet is dedicated to the showroom selling area. Our stores are typically located in industrial or commercial areas that have lower rents than traditional retail locations, are accessible from major roadways and have significant visibility to passing traffic. We can adapt to a range of existing buildings, whether free-standing or in shopping centers. We enter into short leases, generally for base terms of five years, with renewal options to maximize our real estate flexibility. Most of our store showrooms have wall racks holding one-foot by two-foot display boards of our flooring products and larger sample squares serving as the showroom floor. We believe that our store design and location reinforce our customers' belief that they get a good deal when they buy from us.

We have engaged a national broker to assist us with identifying locations for new stores and negotiating with landlords. Our first priority is to expand into markets in which we currently do not have a store, or where

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our existing store is more than an hour's drive away from what we believe is a critical mass of potential customers. We also focus on high density markets that we feel can support multiple stores. In the past, the size of our stores has varied depending on our ability to acquire space opportunistically, but we expect that new stores will generally be between 5,000 and 8,000 square feet, with approximately 800 square feet dedicated to the showroom and the remaining space used as a warehouse. Most of our stores are currently located in primary or secondary metropolitan areas, but we have also succeeded in a number of smaller markets. We believe our primary and secondary metropolitan markets will benefit from additional store locations, and there are many small and medium-sized markets where we have no stores at all. In identifying new markets, we intend to target selected markets that have demographic and other characteristics similar to those where we have been successful and fill in larger markets with additional stores.

As of December 31, 2007, we operated 116 stores in 43 states, and we plan to open approximately 30 to 40 stores during each of the next several years. In 2007, our stores that had been open for more than twelve months had average per-store net sales of \$4.2 million. Across our markets, our average new store has historically become profitable within three months of beginning operations and generally returned its initial cash investment within seven months. We estimate that the cost required to open a typical new store is approximately \$240,000, of which inventory, net of trade payables, represents approximately \$190,000. A typical store staff consists of a manager and two to three associates. We hire additional staff to the extent required by a store's level of business. The store manager is responsible both for store operations and for overseeing our customers' shopping experience. Many of our store managers have previous retail experience with large retailers in the home improvement industry, the retail flooring industry or the flooring installation industry. Store manager compensation consists of a base salary and commissions.

A store's warehouse is stocked with that store's most popular hardwood products and high-volume items, but primarily holds customer-specific merchandise inventory waiting to be picked up or to have delivery arranged. This allows for central inventory management from our Toano facility. Average store inventory for stores that had been open for more than twelve months is approximately \$365,000 and consists of both in-stock inventory and order-specific inventory. With the exception of certain high-volume products, we have found that customers typically request to pick up or arrange delivery of their products approximately one month after placing an order. By generally requiring a 50% deposit when an order is placed, we reduce store-level working capital requirements.

The table below highlights certain information regarding our stores open during each of the following periods:

	2005	2006	2007
Number of stores at January 1	57	76	91
New stores	19	16	25
Closed stores(1)		1	
Number of stores at December 31	76	91	116

- (1) The 2006 closed location represents a laminate flooring-only store established to operate during the remaining lease period of a relocated store.

Customer Service and Sales Force

We position ourselves as hardwood flooring experts and believe our high level of customer service reflects this positioning. Key elements of our service include providing consumers with useful product information and answering their hardwood flooring questions, ensuring product availability, following through on customer requests and selling high-quality products at an attractive value. Our store associates are familiar with all aspects of our store operations and, along with our call center staff, are trained to understand the characteristics and installation method for the broad range of hardwood flooring that we offer, and to guide customers through the purchase process. Many of our staff have relevant industry experience, and we are currently developing a formal standardized training program for all of our store associates.

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While we generally do not provide or arrange flooring installation, nor do we generally recommend or endorse installers or installation companies, as a courtesy to our customers, each of our stores maintains a list of local third-party flooring installers that they may provide to customers. In August 2007, we began to work with a national installation company as either our exclusive or recommended installer at a number of stores we opened in 2007. Depending on the success of this test program, we may expand it to other stores in the future. Even in these limited circumstances, however, choosing an installer remains the sole responsibility of the purchaser or homeowner, and we disclaim any liability for the work performed (or any damage caused) by any installer, including those on any list our stores may provide.

Call Center

More than 50 flooring experts cross-trained in sales, customer service and product support staff our call center. In addition to receiving telephone calls, our call center staff has been made available to chat online with visitors to our website, respond to e-mails from our customers and engage in telemarketing activities. Customers can contact our call center to place an order to be delivered directly to their home or picked up at a nearby store, to make an inquiry or to order a catalog. Callers can also order flooring samples for a nominal fee that is credited towards their first purchase. Our call center staff work on a commission basis. Call center sales fulfilled through our Toano facility are credited to the call center, while those picked up at one of our stores are credited to that store.

Website

Our website serves both to educate consumers and to generate sales, whether through a store, our call center or directly via the website itself. Potential customers want information about the products they are considering, and we seek to provide them with what they need to make an informed decision. Visitors to our website can interact with our flooring experts and can search through a large database of frequently asked questions. We also offer product reviews and an extensive before and after gallery from previous customers, as well as detailed product information and how-to videos that explain the installation process. As with our call center, visitors can also order flooring samples.

Catalog and Other Mailings

Our direct mail strategy focuses on regular contact with our customers and the targeting of prospective purchasers. We distribute our catalog, as well as other direct mailings, to key consumer and commercial segments around specific store locations. Copies of our catalog can also be obtained through our stores, our call center and our website. We believe these mailings contribute to increases in store traffic and call center volume that lead to more sales. We expect to continue expanding our catalog mailing efforts to prospective customers in markets where we have stores.

Our Customers

We seek to appeal to customers who desire a high-quality product at an attractive value, and are willing to travel to less convenient locations to get it. We sell our products principally to existing homeowners, who represent about 80% of our customer count. Historically, these homeowners are in their mid-30's or older, are well-educated and have been living in their homes for at least several years. Over 60% of hardwood surface flooring purchases are made by households with incomes of \$70,000 or more. We have found that homeowners like various aspects of wood floors, including appearance and durability, ease of installation, renewability of resources and increasingly higher quality of engineered and laminate flooring. The majority of these customers hire a third-party installer to put in their flooring, with the remainder being do-it-yourself installers. Most of our other sales are to contractors, who are primarily small businesses that are either building a small number of new homes or have been hired by an owner to put in a new floor.

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Our Products

We offer a complete assortment of hardwood flooring that includes prefinished premium domestic and exotic hardwoods, engineered hardwoods, unfinished hardwoods, bamboo, cork and laminates. Our product offering is substantially comprised of our proprietary brands, led by our flagship Bellawood brand. Our hardwood flooring products are generally available in various widths and lengths. They are generally differentiated in terms of quality and price based on the species, grade of the hardwood and quality of finishing, as well as the length of the warranty. In total, we offer nearly 350 different flooring product stock-keeping units. Prefinished floors are finished in a factory under controlled conditions and are ready to be enjoyed immediately after they are installed. Our prefinished products generally have warranties ranging from 10 to 50 years when used in residential settings.

We continue to develop breadth within our proprietary brands. In 2007, we introduced additional lines of solid and engineered handscraped products under our Virginia Mill Works Co. brand, stained and strand bamboo products under our Morningstar and newly-developed Ty Pennington brands, and heavier-wear layer laminates with foam backing under our Dream Home brand. We also offer a broad assortment of flooring enhancements and installation accessories, including moldings, noise-reducing underlay and adhesives, that complement our assortment of floor offerings.

	2007	2006
Percentage of Net Sales:		
Hardwood (Solid and Engineered)	69%	72%
Laminates	10%	10%
Bamboo and Cork	9%	8%
Moldings and Accessories	10%	8%
Other	2%	2%
Total	100%	100%

Solid Hardwood. Our proprietary solid hardwood products are milled from one thick piece of wood, which can be sanded and refinished numerous times. We offer flooring products made from more than 25 wood species, including both domestic woods, such as ash, beech, birch, hickory, northern hard maple, northern red oak, pine and American walnut, and exotic woods, such as bloodwood, cherry, cypress, ebony, koa, mesquite, mahogany, rosewood and teak. We sell these products as both prefinished and unfinished.

Engineered Hardwood. Our proprietary engineered hardwood products are produced by bonding a layer of hardwood to a plywood backing. Like our solid hardwood floors, our engineered hardwood floors are offered in domestic and exotic wood species. All of our engineered hardwood products are prefinished.

Bamboo and Cork. Our proprietary bamboo products, harvested from the fast growing bamboo plant, is offered as a prefinished or stained solid wood 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.

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 and a ceramic finish, abrasion-resistant laminate top. These products are produced and assembled to our specifications by third parties. Some of our laminate flooring brands allow for easy-click installation or V-groove installation, while others offer a pre-glued undersurface, moisture repellent, soundproofing, single-strip format or a handscraped textured finish.

Moldings, Accessories and Other Products. We offer a wide variety of wood flooring moldings and accessories. We sell a complete selection of moldings that complement our various wood flooring products, and we also sell stair treads and risers. Accessories include underlays that can be placed between the new floor and the sub-floor, insulating sound and cushioning the floors. In addition, we sell installation supplies (such as adhesive and trowels), floor cleaning supplies and butcher-block kitchen countertops.

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Our Suppliers

We work directly with a select group of vendors and mills with whom we have cultivated long-standing relationships to ensure a consistent supply of high-quality product at the lowest prices. As part of ensuring the high-quality nature of our brands, we have developed demanding product standards. As we have grown, we believe our supplier relationships have strengthened, which we believe helps to ensure our access to a broad selection of products. Many suppliers have grown to support our business. We select suppliers based on a variety of factors, including their ability to supply products that meet industry grading standards and our specifications. As part of ensuring that they are meeting relevant standards, we inspect samples, make periodic site visits to our suppliers' mills and selectively inspect inbound shipments at our distribution center. Based on our historical experience, we believe that some of the mills that we use are among the best in their respective markets. We also support social and environmental responsibility among our supplier community, and the majority of our suppliers have entered into an environmental and social responsibility agreement with us. This agreement contains a code of conduct regarding our expectations concerning environmental, labor and health and safety matters. We encourage the use of renewable resources, and generally prefer to use suppliers that operate in areas where the harvest rate is slower than tree planting and growth rates.

We currently purchase products from approximately 90 domestic and international vendors, which are primarily mills or trading companies. Trading companies contract with mills, primarily Chinese, to make products for us, and handle certain shipping and customs matters. In 2007, one of the trading companies, Sequoia Floorings, accounted for approximately 22% of our purchases, and acted as an agent for another of our suppliers that accounted for another 3% of our purchases. Including these companies, our top 10 suppliers account for approximately 66% of our supply purchases in 2007. We believe that we are the largest customer for most of our suppliers, which we believe enables us to obtain better prices in some circumstances. We maintain strong relationships with our current suppliers, but we also seek out new mills that can meet our standards, and we work with them to evaluate new hardwood species and new technologies that may allow us to expand or improve our operations. We continually seek out new suppliers to ensure that we have sufficient product flow to support our current operations and expected growth. In evaluating suppliers, one of the factors we consider is their access to new or hard-to-find species of wood, so that we can continue to expand our range of exotic hardwood products. We believe that alternative and competitive suppliers are available for most of our products.

We do not have long-term contracts with most of our suppliers, as we believe is standard in our industry, but we believe we have stable long-term historical relationships with the majority of mills with whom we do business. We generally purchase product on an order-by-order basis, and write orders for delivery in 90 to 180 days. We have one long-term purchase agreement with a trading and import company that we entered into in July 2006. Pursuant to the terms of that agreement, we are required to order a specified minimum amount of product each year, totaling approximately 27 million square feet of product. Certain disputes have arisen between the parties primarily with regard to product quality, unit price changes and delivery and payment obligations. We are not currently receiving any product under the agreement and we intend to seek payment for our cover costs relating to purchase orders that were not delivered. The products we ordered from the vendor that are not being delivered have been purchased from other suppliers and we expect the cover costs to be immaterial.

Overseas suppliers deliver our product to us by sea, usually requiring between 21 and 35 days from port to port. These products are delivered to a U.S. port of entry, most frequently Norfolk, Virginia, after which the majority is shipped to our Toano facility for finishing (when required) and distribution to our stores. The balance is shipped directly from the port of entry to our stores. Products supplied by our North American suppliers are generally delivered to our Toano facility or our stores by truck. Our Toano facility is strategically located near the international shipping port in Norfolk and major east-west and north-south interstate highways. In 2007, approximately 38% of our product was sourced from Asia, approximately 35% was sourced from North America, approximately 18% was sourced from South America and 9% was sourced from other locations. All of our foreign purchases are negotiated and paid for in U.S. dollars.

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Finishing

Annually, we finish approximately 70% of our Bellawood products (about 20 million square feet in 2007) at our state-of-the-art finishing facility in Toano, and we obtain the balance from qualified finishing suppliers in North America, South America and Australia. We also finish small quantities of certain of our other products at that facility. We currently operate one finishing line at Toano and we have the space to construct a second finishing line in that facility. We continually invest in improving our process controls and product quality, and we believe that our existing finishing infrastructure at our Toano facility can support our planned growth over at least the next three years with limited capital expenditures to increase capacity. Bellawood products have one of the highest scuff resistant finishes in the industry as measured by the Taber Abrasion Test, an abrasion testing method designed to measure the abrasion resistance of protective floor finishes. We have adopted sophisticated quality assurance policies and techniques and throughout the finishing process, we perform numerous tests and visual inspections to verify that the flooring complies with our specifications, and that the final prefinished hardwood flooring meets our standards. In developing these policies and techniques, we emphasize defect prevention, minimizing variations in our products, decreased waste and workplace safety.

Distribution, Order Fulfillment and Inventory Management

We operate a single distribution center located in Toano, Virginia. We warehouse our products at that facility before shipping them to our stores by truck or intermodal, and approximately 85% of our merchandise passes through that facility before we move it to our stores. It generally takes between two to five days for a shipment to reach our stores, and each store receives an average of 1.4 shipments per week. In some cases, our suppliers deliver products directly to our stores. We believe that our existing distribution infrastructure at our Toano facility can support our planned growth over at least the next three years with limited capital expenditures and planned logistics initiatives.

In the first quarter of 2007, we upgraded our corporate network with high-speed dedicated lines capable of carrying both voice and data communications. At this time all of our stores were rewired for voice and data. Voice communications are now carried over a scalable Internet-based network. During the first half of 2008, we plan to implement a new point-of-sale system in all of our stores. This touch screen system will provide for real-time tracking of inventory and sales information. We believe that our updated inventory management and communications systems will allow for improved forecasting, more efficient inventory management, rapid stock replenishment and concise merchandise planning.

Our Market

The hardwood flooring market represents approximately 10% of the overall U.S. floor coverings market, which includes carpet and area rugs, hardwood and softwood flooring, ceramic floor and wall tile, resilient sheet and floor tile and laminate flooring. In its November 2007 Wood Flooring report, Catalina Research estimates that the value of U.S. hardwood flooring wholesale sales in 2007 was approximately \$2.5 billion in manufacturers dollars or \$4.1 billion in retail sales. In 2007, approximately 69% of our net sales, or \$280 million, were hardwood flooring, representing an estimated market share of 6.8%. Catalina estimates that sales of hardwood flooring declined 5.0% in comparing 2007 to 2006, following a decline of 4.2% in comparing 2006 to 2005. However, without estimating a turnaround period, Catalina estimates a rebound in demand will be sharp, and hardwood flooring sales will grow at a compound annual growth rate of 7.5% through 2012.

We believe the demand impacting the wood flooring market which serves the homeowner depends on complex economic and demographic factors that influence home-related discretionary spending, and these factors may vary locally, regionally and nationally. We believe our market is impacted by home remodeling activity, employment levels, housing turnover, real estate prices, new housing starts, consumer confidence, credit availability, and the general health of consumer discretionary spending. We do not anticipate significant improvement in the general wood flooring market at least through the first half of 2008.

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Our total net sales, comparable net sales and average net sales per store older than one year all improved in 2007 compared to 2006. We believe the number of retailers serving the homeowner-based segment of the wood floor market declined in 2007, and our results benefited from increased market share. While the housing market may continue to be volatile, we also believe we will continue to benefit from several key long-term industry trends and characteristics including:

Increased Home Improvement Spending. Based on the U.S. Census Bureau construction report, residential improvement spending grew at a 7.0% compound annual growth rate from 2000 to 2005. According to the Home Improvement Research Institute, spending on home improvement products is forecasted to grow at a 5.2% compound annual growth rate from 2005 to 2010. The home improvement market is driven by several factors, which include the age of the existing housing stock, home ownership levels, average home size and demographic shifts in the population. We believe home improvement spending is currently being driven in particular by persons engaged in home remodeling projects.

Aging Housing Stock. As homes get older, homeowners remodel in order to maintain habitability, marketability and attractiveness of the home. Also, as homes get older, materials such as floor coverings that were used at the time of initial construction wear out and must be replaced or upgraded to compete with new homes. According to the U.S. Census Bureau, the median age of the U.S. housing stock was 33 years in 2005, which compares to 25 years in 1990.

Increasing Home Ownership. Data from the U.S. Census Bureau shows that the home ownership rate was 68% and owner-occupied homes totaled 75.2 million in the fourth quarter of 2007, a long-term increase from the fourth quarter of 1995, where the home ownership rate was 65% and owner-occupied homes totaled 65.4 million. Homeowners are significantly more likely to spend on residential improvements than landlords and renters. According to the Joint Center for Housing Studies of Harvard University, homeowners increased their residential improvement expenditures 10% annually from 2000 to 2005, while owners of rental properties have increased their spending by less than 4% annually over the same period.

Increasing Average Size of Homes. As homes have increased in average size, there is more floor surface to be covered. According to the U.S. Census Bureau, the average new single family home was estimated to be 2,469 square feet in 2006, a 17.9% increase from 2,095 square feet in 1995.

Favorable Demographic Trends. Purchases by households with more discretionary income have driven increased hardwood flooring sales. Catalina estimates that households with incomes of \$70,000 or more made approximately 60.9% of total hard surface flooring purchases in 2005, up from 32.8% in 1997. The population segment represented by this income bracket was one of the most quickly growing over the past decade. Similarly, households headed by people between 35 and 64 years of age tended to dominate total hard surface flooring purchases, representing 64.1% of purchases in 2005, up from 63.8% in 1997. The most significant change in this category, however, was in the age segment category 45 to 64, representing 48.3% of total hard surface flooring purchases in 2005, up from 41.1% in 1997. This segment's population will continue to grow, as the U.S. Census Bureau projects the 45 to 64 age segment to increase to 26.2% of the population by 2010 (up from 22.1% of the population in 2000). This constitutes the largest estimated population increase of any age group over that period.

Evolution of the Hardwood Flooring Market. Manufacturers today offer a wider range of wood species than they have historically, including exotic woods and bamboo, as well as distressed and handscraped flooring lines that appeal to a wider range of consumers. Additionally, manufacturers have designed hardwood flooring that is increasingly easier and less costly to install, such as prefinished, engineered floors that can be installed without glue. Prefinished hardwood floors have become highly prevalent due to ease of installation, multiple styles and applications for situations that in the past precluded the use of hardwood floors. Unfinished products usually require professional installation, sanding and multiple coats of varnish. According to industry sources, the percentage of prefinished square feet of flooring sold increased from 38% in 1999 to over 50% estimated for 2007.

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Greater Attractiveness of Hardwood Flooring. Hardwood flooring sales have grown historically, and we expect that they will continue to grow as consumer preferences shift to hardwood flooring and as industry innovations drive growth, such as through a greater range of product offerings that appeal to varied consumer preferences and hardwood flooring that has been designed for easier and less costly installation. We believe that consumers increasingly prefer hardwood flooring for its perceived cosmetic and durability advantages, as well as its ability to contribute to a healthy home because it is relatively easy to clean and traps less dust, dirt and bacteria than some other types of flooring.

Our Competition

We are the largest specialty retailer of hardwood flooring in the United States, and compete in a hardwood flooring market that is highly fragmented. We compete on the basis of price, quality, selection and availability of the hardwood flooring that we offer our customers, as well as the level of customer service we can provide. 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. The market includes both national and regional home improvement chains which specialize in the lower-end, higher-volume flooring market and offer a wide range of home improvement products other than flooring. We also compete against smaller national specialty flooring chains, some of which have an Internet presence, and a large number of local and regional independent flooring retailers, including a large number of privately-owned single-site enterprises.

We estimate, based on internal market research that our share of the hardwood flooring retail market was approximately 7% in 2007, up from approximately 6% in 2006. We believe that we compete effectively against the large national chains by offering competitive prices, higher-quality hardwood flooring products, a broader product assortment, a shorter delivery time, and better customer service by virtue of our more knowledgeable sales staff. In addition, we believe that our largest competitors with Internet operations focus to a greater extent on the lower-priced segment of the hardwood flooring market, particularly engineered, bamboo and laminate flooring. The remainder of the hardwood flooring market is dominated by small local independent retailers that usually sell carpet and tile in addition to hardwood flooring. Most of these retailers purchase their hardwood flooring from domestic manufacturers or distributors, and typically do not stock hardwood flooring, but order it only when the customer makes a purchase. As a result, we believe it takes these retailers longer than us to deliver their product to customers, and their prices tend to be higher than ours. We also compete against companies that sell other types of floor coverings, such as carpet, vinyl sheet and tile, ceramic tile, natural stone and others.

Our Employees

As of December 31, 2007, we had 670 employees, 96% of whom were full-time and none of whom were represented by a union. Of these employees, 65% work in our stores, 16% work in corporate store support infrastructure or similar functions (including our call center employees) and 19% work either on our finishing line or in our distribution center. We believe that we have good relations with our employees.

Intellectual Property and Trademarks

We have a number of marks registered in the United States, including Lumber Liquidators®, Bellwood®, 1-800-FLOORING®, Dura-Wood®, Blutec®, 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, Australia and Japan, and have registration applications pending in several other jurisdictions. We regard our intellectual property as having significant value and these names are an important factor in the marketing of our brands. We are not aware of any facts that could be expected to have a material adverse effect on our intellectual property.

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Government Regulation

We are subject to extensive and varied federal, state and local government regulation, including regulations relating to employment, public health and safety, zoning and fire codes. We operate each of our stores, finishing facility and distribution center in accordance with standards and procedures designed to comply with applicable codes and regulations.

Our operations and properties are also subject to federal, 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 clean up of contaminated properties, including off-site disposal locations. We do not incur significant costs complying with environmental laws and regulations. However, we could be subject to material environmental costs, liabilities or claims in the future, especially in the event of changes in existing laws and regulations or in their interpretation.

Our suppliers are also subject to the laws and regulations of their home countries, including in particular laws regulating forestry and the environment. We consult with our suppliers as appropriate to ensure that they are in compliance with applicable home country laws. We also support social and environmental responsibility among our supplier community, and the majority of our major suppliers have entered into an environmental and social responsibility agreement with us. This agreement contains a code of conduct regarding our expectations concerning environmental, labor and health and safety matters, which includes among its guidelines an understanding that our suppliers must comply with the laws, rules and regulations of the countries in which they operate.

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 SEC free of charge at 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 450 Fifth Street, NW., 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, that contains reports, proxy and information statements, and other information that we file electronically with the SEC.

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Item 1A. Risk Factors.

Cautionary Note Regarding Forward-Looking Statements

This report includes statements of our expectations, intentions, plans and beliefs that constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 and are intended to come within the safe harbor protection provided by those sections. These statements, which involve risks and uncertainties, relate to matters such as sales growth, comparable store net sales, impact of cannibalization, price changes, earnings performance, stock-based compensation expense, margins, return on invested capital, strategic direction, the demand for our products and store openings. We have used words such as may, will, should, expects, intends, plans, anticipates, believes, thinks, estimates, seeks, expects, predicts, could, projects, potential and other similar including references to assumptions, in this report to identify forward-looking statements. These forward-looking statements are made based on expectations and beliefs concerning future events affecting us and are subject to uncertainties, risks and factors relating to our operations and business environments, all of which are difficult to predict and many of which are beyond our control, that could cause our actual results to differ materially from those matters expressed or implied by these forward-looking statements. These risks and other factors include those listed in this Item 1A. Risk Factors, and elsewhere in this report.

When considering these forward-looking statements, you should keep in mind the cautionary statements in this report and the documents incorporated by reference. New risks and uncertainties arise from time to time, and we cannot predict those events or how they may affect us. There may also be other factors that we cannot anticipate or that are not described in this report that could cause results to differ materially from our expectations. Forward-looking statements speak only as of the date they are made and we assume no obligation to update them after the date of this report as a result of new information, future events or subsequent developments, except as required by the federal securities laws.

Risks Related to Our Business and Industry

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. If:

the national economy or any regional or local economy where we operate weakens;

interest rates rise;

credit becomes less available;

regions where we operate experience unfavorable demographic trends;

fuel costs or utility expenses increase; or

home-price appreciation slows;

that could limit discretionary consumer spending, reduce spending on remodeling of existing homes and cause purchases of new homes to decline. For example, although our net sales increased during 2006 and 2007, Catalina Research estimates that sales of hardwood flooring declined 5.0% in comparing 2007 to 2006, following a decline of 4.2% in comparing 2006 to 2005. Any one or a combination of these factors could result in decreased demand for hard surface flooring, including in particular premium hardwood flooring, in remodeled and new homes, which would harm our business and operating results.

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The planned rapid increase in the number of our stores may make our future results unpredictable.

As of December 31, 2007, we had 116 stores throughout the United States, 60 of which we opened after January 1, 2005. We plan to open between 30 and 40 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 successful selection of new markets and store locations, our ability to negotiate leases on acceptable terms, management of pre-opening expenses, 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, 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 a new market may be less familiar with our brands, and we may need to increase brand awareness in that market through additional investments in advertising. Stores opened in new markets may have higher construction, occupancy or operating costs, or may have lower average store net sales, than stores opened in the past. In addition, we may incur higher maintenance costs associated with our strategy of seeking out low-cost store locations 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. 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.

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 catalog. 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 staff. In addition, we have hired a number of senior managers in 2006 and 2007, and execution of our strategy requires that they be integrated effectively. We may not respond quickly enough to the changing demands that our expansion will impose on our management, staff and existing infrastructure. Any failure to manage our growth effectively could harm our business and operating results.

Our ability to produce 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, ebony, mahogany and teak. Some of these species are scarce, and we cannot be assured of their continued availability, especially of exotic hardwoods that comprise a significant portion of our more profitable products. 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 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, we would need to curtail finishing of the relevant product lines, which could cause our operating results to deteriorate.

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

We rely on a concentrated number of suppliers for the majority of our supply needs. In 2007, one of our suppliers, Sequoia Floorings, accounted for approximately 22% of our purchases, and acted as an agent for another of our suppliers which accounted for another 3% of our purchases. Including those companies, our top 10

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suppliers account for approximately 66% of our purchases in 2007. 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. Our suppliers may be unable to supply us in the future 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 or tariffs, insufficient transport capacity and other factors beyond our control. If we can no longer obtain merchandise from our major 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 a deterioration in our net sales and operating results.

If we fail to identify and develop relationships with a sufficient number of qualified mills, our ability to obtain hardwood 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 mills 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 in the future. Any inability to do so could reduce our competitiveness, slow our plans for further expansion and cause our sales and operating results to deteriorate.

Our ability to obtain hardwood 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 hardwood products that meet our specifications. In 2007, approximately 38% of our product was sourced from Asia, approximately 18% was sourced from South America and approximately 9% was sourced from other locations outside of North America. As a result, we are subject to risks associated with obtaining products from abroad, including:

political unrest, terrorism and