

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2004

or

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

For the transition period from _____ to _____

Commission File Number: 1-11692

Ethan Allen Interiors Inc.

(Exact name of registrant as specified in its charter)

Delaware

06-1275288

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer ID No.)

Ethan Allen Drive, Danbury, Connecticut 06811

(Address of principal executive offices)

(203) 743-8000

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

At September 30, 2004, there were 35,942,528 shares of Class A Common Stock, par value \$.01, outstanding.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(In thousands, except share data)

	September 30, 2004	June 30, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 35,960	\$ 27,528
Accounts receivable, less allowance for doubtful accounts of \$2,030 at September 30, 2004 and \$2,194 at June 30, 2004	25,932	26,967
Inventories (note 4)	179,194	186,895
Prepaid expenses and other current assets	31,106	28,166
Deferred income taxes	25,575	26,026
Total current assets	297,767	295,582
Property, plant and equipment, net	274,794	277,021
Intangible assets, net (note 6)	80,181	80,038
Other assets	2,549	1,790
Total assets	\$ 655,291	\$ 654,431
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current maturities of long-term debt and capital lease obligations	\$ 4,693	\$ 4,712
Customer deposits	59,973	56,026
Accounts payable	28,387	22,222
Accrued compensation and benefits	26,370	27,950
Accrued expenses and other current liabilities (note 5)	24,563	25,779
Total current liabilities	143,986	136,689
Long-term debt	4,490	4,509
Other long-term liabilities	1,154	1,205
Deferred income taxes	52,287	51,248
Total liabilities	201,917	193,651
Shareholders' equity:		
Class A common stock, par value \$.01, 150,000,000 shares authorized; 45,822,983 shares issued at September 30, 2004 and 45,812,032 shares issued at June 30, 2004	458	458
Class B common stock, par value \$.01, 600,000 shares authorized; no shares issued and outstanding at September 30, 2004 and June 30, 2004	--	--

Preferred stock, par value \$.01, 1,055,000 shares authorized; no shares issued and outstanding at September 30, 2004 and June 30, 2004	--	--
Additional paid-in capital	290,060	289,707
	<u>290,518</u>	<u>290,165</u>
Less: Treasury stock (at cost), 9,880,455 shares at September 30, 2004 and 9,255,955 shares at June 30, 2004	(265,786)	(244,026)
Retained earnings	427,558	414,041
Accumulated other comprehensive income (note 9)	1,084	600
	<u>453,374</u>	<u>460,780</u>
Total shareholders' equity	453,374	460,780
Total liabilities and shareholders' equity	\$ 655,291	\$ 654,431

See accompanying notes to consolidated financial statements.

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ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES
Consolidated Statements of Operations
(In thousands, except per share data)

	Three Months Ended September 30,	
	2004	2003
Net sales	\$ 230,346	\$ 222,765
Cost of sales	119,953	114,322
	<u>110,393</u>	<u>108,443</u>
Gross profit	110,393	108,443
Operating expenses:		
Selling	43,213	44,609
General and administrative	36,112	35,522
Restructuring and impairment charges (note 5)	(167)	(264)
	<u>79,158</u>	<u>79,867</u>
Total operating expenses	79,158	79,867
Operating income	31,235	28,576
Interest and other miscellaneous income, net	(55)	2,211
Interest and other related financing costs	149	141
	<u>31,031</u>	<u>30,646</u>
Income before income taxes	31,031	30,646
Income tax expense	12,102	11,707
	<u>18,929</u>	<u>18,939</u>
Net income	\$ 18,929	\$ 18,939
Per share data (note 8):		
Basic earnings per common share:		
Net income per basic share	\$ 0.52	\$ 0.51
	<u>36,211</u>	<u>37,227</u>
Basic weighted average common shares	36,211	37,227
Diluted earnings per common share:		
Net income per diluted share	\$ 0.51	\$ 0.50
	<u>37,098</u>	<u>38,247</u>
Diluted weighted average common shares	37,098	38,247

See accompanying notes to consolidated financial statements.

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ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(In thousands)

	Three Months Ended September 30,	
	2004	2003
Operating activities:		
Net income	\$ 18,929	\$ 18,939
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,250	5,265
Compensation expense (benefit) related to restricted stock award	79	66
Provision (benefit) for deferred income taxes	1,490	2,014
Restructuring and impairment charges (credits)	(167)	(264)

(Gain) loss on disposal of property, plant and equipment	200	(1,129)
Other	14	12
Change in assets and liabilities, net of the effects of acquired and divested businesses:		
Accounts receivable	1,035	(1,699)
Inventories	7,701	7,910
Prepaid expenses and other current assets	1,117	3,681
Other assets	(945)	331
Customer deposits	3,947	6,511
Accounts payable	3,069	7,569
Accrued expenses and other current liabilities	(4,302)	1,137
Other long-term liabilities	(51)	(371)
Net cash provided by operating activities	37,366	49,972
Investing activities:		
Proceeds from the disposal of property, plant and equipment	34	3,425
Capital expenditures	(7,480)	(4,010)
Acquisitions	(54)	--
Other	338	35
Net cash used in investing activities	(7,162)	(550)
Financing activities:		
Payments on long-term debt and capital leases	(42)	(53)
Net proceeds from issuance of common stock	183	861
Dividends paid	(3,664)	(2,614)
Payments to acquire treasury stock	(18,573)	--
Net cash used in financing activities	(22,096)	(1,806)
Effect of exchange rate changes on cash	324	13
Net increase (decrease) in cash and cash equivalents	8,432	47,629
Cash and cash equivalents - beginning of year	27,528	81,856
Cash and cash equivalents - end of period	\$ 35,960	\$ 129,485

See accompanying notes to consolidated financial statements.

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ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES
Consolidated Statements of Shareholders' Equity
Three Months Ended September 30, 2004
(In thousands, except share data)

	Common Stock	Additional Paid-in Capital	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total
Balance at June 30, 2004	\$ 458	\$ 289,707	\$ (244,026)	\$ 600	\$ 414,041	\$ 460,780
Issuance of 10,951 shares of common stock upon the exercise of stock options and restricted stock award compensation	--	262	--	--	--	262
Purchase of treasury stock	--	--	(21,760)	--	--	(21,760)
Tax benefit associated with the exercise of employee stock options	--	91	--	--	--	91
Dividends declared on common stock	--	--	--	--	(5,412)	(5,412)
Other comprehensive income (note 9)	--	--	--	484	--	484
Net income	--	--	--	--	18,929	18,929
Total comprehensive income						19,413
Balance at September 30, 2004	\$ 458	\$ 290,060	\$ (265,786)	\$ 1,084	\$ 427,558	\$ 453,374

See accompanying notes to consolidated financial statements.

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Notes to Consolidated Financial Statements

(1) Basis of Presentation

Ethan Allen Interiors Inc. (the "Company") is a Delaware corporation incorporated on May 25, 1989. The consolidated financial statements include the accounts of the Company, its wholly-owned subsidiary Ethan Allen Inc. ("Ethan Allen"), and Ethan Allen's subsidiaries. All of Ethan Allen's capital stock is owned by the Company. The Company has no assets or operating results other than those associated with its investment in Ethan Allen.

(2) Interim Financial Presentation

All intercompany accounts and transactions have been eliminated in the consolidated financial statements. In the opinion of the Company, all adjustments, consisting only of normal recurring accruals necessary for fair presentation, have been included in the consolidated financial statements. The results of operations for the three months ended September 30, 2004 are not necessarily indicative of results that may be expected for the entire fiscal year. The interim consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in the Company's Annual Report on Form 10-K for the year ended June 30, 2004.

Certain reclassifications have been made to prior years' financial statements in order to conform to the current year's presentation. These changes were made for disclosure purposes only and did not have any impact on previously reported results of operations or shareholders' equity.

(3) Employee Stock Plans

The Company's 1992 Stock Option Plan (the "Plan") is accounted for in accordance with the recognition and measurement provisions of Accounting Principles Board Opinion ("APB") No. 25, *Accounting for Stock Issued to Employees*, and related interpretations, which employs the intrinsic value method of measuring compensation cost. Accordingly, compensation expense is not recognized for fixed stock options if the exercise price of the option equals the fair value of the underlying stock at the grant date. For certain stock-based awards, where the exercise price is equal to zero, the fair value of the award, measured at the grant date, is amortized to compensation expense on a straight-line basis over the vesting period. In addition, other stock-based award programs provided for under the Plan may also result in the recognition of compensation expense (benefit) to the extent they are deemed to be variable (as that term is defined in APB No. 25) in nature.

Statement of Financial Accounting Standards ("SFAS") No. 123, *Accounting for Stock-Based Compensation*, encourages recognition of the fair value of all stock-based awards on the date of grant as expense over the vesting period. However, as permitted by SFAS No. 123, the Company continues to apply the intrinsic value-based method of accounting prescribed by APB Opinion No. 25 and discloses certain pro-forma amounts as if the fair value approach of SFAS No. 123 had been applied.

In December 2002, the FASB issued SFAS No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure, an amendment of SFAS No. 123*, to provide alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation. In addition, this standard amends the disclosure requirements of SFAS No. 123 by requiring more prominent pro-forma disclosures in both the annual and interim financial statements. The following table, which addresses the disclosure requirements of SFAS No. 148, illustrates the effect on net income and earnings per share if the fair value recognition provisions of SFAS No. 123 had been applied to all outstanding and unvested awards in each period.

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ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

The Company employs the Black-Scholes option-pricing model for purposes of estimating the fair value of stock options granted.

(in thousands, except per share data)	Three Months Ended September 30,	
	2004	2003
Net income as reported	\$ 18,929	\$ 18,939
Add: Stock-based employee compensation expense (benefit) included in reported net income, net of related tax effects	48	41
Deduct: Stock-based employee compensation expense determined under the fair value-based method for all awards granted since July 1, 1995, net of related tax effects	(1,597)	(1,007)
Pro forma net income	\$ 17,380	\$ 17,973
Net income per share:		
Basic - as reported	\$ 0.52	\$ 0.51
Basic - pro forma	\$ 0.48	\$ 0.48
Diluted - as reported	\$ 0.51	\$ 0.50
Diluted - pro forma	\$ 0.47	\$ 0.47

(4) Inventories

Inventories at September 30, 2004 and June 30, 2004 are summarized as follows (in thousands):

	September 30, 2004	June 30, 2004
Finished goods	\$ 140,468	\$ 148,240
Work in process	10,029	10,840
Raw materials	28,697	27,815
	<u>\$ 179,194</u>	<u>\$ 186,895</u>

Inventories are presented net of a related valuation allowance of \$3.6 million at September 30, 2004 and \$3.2 million at June 30, 2004.

(5) Restructuring and Impairment Charges

In recent years, the Company has developed, announced and executed plans to consolidate its manufacturing operations as part of an overall strategy to maximize production efficiencies and maintain its competitive advantage.

In the fourth quarter of fiscal 2004, the Company announced a plan to close and consolidate two of its manufacturing facilities. The plants, both involved in the production of wood case goods furniture, were located in Boonville, New York and Bridgewater, Virginia. The plant closures resulted in a headcount reduction totaling approximately 460 employees; 270 employees effective June 25, 2004, and 190 employees throughout the first quarter of fiscal 2005. A pre-tax restructuring and impairment charge of \$12.8 million was recorded for costs associated with these plant closings, of which \$4.5 million was related to employee severance and benefits and other plant exit costs, and \$8.3 million was related to fixed asset impairment charges, primarily for real property and machinery and equipment associated with the closed facilities. During the quarter ended September 30, 2004, adjustments

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ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

totaling \$0.2 million were recorded to reverse certain of these previously established accruals which were no longer deemed necessary.

As of September 30, 2004, restructuring reserves totaling \$0.2 million were included in the Consolidated Balance Sheet as an accrued expense within current liabilities. Activity in the Company's fiscal 2004 restructuring reserve is summarized as follows (in thousands):

	Original Charges	Cash Payments	Non-cash Utilized	Balance at September 30, 2004
Employee severance and other related payroll and benefit costs	\$ 4,393	\$ (4,051)	\$ (167)(a)	\$ 175
Other plant exit costs	120	(120)	--	--
Write-down of long-lived assets	8,271	--	(8,271)	--
	<u>\$ 12,784</u>	<u>\$ (4,171)</u>	<u>\$ (8,438)</u>	<u>\$ 175</u>

(a) Amount represents the reversal of certain previously established accruals which were no longer required.

(6) Goodwill and Other Intangible Assets

On July 1, 2001, the Company adopted SFAS No. 142, *Goodwill and Other Intangible Assets*. As of September 30, 2004, the Company had goodwill, including product technology, of \$60.4 million and other identifiable intangible assets of \$19.7 million. Comparable balances as of June 30, 2004 were \$60.3 million and \$19.7 million, respectively.

Goodwill in the wholesale and retail segments was \$27.5 million and \$32.9 million, respectively, at September 30, 2004 and \$27.5 million and \$32.8 million, respectively, at June 30, 2004.

The wholesale segment, at both dates, includes additional intangible assets of \$19.7 million. These assets consist of Ethan Allen trade names which were formerly being amortized over 40 years. The Company re-assessed the useful lives of goodwill and other intangible assets and both were determined to have indefinite useful lives. As such, amortization of these assets ceased on July 1, 2001. No impairment losses have been recorded on these intangible assets as a result of the adoption of Statement 142.

(7) Litigation

The Company and its subsidiaries are subject to various environmental laws and regulations. Under these laws, the Company and/or its subsidiaries are, or may be, required to remove or mitigate the effects on the environment of the disposal or release of certain hazardous materials.

As of September 30, 2004, the Company and/or its subsidiaries has been named as a potentially responsible party ("PRP") with respect to the remediation of four active sites currently listed, or proposed for inclusion, on the National Priorities List ("NPL") under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, ("CERCLA"). The sites are located in Lyndonville, Vermont; Southington, Connecticut; High Point, North Carolina; and Atlanta, Georgia.

With respect to the Lyndonville, Vermont site, the Company has substantially resolved its liability by completing remedial construction activities. The Company continues to work with the U.S. Environmental Protection Agency (“EPA”) and has obtained its certificate of construction completion, subject to certain limited

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

conditions. The Company does not anticipate incurring significant costs with respect to the Southington, Connecticut and High Point, North Carolina sites as it believes that it is not a major contributor based on the very small volume of waste generated by the Company in relation to total volume at those sites. Specifically, with respect to the Southington site, the Company’s volumetric share is less than 1% of over 51 million gallons disposed of at the site and there are more than 1,000 PRPs. With respect to the High Point site, the Company’s volumetric share is less than 1% of over 18 million gallons disposed of at the site and there are more than 2,000 PRPs, including 1,100 “de-minimis” parties (of which Ethan Allen is one). With respect to the Atlanta site, a former solvent recycling/reclamation facility, the Company’s volumetric share is currently under review, but it is believed to consist of less than 1% of over 20 million gallons disposed of at the site by more than 1,700 PRPs. In all three cases, the other PRPs consist of local, regional, national and multi-national companies.

Liability under CERCLA may be joint and several. As such, to the extent certain named PRPs are unable, or unwilling, to accept responsibility and pay their apportioned costs, the Company could be required to pay in excess of its pro rata share of incurred remediation costs. The Company’s understanding of the financial strength of other PRPs has been considered, where appropriate, in the determination of the Company’s estimated liability. As of September 30, 2004, the Company believes that established reserves related to these environmental contingencies are adequate to cover probable and reasonably estimable costs associated with the remediation and restoration of these sites.

Additionally, the Company was notified, in July 2000, by the State of New York (the “State”) that it may be named a PRP in a separate, unrelated matter with respect to a site located in Carroll, New York. To date, no further notice has been received from the State and the EPA has still not conducted its initial environmental study at this site. Therefore, the extent of any adverse effect on the Company’s financial condition, results of operations, or cash flows with respect to this matter cannot be reasonably estimated at this time.

Ethan Allen is subject to other federal, state and local environmental protection laws and regulations and is involved, from time to time, in investigations and proceedings regarding environmental matters. Such investigations and proceedings typically concern air emissions, water discharges, and/or management of solid and hazardous wastes. The Company believes that its facilities are in material compliance with all such applicable laws and regulations.

Regulations issued under the Clean Air Act Amendments of 1990 required the industry to reformulate certain furniture finishes or institute process changes to reduce emissions of volatile organic compounds. Compliance with many of these requirements has been facilitated through the introduction of high solids coating technology and alternative formulations. In addition, the Company has instituted a variety of technical and procedural controls, including reformulation of finishing materials to reduce toxicity, implementation of high velocity low pressure spray systems, development of storm water protection plans and controls, and further development of related inspection/audit teams, all of which have served to reduce emissions per unit of production. Ethan Allen remains committed to implementing new waste minimization programs and/or enhancing existing programs with the objective of (i) reducing the total volume of waste, (ii) limiting the liability associated with waste disposal, and (iii) continuously improving environmental and job safety programs on the shop floor which serve to minimize emissions and safety risks for employees. The Company will continue to evaluate the most appropriate, cost effective, control technologies for finishing operations and design production methods to reduce the use of hazardous materials in the manufacturing process.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(8) Earnings Per Share

Basic and diluted earnings per share are calculated using the following weighted average share data (in thousands):

	Three Months Ended September 30,	
	2004	2003
Weighted average common shares outstanding for basic calculation	36,211	37,227
Effect of dilutive stock options and awards	887	1,020
Weighted average common shares outstanding, adjusted for diluted calculation	37,098	38,247

As of September 30, 2004 and 2003, stock options to purchase 308,266 and 69,973 shares of common stock, respectively, had exercise prices which exceeded the average market price of the Company’s common stock for the corresponding period. These options have been excluded from the respective diluted earnings per share calculation as their impact is anti-dilutive.

(9) Comprehensive Income

Total comprehensive income represents the sum of net income and items of “other comprehensive income or loss” that are reported directly in equity. Such items may include foreign currency translation adjustments, minimum pension liability adjustments, fair value adjustments on certain derivative instruments, and unrealized gains and losses on certain investments in debt and equity securities. The Company has reported its total comprehensive income in the Consolidated Statement of Shareholders’ Equity.

The Company's accumulated other comprehensive income, which is attributable solely to foreign currency translation adjustments, was \$1.1 million at September 30, 2004 and \$0.6 million at June 30, 2004. These amounts are the result of changes in foreign currency exchange rates related to the operations of 7 Ethan Allen-owned retail stores located in Canada. Foreign currency translation adjustments exclude income tax expense (benefit) given that the earnings of non-U.S. subsidiaries are deemed to be reinvested for an indefinite period of time.

(10) Segment Information

The Company's reportable segments represent strategic business areas which, although they operate separately, both offer the Company's complete line of home furnishings through their own distinctive services. The Company's operations are classified into two such segments: wholesale and retail.

The wholesale segment is principally involved in the development of the Ethan Allen brand, which encompasses the design, manufacture, domestic and off-shore sourcing, sale and distribution of a full range of home furnishings to a network of independently-owned and Ethan Allen-owned stores as well as related marketing and brand awareness efforts. Wholesale profitability includes the wholesale gross margin, which is earned on wholesale sales to all retail stores, including Ethan Allen-owned stores.

The retail segment sells home furnishings to consumers through a network of Company-owned stores. Retail profitability includes the retail gross margin, which represents the difference between retail sales price and the cost of goods purchased from the wholesale segment.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

While the manner in which the Company's home furnishings are marketed and sold is consistent, the nature of the underlying recorded sales (i.e. wholesale versus retail) and the specific services that each operating segment provides (i.e. wholesale manufacture and distribution versus retail sales) are different.

Within the wholesale segment, the Company maintains revenue information according to each respective product line (i.e. case goods, upholstery, or home accessories and other). A breakdown of wholesale sales by these product lines is provided below:

	Three Months Ended September 30,	
	2004	2003
Case Goods	52%	53%
Upholstered Products	34	33
Home Accessories and Other	14	14
	100%	100%

Revenue information by product line is not readily available within the retail segment as it is not practicable. However, because wholesale production and sales are matched, for the most part, to incoming orders, the Company believes that the allocation of retail sales would be similar to that of the wholesale segment.

The Company evaluates performance of the respective segments based upon revenues and operating income. Inter-segment eliminations result, primarily, from the wholesale sale of inventory to the retail segment, including the related profit margin. Inter-segment eliminations also include items not allocated to reportable segments.

The following table presents segment information for the three months ended September 30, 2004 and 2003 (in thousands):

	Three Months Ended September 30,	
	2004	2003
Net Sales:		
Wholesale segment	\$ 161,315	\$ 158,919
Retail segment	141,710	132,656
Elimination of inter-company sales	(72,679)	(68,810)
Consolidated Total	\$ 230,346	\$ 222,765
Operating Income:		
Wholesale segment	\$ 28,300	\$ 26,976
Retail segment	3,199	205
Elimination (1)	(264)	1,395
Consolidated Total	\$ 31,235	\$ 28,576
Capital Expenditures:		
Wholesale segment	\$ 1,294	\$ 1,868
Retail segment	6,186	2,142
Acquisitions (2)	54	--
Consolidated Total	\$ 7,534	\$ 4,010
	September 30, 2004	June 30, 2003
Total Assets:		

Wholesale segment	\$ 381,941	\$ 383,521
Retail segment	304,503	301,627
Inventory profit elimination (3)	(31,153)	(30,717)
Consolidated Total	\$ 655,291	\$ 654,431

- (1) Adjustment represents the change in the elimination entry for profit in ending inventory.
- (2) There were no acquisitions completed during the three months ended September 30, 2004 or 2003.
- (3) Inventory profit elimination reflects the embedded wholesale profit in the Ethan Allen-owned store inventory that has not been realized. These profits will be realized when inventory is shipped to the retail customer.

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ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

At September 30, 2004, there were 32 Ethan Allen retail stores located outside the United States, of which 25 were independently-owned. The Company's net sales derived from sales to non-domestic, independently-owned retail stores totaled less than 2% of consolidated sales for the three month periods ended September 30, 2004 and 2003.

(11) Subsequent Events

Stock Repurchases and Remaining Authorization

The Company has been authorized by its Board of Directors to repurchase its common stock, from time to time, either directly or through agents, in the open market at prices and on terms satisfactory to the Company. As of September 30, 2004, the Company had a remaining Board authorization to purchase 1.2 million shares. Subsequent to September 30, 2004 and through November 4, 2004, the Company repurchased, in 10 separate open market transactions, an additional 477,000 shares of its common stock at a total cost of \$16,595,872, representing an average price per share of \$34.79. All of the Company's common stock repurchases and retirements are recorded as treasury stock and result in a reduction of shareholders' equity.

Repayment of Debt

As of September 30, 2004, approximately \$4.6 million of the Company's debt is related to floating rate industrial revenue bonds which were issued to finance the construction of its Maiden, North Carolina manufacturing facility. These bonds matured on October 1, 2004 and were fully repaid by the Company on that date.

Recent Tax Legislation

On October 22, 2004, the American Jobs Creation Act of 2004 (the "Act") was signed into law. The Company is currently reviewing the provisions of the Act in order to determine its impact, if any, on the Company's future consolidated financial condition, results of operations, and cash flows.

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ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion of financial condition and results of operations should be read in conjunction with (i) the Consolidated Financial Statements of the Company, and notes thereto, as set forth in this Form 10-Q and (ii) the Company's Annual Report on Form 10-K for the year ended June 30, 2004.

Forward-Looking Statements

Management's discussion and analysis of financial condition and results of operations and other sections of this Quarterly Report contain forward-looking statements relating to future results of the Company. Such forward-looking statements are identified by use of forward-looking words such as "anticipates", "believes", "plans", "estimates", "expects", and "intends" or words or phrases of similar expression. These forward-looking statements are subject to management decisions and various assumptions, risks and uncertainties, including, but not limited to: changes in political and economic conditions; changes in demand for the Company's products; acceptance of new products; changes in conditions in the various geographic markets where the Company does business; technology developments affecting the Company's products; changes in laws and regulations; and those matters discussed in the Company's filings with the Securities and Exchange Commission ("SEC"). Accordingly, actual circumstances and results could differ materially from those contemplated by the forward-looking statements.

Critical Accounting Policies

The Company's consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America which require, in some cases, that certain estimates and assumptions be made that affect the amounts and disclosures reported in those financial statements and the related accompanying notes. Estimates are based on currently known facts and circumstances, prior experience and other assumptions believed to be reasonable. Management uses its best judgment in valuing these estimates and may, as warranted, solicit external advice. Actual results could differ from these estimates, assumptions and judgments and these differences could be material. The following critical accounting policies, some of which are impacted significantly by estimates, assumptions and judgments, affect the Company's consolidated financial statements.

Inventories – Inventories (finished goods, work in process and raw materials) are stated at the lower of cost, determined on a first-in, first-out basis, or market. Cost is determined based solely on those charges incurred in the acquisition and production of the related inventory (i.e. material, labor and manufacturing overhead costs). The Company estimates an inventory reserve for excess quantities and obsolete items based on specific identification and historical write-offs, taking into account future demand and market conditions. If actual demand or market conditions in the future are less favorable than those estimated, additional inventory write-downs may be required.

Revenue Recognition – Revenue is recognized when all of the following have occurred: persuasive evidence of a sales arrangement exists (e.g. a wholesale purchase order or retail sales invoice); the sales arrangement specifies a fixed or determinable sales price; product is shipped or services are provided to the customer; and collectibility is reasonably assured. This occurs upon the shipment of goods to independent retailers or, in the case of Ethan Allen-owned retail stores, upon delivery to the customer. Recorded sales provide for estimated returns and allowances. The Company permits retail customers to return defective products and incorrect shipments, and terms offered by the Company are standard for the industry.

Allowance for Doubtful Accounts – The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. The allowance for doubtful accounts is based on a review of specifically identified accounts in addition to an overall aging analysis. Judgments are made with respect to the collectibility of accounts receivable based on historical experience and current economic trends. Actual losses could differ from those estimates.

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Retail Store Acquisitions – The Company accounts for the acquisition of retail stores and related assets in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 141, *Business Combinations*, which requires application of the purchase method for all business combinations initiated after June 30, 2001. Accounting for these transactions as purchase business combinations requires the allocation of purchase price paid to the assets acquired and liabilities assumed based on their fair values as of the date of the acquisition. The amount paid in excess of the fair value of net assets acquired is accounted for as goodwill.

Impairment of Long-Lived Assets and Goodwill – The Company periodically evaluates whether events or circumstances have occurred that indicate that long-lived assets may not be recoverable or that the remaining useful life may warrant revision. When such events or circumstances are present, the Company assesses the recoverability of long-lived assets by determining whether the carrying value will be recovered through the expected undiscounted future cash flows resulting from the use of the asset. In the event the sum of the expected undiscounted future cash flows is less than the carrying value of the asset, an impairment loss equal to the excess of the asset’s carrying value over its fair value is recorded. The long-term nature of these assets requires the estimation of its cash inflows and outflows several years into the future and only takes into consideration technological advances known at the time of the impairment test.

In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, goodwill and other intangible assets are to be evaluated for impairment at the reporting unit level on an annual basis and between annual tests whenever events or circumstances indicate that the carrying value of a reporting unit may exceed its fair value. The Company conducts its required annual impairment test during the fourth quarter of each fiscal year. The impairment test uses a discounted cash flow model to estimate the fair value of a reporting unit. This model requires the use of long-term planning forecasts and assumptions regarding industry-specific economic conditions that are outside the control of the Company.

Business Insurance Reserves – The Company has insurance programs in place to cover workers’ compensation and property/casualty claims. The insurance programs, which are funded through self-insured retention, are subject to various stop-loss limitations. The Company accrues estimated losses using actuarial models and assumptions based on historical loss experience. Although management believes that the insurance reserves are adequate, the reserve estimates are based on historical experience, which may not be indicative of current and future losses. In addition, the actuarial calculations used to estimate insurance reserves are based on numerous assumptions, some of which are subjective. The Company adjusts insurance reserves, as needed, in the event that future loss experience differs from historical loss patterns.

Other Loss Reserves – The Company has a number of other potential loss exposures incurred in the ordinary course of business such as environmental claims, product liability, litigation, tax liabilities, restructuring charges, and the recoverability of deferred income tax benefits. Establishing loss reserves for these matters requires management’s estimate and judgment with regard to maximum risk exposure and ultimate liability or realization. As a result, these estimates are often developed with the Company’s counsel, or other appropriate advisors, and are based on management’s current understanding of the underlying facts and circumstances. Because of uncertainties related to the ultimate outcome of these issues or the possibilities of changes in the underlying facts and circumstances, additional charges related to these issues could be required in the future.

Results of Operations

Ethan Allen’s revenues are comprised of (i) wholesale sales to independently-owned and Company-owned retail stores and (ii) retail sales of Company-owned stores. See Note 10 to the Company’s Consolidated Financial Statements for the three months ended September 30, 2004 and 2003.

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The components of consolidated revenue and operating income were as follows (in millions):

	Three Months Ended September 30,	
	2004	2003
Revenue:		
Wholesale segment	\$ 161.3	\$ 158.9
Retail segment	141.7	132.7
Elimination of inter-company sales	(72.7)	(68.8)
Consolidated Revenue	<u>\$ 230.3</u>	<u>\$ 222.8</u>
Operating Income:		
Wholesale segment	\$ 28.3	\$ 27.0
Retail segment	3.2	0.2
Elimination (1)	(0.3)	1.4
Consolidated Operating Income	<u>\$ 31.2</u>	<u>\$ 28.6</u>

(1) Adjustment represents the change in the elimination entry for profit in ending inventory.

Quarter Ended September 30, 2004 Compared to Quarter Ended September 30, 2003

Consolidated revenue for the three months ended September 30, 2004 increased by \$7.5 million, or 3.4%, to \$230.3 million, from \$222.8 million for the three months ended September 30, 2003. Net sales for the period reflect the delivery of product associated with booked orders and related backlog existing as the end of the preceding quarter. The increase in net sales for the period was due, primarily, to the continued expansion and strategic re-positioning of the Company’s retail segment and the success of recent

product introductions. These increases were partially offset by the effects of hurricanes and resultant flooding experienced during the period throughout the South and Southeast regions of the country which adversely impacted the Company's ability to make deliveries.

Total wholesale revenue for the first quarter of fiscal 2005 increased by \$2.4 million, or 1.5%, to \$161.3 million from \$158.9 million in the first quarter of fiscal 2004. The increase is attributable to higher backlog existing as of the end of the preceding quarter as compared to the same period in the prior year, improved stock position in certain imported product lines, and increased throughput within the Company's upholstery operations.

Total retail revenue from Ethan Allen-owned stores for the three months ended September 30, 2004 increased by \$9.0 million, or 6.8%, to \$141.7 million from \$132.7 million for the three months ended September 30, 2003. The increase in retail sales by Ethan Allen-owned stores was attributable to an increase in sales generated by newly opened (including relocated) or acquired stores of \$5.0 million, and an increase in comparable store delivered sales of \$6.1 million, or 4.9%, partially offset by a decrease resulting from closed stores, which generated \$2.1 million fewer sales in the first quarter of fiscal 2005 as compared to the same period in fiscal 2004. The number of Ethan Allen-owned stores increased to 127 as of September 30, 2004 as compared to 120 as of September 30, 2003. During that twelve month period, the Company acquired 4 stores from an independent retailer, closed 1 store and opened 1 store. The Company-owned store count at September 30, 2004 also reflects the net addition of 3 stores stemming from Ethan Allen's acquisition of the 25% minority interest in a joint venture previously established in 1998 between the Company and an independent retailer. While the operations of these stores have been reflected in the Company's consolidated financial statements since inception of the joint venture as a result of the Company's 75% majority ownership, the stores have not been previously included in the Company's store count due to the fact that they were independently managed.

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Comparable stores are those which have been operating for at least 15 months. Minimal net sales, derived from the delivery of customer ordered product, are generated during the first three months of operations of newly opened stores. Stores acquired from retailers by Ethan Allen are included in comparable store sales in their 13th full month of Ethan Allen-owned operations.

Total booked orders, which include wholesale orders and written business of Ethan Allen-owned retail stores, decreased 8.3% from the prior year quarter. Quarter-over-quarter, wholesale orders decreased 11.1% while Ethan Allen-owned store written business decreased 0.2% and comparable store written business decreased 1.7%. The Company conducted two separate Retail conferences during calendar year 2003 (June and October) as compared to only one during calendar year 2004 (September). This resulted in floor sample orders being placed, for new products introduced at those 2003 conferences, throughout the first and second quarters of fiscal 2004. Similar floor sample orders, related to new products introduced at the 2004 conference, have not yet been reflected in the Company's year-to-date booked orders. Retail written sales during the current quarter are indicative of continued uncertainty with respect to the economy and consumer confidence and, to a lesser extent, the aforementioned inclement weather experienced throughout the South and Southeast regions of the country during the period. These factors were partially offset by the continued expansion of the Company's retail segment.

Gross profit increased during the quarter to \$110.4 million from \$108.4 million in the prior year comparable quarter. The \$2.0 million, or 1.8%, increase in gross profit was primarily attributable to (i) an increase in total sales volume, including a higher proportionate share of retail sales to total sales (62% in the current quarter compared to 60% in the prior year quarter), and (ii) a reduction in costs associated with excess capacity at the Company's manufacturing facilities. These favorable variances were partially offset by (i) the increased cost of selected raw materials, namely lumber and steel, and (ii) full implementation of the Company's "everyday pricing" program. Consolidated gross margin decreased to 47.9% in the first quarter of fiscal 2005 from 48.7% in the prior year quarter as a result, primarily, of the factors identified previously.

Operating expenses decreased \$0.7 million, or 0.9%, to \$79.2 million, or 34.4% of net sales, in the current year quarter from \$79.9 million, or 35.9% of net sales, in the prior year quarter. This decrease is primarily attributable to (i) a decline in selling expenses within the wholesale division as the result of a continued Company-wide focus on cost containment, particularly within national television advertising, and (ii) initiatives undertaken in recent periods to streamline the Company's U.S. manufacturing operations. These decreases were partially offset by the continued growth of the retail segment and the higher proportionate share of retail sales to total sales in the current quarter as compared to the prior year quarter. This expansion has resulted in higher costs associated with designer salaries and commissions, occupancy, delivery and warehousing, and other managerial salaries and benefits.

Operating income for the three months ended September 30, 2004 was \$31.2 million, or 13.6% of net sales, compared to \$28.6 million, or 12.8% of net sales, for the three months ended September 30, 2003. This represents an increase of \$2.6 million, and is primarily attributable to lower operating expenses within the wholesale division and an increase in gross profit during the current period, partially offset by increased costs related to continued expansion of the retail segment.

Total wholesale operating income for the first quarter of fiscal 2005 was \$28.3 million, or 17.5% of net sales, as compared to \$27.0 million, or 17.0% of net sales, in the comparable prior year quarter. The increase of \$1.3 million, or 4.9%, is primarily attributable to a decrease in operating expenses within the division, a reduction in costs associated with excess capacity at the Company's manufacturing facilities, and increased wholesale sales volume. These decreases were partially offset by the increased cost of selected raw materials, namely lumber and steel, and full implementation of the Company's "everyday pricing" program.

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Operating income for the retail segment increased \$3.0 million to \$3.2 million, or 2.3% of net sales, for the first quarter of fiscal 2005, as compared to \$0.2 million, or 0.2% of net sales, in the prior year period. The increase in retail operating income generated by Ethan Allen-owned stores is primarily attributable to increased sales volume, partially offset by higher operating expenses related to the continued expansion of the retail network.

Interest and other miscellaneous income for the current quarter decreased \$2.3 million to (\$0.1) million from \$2.2 million in the prior year quarter. The decrease is the result of (i) prior year gains recorded in connection with the sale of real estate, (ii) the favorable settlement of an outstanding legal matter during the prior year quarter, and (iii) a decrease in interest income associated with lower cash balances maintained during the current period.

Income tax expense for the three months ended September 30, 2004 was \$12.1 million as compared to \$11.7 million for the three months ended September 30, 2003. The Company's effective tax rate for the current quarter was 39.0%, up from 38.2% in the prior year quarter. The higher effective tax rate is the result of recently-enacted changes within certain state tax legislation, and increased state income tax liability arising in connection with the operation of a greater number of Company-owned stores, some of which are located in new jurisdictions.

The Company recorded net income of \$18.9 million for both the three month periods ended September 30, 2004 and 2003. Net income per diluted share for the current quarter totaled \$0.51, up slightly from \$0.50 per diluted share in the prior year quarter.

Financial Condition and Liquidity

The Company's principal sources of liquidity include cash and cash equivalents, cash flow from operations and borrowing capacity under a \$100.0 million revolving credit facility. In addition to the \$100.0 million revolving credit component, the facility includes an accordion feature which provides for an additional \$50.0 million of liquidity if needed, as well as sub-facilities for trade and standby letters of credit of \$50.0 million and swing-line loans of \$3.0 million.

As of September 30, 2004, the Company maintained cash and short-term investments totaling \$36.0 million and outstanding debt and capital lease obligations totaling \$9.2

million. The current and long-term portions of the Company's outstanding debt and capital lease obligations totaled \$4.7 million and \$4.5 million, respectively at that date. The Company had no revolving loans outstanding under the credit facility as of September 30, 2004, and trade and standby letters of credit outstanding under the facility at that date totaled \$20.6 million. Remaining available borrowing capacity under the facility was \$79.4 million at September 30, 2004.

Net cash provided by operating activities totaled \$37.4 million for the first quarter of fiscal 2005 as compared to \$50.0 million for the first quarter of fiscal 2004. The current quarter-over-quarter decrease of \$12.6 million was principally the result of (i) changes in accrued expenses (\$5.4 million effect), resulting from the quarter-over-quarter change in dividends accrued and paid, (ii) accounts payable (\$4.5 million effect), resulting from the ordinary timing of related cash disbursements, including income taxes payable and treasury stock repurchases, (iii) changes in customer deposits (\$2.6 million effect), and (iv) changes in prepaid expenses and other current assets (\$2.6 million effect). These unfavorable variances were partially offset by additional cash collections related to outstanding accounts receivable (\$2.7 million effect).

The decrease in inventory levels since June 2004 was the result, primarily, of a decline in finished goods and work-in-process inventories. The decrease in finished goods inventories was related, in part, to reductions within certain off-shore sourced product lines, and is consistent with the increase in sales volume noted during the quarter. The decline in work-in-process inventories is attributable to the consolidation of two manufacturing facilities, announced in April 2004, and the related phase-out of those plants' production during the current period. These decreases were partially offset by an

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increase in raw material inventories resulting from the purchase of logs and lumber in anticipation of future production needs.

Net cash used in investing activities totaled \$7.2 million for the current quarter compared to \$0.6 million in the prior year. The current quarter-over-quarter increase of \$6.6 million was due, primarily, to (i) a \$3.5 million increase in capital spending, exclusive of acquisitions, to \$7.5 million from \$4.0 million in the prior year, and (ii) a \$3.4 million decline in proceeds stemming from the disposal of certain property, plant and equipment during the prior year period. The current level of capital spending is principally attributable to (i) new store development and renovation, (ii) improvements within certain manufacturing facilities, and (iii) Company-wide technology initiatives. The Company anticipates that cash from operations will be sufficient to fund future capital expenditures.

Net cash used in financing activities totaled \$22.1 million for the current quarter as compared to \$1.8 million in the prior year. The current quarter-over-quarter increase of \$20.3 million was the result of an increase of \$18.6 million in payments related to the acquisition of treasury stock, and a \$1.1 million increase in cash utilized in the payment of dividends.

On July 27, 2004, the Company declared a dividend of \$0.15 per common share, payable on October 25, 2004, to shareholders of record as of October 11, 2004. The Company expects to continue to declare quarterly dividends for the foreseeable future.

In addition to using available cash to fund changes in working capital, necessary capital expenditures, acquisition activity, the repayment of debt, and the payment of dividends, the Company has been authorized by its Board of Directors to repurchase its common stock, from time to time, either directly or through agents, in the open market at prices and on terms satisfactory to the Company. The Company also retires shares of unvested restricted stock and, prior to June 30, 2002, repurchased shares of common stock from terminated or retiring employee's accounts in the Ethan Allen Retirement Savings Plan. All of the Company's common stock repurchases and retirements are recorded as treasury stock and result in a reduction of shareholders' equity. During the three month periods ended September 30, 2004 and 2003, the Company repurchased and/or retired the following shares of its common stock:

	Three Months Ended September 30,	
	2004(1)	2003
Common shares repurchased	624,500	-
Cost to repurchase common shares	\$21,760,694	-
Average price per share	\$ 34.85	-

- (1) The cost to repurchase shares during the first quarter of fiscal year 2005 reflects \$3,933,146 in common stock repurchases with a September 2004 trade date and a October 2004 settlement date, and excludes \$745,735 in common stock purchases with a June 2004 trade date and a July 2004 settlement date.

For each of the periods presented above, the Company funded its purchases of treasury stock with existing cash on hand and cash generated through current period operations. On April 27, 2004, the Board of Directors increased the share purchase authorization to 2.5 million shares. As of September 30, 2004, the Company had a remaining Board authorization to purchase 1.2 million shares.

Subsequent to September 30, 2004 and through November 4, 2004, the Company repurchased, in 10 separate open market transactions, an additional 477,000 shares of its common stock at a total cost of \$16.6 million, representing an average price per share of \$34.79.

As of September 30, 2004, aggregate scheduled maturities of long-term debt, including capital lease obligations, for each of the next five fiscal years are: \$0.2 million in fiscal 2006; \$0.1 million in fiscal 2007; \$0.1 million in fiscal 2008; \$0.1 million in fiscal 2009; and \$0.1 million in fiscal 2010. The balance of the Company's long-term debt and capital lease obligations (\$3.9 million) matures in fiscal years 2011 and

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thereafter. The Company believes that its cash flow from operations, together with its other available sources of liquidity, will be adequate to make all required payments of principal and interest on its debt, to permit anticipated capital expenditures and to fund working capital and other cash requirements. As of September 30, 2004, the Company had working capital of \$153.8 million and a current ratio of 2.07 to 1.

Off-Balance Sheet Arrangements and Other Commitments, Contingencies and Contractual Obligations

Except as indicated below, the Company does not utilize or employ any off-balance sheet arrangements, including special-purpose entities, in operating its business. As such, the Company does not maintain any (i) retained or contingent interests, (ii) derivative instruments, or (iii) variable interests which could serve as a source of potential risk to its future liquidity, capital resources and results of operations.

The Company, or its consolidated subsidiaries, may, from time to time in the ordinary course of business, provide guarantees on behalf of selected affiliated entities or become contractually obligated to perform in accordance with the terms and conditions of certain business agreements. The nature and extent of these guarantees and obligations may vary based on the underlying relationship of the benefiting party to the Company and the business purpose for which the guarantee or obligation is being provided. Details of those arrangements for which the Company, or any of its wholly-owned subsidiaries, act as guarantor or obligor are provided below.

Ethan Allen Inc. has obligated itself, on behalf of one of its independent retailers, with respect to a \$1.5 million credit facility (the "Credit Facility") comprised of a \$1.1 million revolving line of credit and a \$0.4 million term loan. This obligation requires the Company, in the event of the retailer's default under the Credit Facility, to repurchase the retailer's inventory, applying such purchase price to the retailer's outstanding indebtedness under the Credit Facility. The Company's obligation remains in effect for the life of the term loan which expires in April 2008. The maximum potential amount of future payments (undiscounted) that the Company could be required to make under this obligation is limited to the amount outstanding under the Credit Facility at the time of default (subject to pre-determined lending limits based on the value of the underlying inventory) and, as such, is not an estimate of future cash flows. No specific recourse or collateral provisions exist that would enable recovery of any portion of amounts paid under this obligation, except to the extent that the Company maintains the right to take title to the repurchased inventory. Management anticipates that the repurchased inventory could subsequently be sold through the Company's retail store network. As of September 30, 2004, the total amount outstanding under the Credit Facility totaled approximately \$1.1 million, of which \$0.9 million was outstanding under the revolving credit line. Management expects, based on the underlying creditworthiness of the respective retailer, this obligation will expire without requiring funding by the Company. However, in accordance with the provisions of FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, a liability has been established to reflect the Company's non-contingent obligation under this arrangement as a result of modifications made to the Credit Facility subsequent to January 1, 2003. As of September 30, 2004, the carrying amount of such liability is less than \$50,000.

Indemnification Agreement

In connection with the Company's joint venture arrangement with United Kingdom-based MFI Furniture Group Plc., Ethan Allen Inc. has entered into a tax cross-indemnification agreement with the joint venture partner. The indemnification agreement stipulates that both parties agree to pay fifty percent of the amount of any tax liability arising as a result of (i) an adverse tax judgment or (ii) the imposition of additional taxes against either partner, and attributable to the operations of the joint venture. The indemnification agreement is effective until such time that the joint venture is

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terminated. At the present time, management anticipates that the joint venture will continue to operate for the foreseeable future.

The maximum potential amount of future payments (undiscounted) that the Company could be required to make under this indemnification agreement is indeterminable as no such tax liability currently exists. Further, the nature, extent and magnitude of any such tax liability arising in the future as a result of an adverse tax judgment or change in applicable tax law cannot be estimated with any reasonable certainty. It should be further noted that no recourse or collateral provisions exist that would enable recovery of any portion of amounts paid under this indemnification agreement. Management expects, based on its current understanding of the applicable tax laws and the existing legal structure of the joint venture, subject to future changes in applicable laws and regulations, this cross-indemnity agreement will expire without requiring funding by the Company. Accordingly, as of September 30, 2004, the carrying amount of the liability related to this indemnification agreement is zero.

Product Warranties

The Company's products, including its case goods, upholstery and home accents, generally carry explicit product warranties that extend from three to five years and are provided based on terms that are generally accepted in the industry. All of the Company's domestic independent retailers are required to enter into, and perform in accordance with the terms and conditions of, a warranty service agreement. The Company records provisions for estimated warranty and other related costs at time of sale based on historical warranty loss experience and makes periodic adjustments to those provisions to reflect actual experience. On rare occasion, certain warranty and other related claims involve matters of dispute that ultimately are resolved by negotiation, arbitration or litigation. In certain cases, a material warranty issue may arise which is beyond the scope of the Company's historical experience. The Company provides for such warranty issues as they become known and are deemed to be both probable and estimable. It is reasonably possible that, from time to time, additional warranty and other related claims could arise from disputes or other matters beyond the scope of the Company's historical experience. As of September 30, 2004, the Company's product warranty liability totaled \$1.4 million.

Recent Tax Legislation

On October 22, 2004, the American Jobs Creation Act of 2004 (the "Act") was signed into law. The Company is currently reviewing the provisions of the Act in order to determine its impact, if any, on the Company's future consolidated financial condition, results of operations, and cash flows.

Business Outlook

We continue to believe that the business outlook for the Company is promising. Encouraging signs noted during much of the past year seemed to indicate that improved levels of consumer confidence and a strengthening of the economy were, for the most part, sustainable. During the last twelve months, the U.S. economy appears to have benefited from positive employment trends and an interest rate environment which, despite recent actions taken by the Federal Reserve Board (the "Board"), continues to be favorable. While the Board recently took steps to increase short-term interest rates for the first time in four years (25 basis points effective June 30, 2004 and 25 basis points effective August 10, 2004), their comments suggest a "measured" approach toward future interest rate increases with the objective of returning rates to a level appropriate to maintain a healthy economy. We believe that the modest increases initiated by the Board will have little negative effect on the increased levels of refinancing activity and housing purchases noted during this recent period of historically low interest rates.

Although the recent Presidential election has, in our view, served as a distraction to further economic growth, a combination of the aforementioned factors over the course of the past year seems to have had some positive effect on consumer spending habits, as is reflected in the Company's incoming order trends noted during much of that time. We anticipate that consumer confidence and discretionary spending will return to the levels noted during the fourth quarter of calendar year 2003 and the first quarter calendar year 2004 now that the results of the election are known. If these apparent signs of economic recovery continue and prove to be sustainable, we believe the longer-term outlook is promising as well.

As the economy strengthens, however, it is also possible that costs associated with production (including raw materials and labor), distribution (including freight and fuel

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charges), and retail operations (including compensation, delivery and warehousing, occupancy and advertising expenses) may increase. Similarly, continued increases in interest rates and crude oil prices could serve to adversely impact the level of discretionary spending on the part of consumers. We cannot reasonably predict when, or to what extent, such events may occur or what effect, if any, such events may have on the Company's consolidated financial condition or results of operations.

We continue to believe that there is considerable interest on the part of consumers to invest in their homes. We also believe that this interest has, until recently, been restrained by such factors as high unemployment, sluggish consumer confidence levels and the fact that many home buyers stretched themselves financially to purchase as much house as possible in the recent low rate environment. As the economy improves and this interest in home decorating continues to emerge, as we anticipate it will, we believe we will be well positioned to take advantage of the long-awaited increase in demand as a result of (i) our established brand, (ii) our comprehensive complement of home decorating

solutions, and (iii) our vertically-integrated business model.

With respect to the industry's competitive landscape, we continue to monitor the progress of the anti-dumping petition filed, in July 2003, by The American Furniture Manufacturers Committee for Legal Trade with the U.S. Department of Commerce ("DOC") and the International Trade Commission. This petition seeks tariff protection, for U.S. manufacturers, on wooden bedroom furniture imported from China. There have been no further developments with respect to this matter beyond that which was disclosed in Part I, Item 1 — Competition of the Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission on September 10, 2004. As such, the Company continues to believe that tariffs imposed on wooden bedroom furniture imported from China will not have a material adverse effect on its consolidated financial condition or results of operations.

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Item 3. Quantitative and Qualitative Disclosure About Market Risk

The Company is exposed to interest rate risk primarily through its borrowing activities. The Company's policy has been to utilize United States dollar denominated borrowings to fund its working capital and investment needs. Short-term debt, if required, is used to meet working capital requirements and long-term debt is generally used to finance long-term investments. There is inherent rollover risk for borrowings as they mature and are renewed at current market rates. The extent of this risk is not quantifiable or predictable because of the variability of future interest rates and the Company's future financing requirements.

As of September 30, 2004, the Company has one debt instrument outstanding with a variable interest rate. This debt instrument has a principal balance of \$4.6 million and matures in October 2004. Based on the principal balance outstanding during the period, a one-percentage point increase in the variable interest rate would not have had a material impact on the Company's consolidated results of operations.

The Company's exposure to foreign currency exchange risk is primarily limited to its operation of seven Ethan Allen-owned retail stores located in Canada as substantially all purchases of imported parts and finished goods are denominated in United States dollars. As such, gains or losses resulting from market changes in the value of foreign currencies have not had, nor are they expected to have, a material effect on the Company's consolidated results of operations.

Currently, the Company does not enter into financial instrument transactions for trading or other speculative purposes or to manage interest rate or currency exposure.

Item 4. Controls and Procedures

Ethan Allen's management, including the Chairman of the Board and Chief Executive Officer ("CEO") and the Vice President-Finance ("VPF"), conducted an evaluation of the effectiveness of disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on such evaluation, the CEO and VPF have concluded that, as of September 30, 2004, the Company's disclosure controls and procedures are effective in ensuring that material information relating to the Company (including its consolidated subsidiaries), which is required to be included in the Company's periodic filings under the Exchange Act, has been made known to them in a timely manner.

There have been no changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the Company's most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II — OTHER INFORMATION

Item 1. Legal Proceedings

There has been no material change to the matters discussed in Part I, Item 3 — Legal Proceedings in the Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission on September 10, 2004.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Issuer Purchases of Equity Securities

Certain information regarding purchases made by or on behalf of the Company or any affiliated purchaser (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934, as amended) of our common stock during the three months ended September 30, 2004 is provided below:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (d)	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs (d)
July 2004 (a)	312,000	\$ 34.83	312,000	1,543,100
August 2004 (b)	150,000	\$ 34.48	150,000	1,393,100
September 2004 (c)	162,500	\$ 35.21	162,500	1,230,600
Total	624,500	\$ 34.85	624,500	

- (a) Purchased in ten separate open market transactions on ten different days.
- (b) Purchased in three separate open market transactions on three different days.
- (c) Purchased in six separate open market transactions on six different days.
- (d) On November 21, 2002, the Company's Board of Directors approved a share repurchase program authorizing the Company to repurchase up to 2,000,000 shares of its common stock, from time to time, either directly or through agents, in the open market at prices and on terms satisfactory to the Company. On April 27, 2004, the Board of Directors increased the remaining authorization to 2.5 million shares. Subsequent to September 30, 2004 and through November 4, 2004, the Company repurchased, in 10 separate open market transactions, an additional 477,000 shares of its common stock at a total cost of \$16,595,872, representing an average price per share of \$34.79.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits

<u>Exhibit Number</u>	<u>Description</u>
* 31.1	Rule 13a-14(a) Certification of Principal Executive Officer
* 31.2	Rule 13a-14(a) Certification of Principal Financial Officer
* 32.1	Section 1350 Certification of Principal Executive Officer
* 32.2	Section 1350 Certification of Principal Financial Officer

* Filed herewith.

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ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

SIGNATURES

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

ETHAN ALLEN INTERIORS INC.
(Registrant)

DATE: November 5, 2004

BY: /s/ M. Farooq Kathwari
M. Farooq Kathwari
Chairman, President and
Chief Executive Officer
(Principal Executive Officer)

DATE: November 5, 2004

BY: /s/ Jeffrey Hoyt
Jeffrey Hoyt
Vice President, Finance
(Principal Financial Officer and
Principal Accounting Officer)

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EXHIBIT INDEX

<u>Exhibit Number</u>	<u>Description</u>
31.1	Rule 13a-14(a) Certification of Principal Executive Officer
31.2	Rule 13a-14(a) Certification of Principal Financial Officer
32.1	Section 1350 Certification of Principal Executive Officer
32.2	Section 1350 Certification of Principal Financial Officer

RULE 13a-14(a) CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER

I, M. Farooq Kathwari, do hereby certify that:

- (1) I have reviewed this quarterly report on Form 10-Q as filed by Ethan Allen Interiors Inc. (the "Company");
- (2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;
- (4) The Company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the Company and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter (the Company's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting;
- (5) The Company's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and the audit committee of the Company's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.

/s/ M. Farooq Kathwari

Chairman, President and
Chief Executive Officer

(M. Farooq Kathwari)

November 5, 2004

RULE 13a-14(a) CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER

I, Jeffrey Hoyt, do hereby certify that:

- (1) I have reviewed this quarterly report on Form 10-Q as filed by Ethan Allen Interiors Inc. (the "Company");
- (2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;
- (4) The Company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the Company and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter (the Company's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting;
- (5) The Company's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and the audit committee of the Company's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.

/s/ Jeffrey Hoyt

Vice President, Finance

(Jeffrey Hoyt)

November 5, 2004

SECTION 1350 CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER

I, M. Farooq Kathwari, hereby certify that the September 30, 2004 Quarterly Report on Form 10-Q as filed by Ethan Allen Interiors Inc. (the "Company"), which contains the Company's financial statements, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) and that information contained in such Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ M. Farooq Kathwari

(M. Farooq Kathwari)

Chairman, President and
Chief Executive Officer

November 5, 2004

SECTION 1350 CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER

I, Jeffrey Hoyt, hereby certify that the September 30, 2004 Quarterly Report on Form 10-Q as filed by Ethan Allen Interiors Inc. (the "Company"), which contains the Company's financial statements, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) and that information contained in such Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Jeffrey Hoyt

Vice President, Finance

(Jeffrey Hoyt)

November 5, 2004