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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2016

OR

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

For the transition period from – to –

Commission file number: 001-35629

TILE SHOP HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation)

45-5538095
(I.R.S. Employer Identification No.)

1400 Carlson Parkway
Plymouth, Minnesota
(Address of principal executive offices)

55441
(Zip Code)

(763) 852-2950
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

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

As of October 24, 2016, there were 51,593,979 shares of the registrant's common stock, par value \$0.0001 per share, outstanding.

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ITEM 1. FINANCIAL STATEMENTS**Tile Shop Holdings, Inc. and Subsidiaries**
Consolidated Balance Sheets
(dollars in thousands, except share and per share data)
(unaudited)

| | September 30, 2016 | (As Adjusted) December 31, 2015 |
|--|-----------------------|---------------------------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 9,835 | \$ 10,330 |
| Restricted cash | 210 | 219 |
| Trade receivables, net | 2,560 | 1,966 |
| Inventories | 66,379 | 69,878 |
| Prepaid inventory | 415 | 568 |
| Income tax receivable | 1,226 | 735 |
| Other current assets, net | 3,890 | 3,557 |
| Total Current Assets | 84,515 | 87,253 |
| Property, plant and equipment, net | 137,774 | 135,115 |
| Deferred tax assets | 19,781 | 20,846 |
| Other assets | 1,723 | 1,793 |
| Total Assets | \$ 243,793 | \$ 245,007 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 18,008 | \$ 14,584 |
| Current portion of long-term debt | 5,600 | 4,744 |
| Income tax payable | 404 | 1,101 |
| Other accrued liabilities | 22,764 | 19,327 |
| Total Current Liabilities | 46,776 | 39,756 |
| Long-term debt, net | 18,469 | 51,178 |
| Capital lease obligation, net | 725 | 797 |
| Deferred rent | 37,028 | 34,983 |
| Other long-term liabilities | 3,400 | 3,092 |
| Total Liabilities | 106,398 | 129,806 |
| Stockholders' Equity: | | |
| Common stock, par value \$0.0001; authorized: 100,000,000 shares; issued and outstanding: 51,575,420 and 51,437,973 shares, respectively | 5 | 5 |
| Preferred stock, par value \$0.0001; authorized: 10,000,000 shares; issued and outstanding: 0 shares | - | - |
| Additional paid-in-capital | 184,893 | 180,192 |
| Accumulated deficit | (47,482) | (64,985) |
| Accumulated other comprehensive (loss) income | (21) | (11) |
| Total Stockholders' Equity | 137,395 | 115,201 |
| Total Liabilities and Stockholders' Equity | \$ 243,793 | \$ 245,007 |

See accompanying Notes to Consolidated Financial Statements.

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Tile Shop Holdings, Inc. and Subsidiaries
Consolidated Statements of Operations
(dollars in thousands, except per share data)
(unaudited)

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|-----------------|-------------------|------------------|
| | September 30, | | September 30, | |
| | 2016 | 2015 | 2016 | 2015 |
| Net sales | \$ 78,559 | \$ 72,404 | \$ 247,543 | \$ 221,073 |
| Cost of sales | 23,400 | 21,691 | 73,980 | 68,096 |
| Gross profit | 55,159 | 50,713 | 173,563 | 152,977 |
| Selling, general and administrative expenses | 47,361 | 44,047 | 142,300 | 130,678 |
| Income from operations | 7,798 | 6,666 | 31,263 | 22,299 |
| Interest expense | (363) | (503) | (1,382) | (2,101) |
| Other income | 34 | 34 | 102 | 97 |
| Income before income taxes | 7,469 | 6,197 | 29,983 | 20,295 |
| Provision for income taxes | (2,886) | (2,436) | (11,793) | (8,385) |
| Net income | \$ 4,583 | \$ 3,761 | \$ 18,190 | \$ 11,910 |
| Income per common share: | | | | |
| Basic | \$ 0.09 | \$ 0.07 | \$ 0.35 | \$ 0.23 |
| Diluted | \$ 0.09 | \$ 0.07 | \$ 0.35 | \$ 0.23 |
| Weighted average shares outstanding: | | | | |
| Basic | 51,426,104 | 51,161,348 | 51,388,058 | 51,137,650 |
| Diluted | 51,929,226 | 51,424,979 | 51,817,588 | 51,254,547 |

See accompanying Notes to Consolidated Financial Statements.

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Tile Shop Holdings, Inc. and Subsidiaries
Consolidated Statements of Comprehensive (Loss) Income
(dollars in thousands)
(unaudited)

| | Three Months Ended | | Nine Months Ended | |
|-----------------------------------|--------------------|-----------------|-------------------|------------------|
| | September 30, | | September 30, | |
| | 2016 | 2015 | 2016 | 2015 |
| Net income | \$ 4,583 | \$ 3,761 | \$ 18,190 | \$ 11,910 |
| Currency translation adjustment | (2) | (7) | (10) | (6) |
| Other comprehensive (loss) income | (2) | (7) | (10) | (6) |
| Comprehensive income | \$ 4,581 | \$ 3,754 | \$ 18,180 | \$ 11,904 |

See accompanying Notes to Consolidated Financial Statements.

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Title Shop Holdings, Inc. and Subsidiaries
Consolidated Statements of Stockholders' Equity (Deficit)
(dollars in thousands, except share data)
(unaudited)

| | Common stock | | Additional paid-in capital | Treasury units | Retained earnings (deficit) | Accumulated other comprehensive income (loss) | Total |
|--|-------------------|-------------|----------------------------------|-------------------|-----------------------------------|--|-------------------|
| | Shares | Amount | | | | | |
| Balance at December 31, 2014 | 51,314,005 | \$ 5 | \$ 174,371 | \$ - | \$ (80,681) | \$ - | \$ 93,695 |
| Issuance of restricted shares | 54,036 | - | - | - | - | - | - |
| Stock based compensation | - | - | 5,545 | - | - | - | 5,545 |
| Stock option exercises | 69,932 | - | 276 | - | - | - | 276 |
| Foreign currency translation adjustments | - | - | - | - | - | (11) | (11) |
| Net income | - | - | - | - | 15,696 | - | 15,696 |
| Balance at December 31, 2015 | <u>51,437,973</u> | <u>\$ 5</u> | <u>\$ 180,192</u> | <u>\$ -</u> | <u>\$ (64,985)</u> | <u>\$ (11)</u> | <u>\$ 115,201</u> |
| Reclassification of impact of ASU 2016- 09 (see Note 1) | - | - | 687 | - | (687) | - | - |
| Balance at January 1, 2016 | <u>51,437,973</u> | <u>\$ 5</u> | <u>\$ 180,879</u> | <u>\$ -</u> | <u>\$ (65,672)</u> | <u>\$ (11)</u> | <u>\$ 115,201</u> |
| Issuance of restricted shares | 73,384 | - | - | - | - | - | - |
| Stock based compensation | - | - | 3,394 | - | - | - | 3,394 |
| Stock option exercises | 64,063 | - | 620 | - | - | - | 620 |
| Foreign currency translation adjustments | - | - | - | - | - | (10) | (10) |
| Net income | - | - | - | - | 18,190 | - | 18,190 |
| Balance at September 30, 2016 | <u>51,575,420</u> | <u>\$ 5</u> | <u>\$ 184,893</u> | <u>\$ -</u> | <u>\$ (47,482)</u> | <u>\$ (21)</u> | <u>\$ 137,395</u> |

See accompanying Notes to Consolidated Financial Statements.

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Title Shop Holdings, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(dollars in thousands)
(unaudited)

| | Nine Months Ended September 30, | |
|--|------------------------------------|------------------|
| | 2016 | 2015 |
| Cash Flows From Operating Activities | | |
| Net income | \$ 18,190 | \$ 11,910 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation & amortization | 16,954 | 16,597 |
| Amortization of debt issuance costs | 416 | 238 |
| Debt issuance cost writeoff | - | 194 |
| Loss on disposals of property, plant and equipment | 420 | 112 |
| Deferred rent | 1,767 | 2,156 |
| Stock based compensation | 3,394 | 4,226 |
| Deferred income taxes | 1,065 | 954 |
| Changes in operating assets and liabilities: | | |
| Trade receivables | (594) | (536) |
| Inventories | 3,499 | 5,661 |
| Prepaid expenses and other current assets | (303) | (1,634) |
| Accounts payable | 3,337 | 1,341 |
| Income tax receivable/payable | (1,188) | 7,369 |
| Accrued expenses and other liabilities | 3,721 | 2,793 |
| Net cash provided by operating activities | <u>50,678</u> | <u>51,381</u> |
| Cash Flows From Investing Activities | | |
| Purchases of property, plant and equipment | (19,645) | (12,196) |
| Proceeds from the sale of property, plant and equipment | - | 9 |
| Net cash used in investing activities | <u>(19,645)</u> | <u>(12,187)</u> |
| Cash Flows From Financing Activities | | |
| Payments of long-term debt and capital lease obligations | (32,132) | (39,662) |
| Advances on line of credit | - | 10,250 |
| Proceeds from exercise of stock options | 620 | 81 |
| Debt issuance costs | - | (968) |
| Security deposits | (6) | (5) |
| Net cash used in financing activities | <u>(31,518)</u> | <u>(30,304)</u> |
| Effect of exchange rate changes on cash | (10) | (5) |
| Net change in cash | (495) | 8,885 |
| Cash and cash equivalents beginning of period | 10,330 | 5,759 |
| Cash and cash equivalents end of period | <u>\$ 9,835</u> | <u>\$ 14,644</u> |
| Supplemental disclosure of cash flow information | | |
| Purchases of property, plant and equipment included in accounts payable and accrued expenses | \$ 816 | \$ 1,370 |
| Cash paid for interest | 1,483 | 2,310 |
| Cash paid for income taxes, net of refunds | 12,981 | 1,016 |

See accompanying Notes to Consolidated Financial Statements.

Title Shop Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(unaudited)

Note 1: Background

The Tile Shop, LLC (“The Tile Shop”) was formed on December 30, 2002, as a Delaware limited liability company and began operations on January 1, 2003. Tile Shop Holdings, Inc. (“Holdings,” and together with its wholly owned subsidiaries, the “Company”) was incorporated under the laws of the state of Delaware in June 2012 to become the parent company of The Tile Shop, LLC.

The Company is a specialty retailer of manufactured and natural stone tiles, setting and maintenance materials, and related accessories in the United States. The Company manufactures its own setting and maintenance materials, such as thinset, grout, and sealers. The Company’s primary market is retail sales to consumers, contractors, designers and home builders. As of September 30, 2016, the Company had 120 stores in 31 states and an on-line retail operation. The Company also has distribution centers located in Michigan, New Jersey, Oklahoma, Virginia, and Wisconsin. The Company has a sourcing operation located in China.

The accompanying Consolidated Financial Statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the rules and regulations for reporting on Form 10-Q. Accordingly, they do not include certain information and disclosures required for comprehensive financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal recurring nature, including the elimination of all intercompany transactions. Operating results for the three and nine months ended September 30, 2016 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2016.

These statements should be read in conjunction with the Consolidated Financial Statements and footnotes included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015. The accounting policies used in preparing these Consolidated Financial Statements are the same as those described in Note 1 to the Consolidated Financial Statements in such Form 10-K. Debt issuance costs presented in the prior year Consolidated Balance Sheet have been reclassified to conform to current year presentation.

Recently Adopted Accounting Pronouncements

In February 2015, the Financial Accounting Standards Board (“FASB”) issued a new accounting standard that will modify current consolidation guidance. The standard makes changes to both the variable interest entity model and the voting interest entity model, including modifying the evaluation of whether limited partnerships or similar legal entities are variable interest entities or voting interest entities and amending the guidance for assessing how relationships of related parties affect the consolidation analysis of variable interest entities. The standard was effective for the Company as of the beginning of fiscal 2016. The adoption of this new standard did not have a material effect on the Company’s financial statements.

In April 2015, the FASB issued a standard that requires debt issuance costs related to a recognized debt liability be presented in the Consolidated Balance Sheet as a direct deduction from the carrying amount of that debt liability. The Company adopted the provisions of this statement in the first quarter of 2016 and prior periods have been retrospectively adjusted. The adoption of this standard resulted in a \$0.1 million reduction of other current assets, net, a \$0.3 million reduction of other assets, a \$0.3 million reduction of the current portion of long term debt, and a \$0.1 million reduction of long term debt in the Consolidated Balance Sheet for the period ended December 31, 2015.

In March 2016, the FASB issued a standard that amends and simplifies the accounting for stock compensation. The guidance addresses various stock compensation aspects including accounting for income taxes, classification of excess tax benefits on the statement of cash flows, forfeitures, minimum statutory tax withholding requirements, and classification of employee taxes paid on the statement of cash flows when an employer withholds shares for tax withholding purposes, among other things. In order to simplify the accounting for stock-based compensation, the Company made a change in accounting policy to account for forfeitures when they occur, and as a result, the Company recognized a \$0.7 million cumulative-effect reduction to retained earnings under the modified retrospective approach. During the three months ended September 30, 2016, the Company recognized an adjustment to reduce additional paid-in capital and share-based compensation by \$0.1 million to account for current year forfeiture activity.

The Company elected prospective transition for the requirement to classify excess tax benefits as an operating activity in the Consolidated Statement of Cash Flows. The adoption did not have a material impact on the amounts reported in the Consolidated Statement of Cash Flows for the nine months ended September 30, 2016. Additionally, the Company will prospectively recognize all excess tax benefits and tax deficiencies as income tax expense or benefit in the Consolidated Statement of Operations as a discrete item in the period in which awards vest. The adoption did not have a material impact on the amounts reported in the Consolidated Statement of Operations for the three and nine months ended September 30, 2016. The Company applied the modified retrospective method to recognize the cumulative effect of previously unrecognized excess tax benefits in opening retained earnings. The adoption did not have a material impact on the amounts reported in the Consolidated Balance Sheet for the year ended December 31, 2015. The Company

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also retrospectively applied the requirement to present employee taxes paid when an employer withholds shares for tax-withholding purposes as a financing activity in the Consolidated Statement of Cash Flows. The adoption did not have a material impact on the amounts reported in the Consolidated Statement of Cash Flows for the nine months ended September 30, 2016 and 2015.

Accounting Pronouncements Not Yet Adopted

In May 2014, the FASB issued a final standard on revenue from contracts with customers. The new standard sets forth a single comprehensive model for recognizing and reporting revenue. The new standard is effective for the Company in fiscal year 2018 and permits the use of either a retrospective or a cumulative effect transition method. The Company is currently assessing the impact of implementing the new guidance on its consolidated financial statements.

In August 2014, the FASB issued a standard requiring an entity's management to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern within one year after the date of the financial statements. The guidance also sets forth a series of disclosures that are required in the event the entity's management concludes that there is substantial doubt about the entity's ability to continue as a going concern. The new standard becomes effective for the Company in the annual financial statements for fiscal 2016 and requires an ongoing evaluation at each interim and annual period thereafter. The Company is currently assessing the effect the new standard will have on its consolidated financial statements.

In July 2015, the FASB issued a standard which simplifies the subsequent measurement of inventory. Currently, an entity is required to measure inventory at the lower of cost or market, whereby market can be replacement cost, net realizable value, or net realizable value less an approximately normal profit margin. The changes require that inventory be measured at the lower of cost and net realizable value, thereby eliminating the use of the other two market methodologies. Net realizable value is defined as the estimated selling prices in the ordinary course of business less reasonably predictable costs of completion, disposal, and transportation. Currently, the Company applies the net realizable value market option to measure inventories at the lower of cost or market. These changes become effective for the Company in fiscal 2017. The Company is currently assessing the effect the new standard will have on its consolidated financial statements.

In February 2016, the FASB issued a standard that primarily requires organizations that lease assets to recognize the rights and obligations created by those leases on the Consolidated Balance Sheet. The standard is effective in 2019, with early adoption permitted. The Company is currently assessing the effect the new standard will have on its consolidated financial statements.

Note 2: Inventories

Inventories are stated at the lower of cost (determined on the weighted average cost method) or market. Inventories consist primarily of merchandise held for sale. Inventories were comprised of the following as of September 30, 2016 and December 31, 2015:

| | (in thousands) | |
|---------------------------|-----------------------|----------------------|
| | September 30, 2016 | December 31, 2015 |
| Finished goods | \$ 52,896 | \$ 59,503 |
| Raw materials | 2,506 | 2,681 |
| Finished goods in transit | 10,977 | 7,694 |
| Total | <u>\$ 66,379</u> | <u>\$ 69,878</u> |

The Company records provisions for losses related to shrinkage and other amounts that are otherwise not expected to be fully recoverable. These provisions are calculated based on historical shrinkage, selling price, margin and current business trends.

Note 3: Income taxes

The Company's effective tax rate on net income before income taxes for the three months ended September 30, 2016 and 2015 was 38.6% and 39.3%, respectively. The Company's effective tax rate on net income before income taxes for the nine months ended September 30, 2016 and 2015 was 39.3% and 41.3%, respectively. The improvement in the effective tax rate in 2016 was due to an increase in incentive stock option exercise activity classified as a disqualifying disposition to the option holder that gives rise to a deduction for the Company. The Company's tax rate also benefitted from a decrease in non-deductible incentive stock-based compensation expense in 2016 combined with a reduction in the level of state tax rate changes that triggered unfavorable deferred tax adjustments in 2015. For the three months ended September 30, 2016 and 2015, the Company recorded a provision for income taxes of

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\$2.9 million and \$2.4 million, respectively. For the nine months ended September 30, 2016 and 2015, the Company recorded a provision for income taxes of \$11.8 million and \$8.4 million, respectively.

The Company records interest and penalties relating to uncertain tax positions in income tax expense. As of September 30, 2016 and 2015, the Company has not recognized any liabilities for uncertain tax positions nor have interest and penalties related to uncertain tax positions been accrued.

Note 4: Earnings Per Share

Basic earnings per share is calculated by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted earnings per share is calculated by dividing net income by the weighted-average number of common shares outstanding, after taking into consideration all dilutive potential shares outstanding during the period.

Basic and diluted earnings per share were calculated as follows:

| | (dollars in thousands) | | | |
|---|---|------------|--|------------|
| | For the three months ended September 30, | | For the nine months ended September 30, | |
| | 2016 | 2015 | 2016 | 2015 |
| Net income | \$ 4,583 | \$ 3,761 | \$ 18,190 | \$ 11,910 |
| Weighted average basic shares outstanding | 51,426,104 | 51,161,348 | 51,388,058 | 51,137,650 |
| Effect of dilutive securities attributable to stock-based awards | 503,122 | 263,631 | 429,530 | 116,897 |
| Weighted average diluted shares outstanding | 51,929,226 | 51,424,979 | 51,817,588 | 51,254,547 |
| Income per common share: | | | | |
| Basic | \$ 0.09 | \$ 0.07 | \$ 0.35 | \$ 0.23 |
| Dilutive | \$ 0.09 | \$ 0.07 | \$ 0.35 | \$ 0.23 |
| Anti-dilutive securities excluded from earnings per share calculation | 347,699 | 769,778 | 409,599 | 1,021,033 |

Note 5: Other Accrued Liabilities

Other accrued liabilities consisted of the following:

| | (in thousands) | |
|---------------------------------|-----------------------|----------------------|
| | September 30, 2016 | December 31, 2015 |
| Customer deposits | \$ 7,565 | \$ 6,026 |
| Accrued wages and salaries | 5,629 | 4,336 |
| Sales return reserve | 3,003 | 2,781 |
| Taxes (other than income taxes) | 3,451 | 3,043 |
| Other accrued liabilities | 3,116 | 3,141 |
| Total other accrued liabilities | \$ 22,764 | \$ 19,327 |

Note 6: Long-term Debt

On June 2, 2015, Holdings and its operating subsidiary, The Tile Shop, LLC, as well as certain other subsidiaries of Holdings, entered into a credit agreement with Fifth Third Bank, Bank of America, N.A., and Huntington National Bank (the "Credit Agreement"). The Credit Agreement provides the Company with a \$125.0 million senior secured credit facility, comprised of a five-year \$50.0 million term loan and a \$75.0 million revolving line of credit. The Credit Agreement is secured by virtually all of the assets of the Company, including but not limited to, inventory, receivables, equipment and real property. Borrowings pursuant to the Credit Agreement bear interest at either a base rate or a LIBOR-based rate, at the option of the Company. The LIBOR-based rate will range from LIBOR plus 1.50% to 2.00%, depending on The Tile Shop's leverage ratio. The base rate is equal to the greatest of: (a) the Federal funds rate plus 0.50%, (b) the Fifth Third Bank "prime rate," and (c) the Eurodollar rate plus 1.00%, in each case plus 0.50% to 1.00% depending on

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(unaudited)

The Tile Shop's leverage ratio. At September 30, 2016 the base interest rate was 4.00% and the LIBOR-based interest rate was 2.03%. Borrowings outstanding consisted of \$23.4 million on the term loan as of September 30, 2016. The Company can elect to prepay the term loan without incurring a penalty. Additional borrowings pursuant to the Credit Agreement may be used to support the Company's growth and for working capital purposes. The Company incurred \$1.0 million of debt issuance costs in connection with the Credit Agreement, which will be amortized over the five-year life of the Credit Agreement. Debt issuance costs attributable to the term loan are classified as a reduction of debt in the Consolidated Balance Sheet. Debt issuance costs attributable to the revolving line of credit are classified as assets in the Consolidated Balance Sheet. The term loan requires quarterly principal payments as follows (in thousands):

Period

| | |
|--------------------------------------|----------|
| December 31, 2016 to June 30, 2017 | \$ 1,250 |
| September 30, 2017 to June 30, 2018 | 1,875 |
| September 30, 2018 to March 31, 2020 | 2,500 |

The Credit Agreement contains customary events of default, conditions to borrowings, and restrictive covenants, including restrictions on the Company's ability to dispose of assets, make acquisitions, incur additional debt, incur liens, make investments, or enter into transactions with affiliates on other than terms that could be obtained in an arm's length transaction. The Credit Agreement also includes financial and other covenants, including covenants to maintain certain fixed charge coverage ratios and rent adjusted leverage ratios. In addition, except with respect to pro rata payments made by The Tile Shop or other subsidiaries to Holdings or any other equity owner of such entity, the Credit Agreement prohibits the payments of cash dividends. The Company was in compliance with the covenants as of September 30, 2016.

Long-term debt, net of debt issuance costs, consisted of the following at September 30, 2016 and December 31, 2015 (in thousands):

| | September 30, 2016 | December 31, 2015 |
|--|-----------------------|----------------------|
| Term note payable - interest at 2.03% and 2.18% at September 30, 2016 and December 31, 2015, respectively | \$ 23,264 | \$ 47,022 |
| Commercial bank credit facility | - | 8,000 |
| Variable interest rate bonds (0.35% at both September 30, 2016 and December 31, 2015), which mature April 1, 2023, collateralized by buildings and equipment | 805 | 900 |
| Total debt obligations | 24,069 | 55,922 |
| Less: current portion | 5,600 | 4,744 |
| Debt obligations, net of current portion | <u>\$ 18,469</u> | <u>\$ 51,178</u> |

Note 7: Fair Value of Financial Instruments

The accompanying Consolidated Financial Statements include the following financial instruments: cash and cash equivalents, trade receivables, accounts payable, accrued expenses, capital leases, notes payable, and debt. At September 30, 2016 and December 31, 2015, the carrying amount of the Company's cash and cash equivalents, trade receivables, accounts payable and accrued expenses approximated their fair values due to their short-term maturities. The carrying value of the Company's borrowings and capital lease obligation approximates fair value based upon the market interest rates available to the Company for debt and capital lease obligations with similar risk and maturities.

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

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

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(unaudited)

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

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

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

Note 8: Equity Incentive Plans

Stock options:

The Company measures and recognizes compensation expense for all stock-based awards at fair value. The financial statements for the three and nine months ended September 30, 2016 and 2015 include compensation cost for the portion of outstanding awards that vested during those periods. The Company recognizes stock-based compensation costs on a straight-line basis over the requisite service period of the award, which is generally the option vesting term. Total stock-based compensation expense related to stock options was \$0.6 million and \$1.1 million for the three months ended September 30, 2016 and 2015. Total stock-based compensation expense related to stock options was \$2.6 million and \$2.7 million for the nine months ended September 30, 2016 and 2015, respectively. Stock-based compensation expense is included in selling, general and administrative expenses in the accompanying Consolidated Statements of Operations.

As of September 30, 2016, the Company had outstanding stock options to purchase 2,348,777 shares of common stock at a weighted average exercise price of \$13.69.

Restricted stock:

The Company awards restricted common shares to selected employees and to non-employee directors. Recipients are not required to provide any consideration other than continued service. Restricted share awards are subject to certain restrictions on transfer, and all or part of the shares awarded may be subject to forfeiture upon the occurrence of certain events, including employment termination. The restricted stock is valued at its grant date fair value and expensed over the requisite service period or the vesting term of the awards. Total stock-based compensation expense related to restricted stock was \$0.3 million and \$0.5 million for the three months ended September 30, 2016 and 2015, respectively. Total stock-based compensation expense related to restricted stock was \$0.8 million and \$1.5 million for the nine months ended September 30, 2016 and 2015, respectively. Stock-based compensation expense is included in selling, general and administrative expenses in the accompanying Consolidated Statements of Operations.

As of September 30, 2016, the Company had 98,384 outstanding restricted common shares.

Note 9: New Market Tax Credit

In July 2013, the Company entered into a financing transaction with Chase Community Equity ("Chase"), and U.S. Bank Community, LLC ("U.S. Bank", and, collectively with Chase, the "investors") related to a \$19.1 million acquisition, rehabilitation and construction of the Company's new distribution and manufacturing center in Durant, Oklahoma. The investors made a capital contribution to, and Tile Shop Lending made a loan to, Chase New Market Tax Credit, The Tile Shop of Oklahoma Investment Fund, LLC, and The Tile Shop Investment Fund LLC (the "Investment Funds") under a qualified New Markets Tax Credit ("NMTC") program. The NMTC program was provided for in the Community Renewal Tax Relief Act of 2000 (the "Act") and is intended to induce capital investment in qualified lower income communities. The Act permits taxpayers to claim credits against their Federal income taxes for up to 39% of qualified investments in the equity of community development entities ("CDEs"). CDEs are privately managed investment institutions that are certified to make qualified low-income community investments.

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Tile Shop Holdings, Inc. and Subsidiaries Notes to Consolidated Financial Statements (unaudited)

In July 2013, Tile Shop Lending loaned \$13.5 million to the Investment Funds at an interest rate of 1.35% per year and with a maturity of September 30, 2043. The Investment Funds then contributed the loan to certain CDEs, which, in turn, loaned the funds on similar terms to Tile Shop of Oklahoma, LLC, an indirect, wholly-owned subsidiary of Holdings. The proceeds of the loans from the CDEs (including loans representing the capital contribution made by the investors, net of syndication fees) were used to partially fund the new manufacturing and distribution center project.

In July 2013, the investors also contributed \$5.6 million to the Investment Funds and, by virtue of such contribution, are entitled to substantially all of the tax benefits derived from the NMTCs, while the Company effectively received net loan proceeds equal to the investors' contributions to the Investment Fund. This transaction includes a put/call provision whereby the Company may be obligated or entitled to repurchase the investors' interest. The Company believes that the investors will exercise the put option in September 2020 at the end of the recapture period. The value attributed to the put/call is de minimis. The NMTC is subject to 100% recapture for a period of seven years as provided in the Internal Revenue Code. The Company is required to be in compliance with various regulations and contractual provisions that apply to the NMTC arrangement. Non-compliance with applicable requirements could result in projected tax benefits not being realized and, therefore, could require the Company to indemnify the investors for any loss or recapture of NMTCs related to the financing until such time as the obligation to deliver tax benefits is relieved. The Company does not anticipate any credit recaptures will be required in connection with this arrangement.

The Company has determined that the financing arrangement with the Investment Funds and CDEs contains a variable interest entity ("VIE"). The ongoing activities of the Investment Funds – collecting and remitting interest and fees and NMTC compliance – were all considered in the initial design and are not expected to significantly affect economic performance throughout the life of the Investment Funds. Management considered the contractual arrangements that obligate the Company to deliver tax benefits and provide various other guarantees to the structure; Chase's and U.S. Bank's lack of a material interest in the underlying economics of the project; and the fact that the Company is obligated to absorb losses of the Investment Fund. The Company concluded that it is the primary beneficiary of the VIE and consolidated the Investment Funds, as a VIE, in accordance with the accounting standards for consolidation. Chase's and U.S. Bank's contributions of \$4.4 million, net of syndication fees, are included in cash and other long-term liabilities in the accompanying Consolidated Balance Sheet. The benefit of this net \$4.4 million contribution is recognized as a decrease in depreciation expense as the Company amortizes the contribution liability over the seven-year compliance period as it is being earned through the on-going compliance with the conditions of the NMTC program. As of September 30, 2016, the balance of the contribution liability was \$2.6 million and is classified as other long-term liabilities on the Consolidated Balance Sheet.

Note 10: Commitments and Contingencies

The Company, two of its former executive officers, five of its outside directors, and certain companies affiliated with the directors, are defendants in a consolidated class action brought under the federal securities laws and now pending in the United States District Court for the District of Minnesota under the caption Beaver County Employees' Retirement Fund, et al. v. Tile Shop Holdings, Inc., et al. Several related actions were filed in 2013 and subsequently consolidated. The plaintiffs are three investors who represent classes consisting of (1) all purchasers of Tile Shop common stock between August 22, 2012 and January 28, 2014 (the "class period"), seeking to pursue remedies under the Securities Exchange Act of 1934; and (2) all purchasers of Tile Shop common stock pursuant and/or traceable to the Company's December 2012 registration statement, seeking to pursue remedies under the Securities Act of 1933. Six firms who were underwriters in the December 2012 secondary public offering are also named as defendants. The plaintiffs allege that during the class period, defendants failed to disclose certain related party transactions in the Company's SEC filings and press releases. The plaintiffs assert claims under Sections 11, 12(a)(2), and 15 of the Securities Act of 1933, and under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. In addition to attorneys' fees and costs, the plaintiffs seek to recover damages on behalf of class members. Discovery has closed, and the parties are in the process of briefing and arguing dispositive motions.

The Company also is a Defendant in three actions brought derivatively on behalf of the Company by three shareholders in the Court of Chancery for the State of Delaware ("Delaware Chancery Court"). Two of the actions were filed in 2015 and then consolidated (the "Consolidated Actions"). On July 31, 2015, the plaintiff-shareholders in the Consolidated Actions filed a consolidated complaint. The consolidated complaint names as defendants six members of the Company's Board of Directors and a former employee of the Company. The third action (the "Third Action") was filed on or about September 28, 2016 against seven members of the Company's Board of Directors, a former officer, and a former employee. All of the complaints track many of the same factual allegations as have been made in the above-described federal securities class action. They allege that the defendant-directors and/or officer breached their fiduciary duties by failing to adopt adequate internal controls for the Company, by approving false and misleading statements issued by the Company, by causing the Company to violate generally accepted accounting principles and SEC regulations, by engaging in or approving alleged insider trading, and by permitting the Company's primary product to contain illegal amounts of lead. The complaints also allege claims for insider trading and/or unjust enrichment. The complaints seek damages, disgorgement, an award of attorneys' fees and other expenses, and an order compelling changes to the Company's corporate governance and internal procedures. In 2015, the defendants moved to dismiss the Consolidated Actions, or in the alternative, to stay the Consolidated Actions pending resolution of the

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Tile Shop Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(unaudited)

Beaver County Employees' Retirement Fund action described above. Subsequently, upon agreement of the parties, the Court entered an Order staying the Consolidated Actions. Recently the Company moved to dismiss the newly-filed Third Action, or in the alternative, to stay the Third Action until resolution of the Beaver County Employees' Retirement Fund action described above, or until the Company's Board of Directors takes action on the demand described below. That motion has not yet been decided.

By letter dated May 19, 2016, a shareholder of the Company, through his attorney and prior to filing the Third Action, demanded that the Board of Directors investigate alleged breaches of fiduciary duty related to the same matters described above, and take action against certain present and former officers and directors of the Company. The Board of Directors has appointed a committee of two independent directors to investigate and evaluate the matters raised in the demand letter, and to recommend to the Company's Board of Directors what actions, if any should be taken by the Company with respect to the matters raised in the demand letter.

Given the uncertainty of litigation and the preliminary stage of these cases, the Company cannot reasonably estimate the possible loss or range of loss that may result from these actions. The Company maintains directors and officers liability insurance policies that may reduce the Company's exposure, if any. In the event the Company incurs a loss, the Company will pursue recoveries to the maximum extent available under these policies.

The Company is also, from time to time, subject to claims and disputes arising in the normal course of business. In the opinion of management, while the outcome of such claims and disputes cannot be predicted with certainty, the Company's ultimate liability in connection with these matters is not expected to have a material adverse effect on the results of operations, financial position, or cash flows.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2015 and our consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q.

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains "forward-looking statements" that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. The statements contained in this Quarterly Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or Exchange Act. Forward-looking statements are often identified by the use of words such as, but not limited to, "anticipate," "believe," "can," "continue," "could," "estimate," "expect," "intend," "may," "might," "plan," "project," "seek," "should," "target," "will," "will likely result," "would," and similar expressions or variations intended to identify forward-looking statements. These statements are based on the beliefs and assumptions of our management based on information currently available to management. Such forward-looking statements are subject to risks, uncertainties and other important factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, unexpected delays or expenses related to opening new stores and maintaining, renovating or relocating existing stores, changes to economic conditions and customer preferences, disruptions in our supply chain, or inventory management, competitive factors, increases to interest rates or other impacts on our ability to obtain or maintain financing, unanticipated expenses related to operating as a public company including but not limited to litigation-related expenses, and those factors disclosed in the section captioned "Risk Factors" in our Annual Report for the fiscal year ended December 31, 2015, filed with the Securities and Exchange Commission. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

Overview and Recent Trends

We are a specialty retailer of manufactured and natural stone tiles, setting and maintenance materials, and related accessories in the United States. We offer a wide selection of products, attractive prices, and exceptional customer service in an extensive showroom setting. As of September 30, 2016, we operated 120 stores in 31 states, with an average size of 21,400 square feet. We also sell our products on our website.

We purchase our tile products and accessories directly from suppliers and manufacture our own setting and maintenance materials, such as thinset, grout, and sealers. We believe that our long-term supplier relationships, together with our design, manufacturing and distribution capabilities, enable us to offer a broad assortment of high-quality products to our customers, who are primarily homeowners and professionals, at competitive prices. We have invested significant resources to develop our proprietary brands and product sources, and we believe that we are a leading retailer of manufactured and natural stone tiles, accessories, and related materials in the United States.

We believe that the highly-fragmented United States retail tile market provides us with a significant opportunity to expand our store base. We opened seven new stores during the nine months ended September 30, 2016, including one relocation, while we opened four new stores during the nine months ended September 30, 2015. We plan to open an additional four new stores and relocate one additional store during the remainder of 2016. We believe that there will continue to be additional expansion opportunities in the United States and Canada. We expect store base growth will drive productivity and operational efficiencies. Our growth plans also require us to maintain significant inventory on-hand in order to fulfill transactions at these new locations.

For the three and nine months ended September 30, 2016, we reported net sales of \$78.6 million and \$247.5 million, respectively, and income from operations of \$7.8 million and \$31.3 million respectively. For the three and nine months ended September 30, 2015, we reported net sales of \$72.4 million and \$221.1 million, respectively, and income from operations of \$6.7 million and \$22.3 million, respectively. The increase in net sales and income from operations was primarily due to same store sales growth of 5.7% and 9.7% for the three months ended September 30, 2016 and 2015, respectively.

Net cash provided by operating activities was \$50.7 million and \$51.4 million for the nine months ended September 30, 2016 and 2015, respectively, which was used to fund operations, new store construction activities and debt repayments. We expect to continue to fund our capital expenditures and daily operations from our operating cash flows. As of September 30, 2016, we had cash of \$9.8 million and working capital of \$37.7 million.

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Key Components of our Consolidated Statements of Operations

Net Sales Net sales represents total charges to customers, net of returns, and includes freight charged to customers. We recognize sales at the time that the customer takes possession of the merchandise or final delivery of the product has occurred. We recognize service revenue, which consists primarily of freight charges for home delivery, when the service has been rendered. We are required to charge and collect sales and other taxes on sales to our customers and remit these taxes back to government authorities. Total revenues do not include sales tax because we are a pass-through conduit for collecting and remitting sales tax.

Comparable store sales for the three months ended September 30, 2016 increased \$4.1 million, compared to the three months ended September 30, 2015. Comparable store sales for the nine months ended September 30, 2016 increased \$19.9 million, compared to the nine months ended September 30, 2015. The table below sets forth information about our same store sales growth for the three and nine months ended September 30, 2016 and 2015.

| | For the three months ended | | For the nine months ended | |
|-------------------------|----------------------------|-------|---------------------------|-------|
| | September 30, | | September 30, | |
| | 2016 | 2015 | 2016 | 2015 |
| Same store sales growth | 5.7 % | 9.7 % | 9.0 % | 6.6 % |

The increase in same store sales growth is primarily attributable to an increase in the volume of transactions, as well as increases in average transaction size. Same store sale amounts include total charges to customers less any actual returns, and the change in the returns provision related to comparable stores. In general, we include a new or relocated store in the comparable store sales calculation on the first day of the 13th full month of operation.

Between October 1, 2015 and September 30, 2016, we opened nine new store locations. Incremental net sales of \$2.1 million and \$6.6 million occurred in the three and nine months ended September 30, 2016 respectively, from stores not included in the comparable store base.

Cost of Sales Cost of sales consists primarily of material costs, freight, duties, and storage and delivery of product to the customers, as well as costs associated with manufacturing of setting and maintenance materials. For the three months ended September 30, 2016 and 2015, our cost of sales as a percentage of net sales was 29.8% and 30.0%, respectively. The decrease was primarily attributable to decreases in shrink, damage and other inventory control process improvements. For the nine months ended September 30, 2016 and 2015, our cost of sales as a percentage of net sales was 29.9% and 30.8% respectively. The decrease was primarily attributable to fewer discounts, improved freight collection, and inventory control process improvements.

Selling, General, and Administrative Expenses Selling, general, and administrative expenses consists of general operating expenses. For the three months ended September 30, 2016 and 2015, our selling, general, and administrative expenses as percentage of net sales were 60.3% and 60.8%, respectively. The decrease was primarily attributable to an increase in same store sales, which outpaced the growth of selling, general, and administrative expenses for the three months ended September 30, 2016. For the nine months ended September 30, 2016 and 2015, our selling, general, and administrative expenses as a percentage of net sales were 57.5% and 59.1%, respectively. The decrease was primarily attributable to an increase in same store sales, which outpaced the growth of selling, general, and administrative expense for the nine months ended September 30, 2016.

Provision for Income Taxes We are subject to income tax in the United States as well as in other tax jurisdictions in which we conduct business. Our effective tax rate for the three months ended September 30, 2016 and 2015 was 38.6% and 39.3%, respectively. Our effective tax rate for the nine months ended September 30, 2016 and 2015 was 39.3% and 41.3%, respectively. The improvement in the three and nine months effective tax rate is due to an increase in incentive stock option exercise activity classified as a disqualifying disposition to the option holder that gives rise to a deduction for the Company. The Company's tax rate also benefitted from a decrease in non-deductible incentive stock-based compensation expense in 2016 combined with a reduction in the level of state tax rate changes that triggered unfavorable deferred tax adjustments in 2015.

Non-GAAP Measures

We calculate Adjusted EBITDA by taking net income calculated in accordance with accounting principles generally accepted in the United States ("GAAP"), and adjusting for interest expense, income taxes, depreciation and amortization, stock based compensation expense, and special charges, which consist of shareholder and other litigation costs, and losses incurred with the renegotiation of debt. Adjusted EBITDA margin is equal to Adjusted EBITDA divided by net sales. Free cash flows is calculated by taking net cash provided by operating activities and subtracting net cash used for the purchase of property, plant and equipment. Non-GAAP net income excludes the special charges, which consist of shareholder and other litigation costs, and losses incurred in connection with the renegotiation of debt, and is net of tax.

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We believe that these non-GAAP measures of financial results provide useful information to management and investors regarding certain financial and business trends relating to our financial condition and results of operations. Our management uses these non-GAAP measures to compare our performance to that of prior periods for trend analyses, for purposes of determining management incentive compensation, and for budgeting and planning purposes. These measures are used in monthly financial reports prepared for management and our board of directors. We believe that the use of these non-GAAP financial measures provides an additional tool for investors to use in evaluating ongoing operating results and trends and in comparing our financial measures with other specialty retailers, many of which present similar non-GAAP financial measures to investors.

The reconciliation of Adjusted EBITDA to net income for the three and nine months ended September 30, 2016 and 2015 is as follows:

| | (in thousands) | | | |
|--------------------------------|--------------------|------------------|-------------------|------------------|
| | Three Months Ended | | Nine Months Ended | |
| | September 30, | | September 30, | |
| | 2016 | 2015 | 2016 | 2015 |
| Net income | \$ 4,583 | \$ 3,761 | \$ 18,190 | \$ 11,910 |
| Interest expense | 363 | 503 | 1,382 | 2,101 |
| Income taxes | 2,886 | 2,436 | 11,793 | 8,385 |
| Depreciation & amortization | 5,770 | 5,504 | 16,954 | 16,597 |
| Special charges ⁽¹⁾ | 725 | 162 | 1,827 | 952 |
| Stock-based compensation | 930 | 1,583 | 3,394 | 4,226 |
| Adjusted EBITDA | <u>\$ 15,257</u> | <u>\$ 13,949</u> | <u>\$ 53,540</u> | <u>\$ 44,171</u> |

⁽¹⁾ Shareholder and other litigation costs.

The reconciliation of free cash flows to net cash provided by operating activities for the three and nine months ended September 30, 2016 and 2015 is as follows:

| | (in thousands) | |
|---|-------------------|------------------|
| | Nine Months Ended | |
| | September 30, | |
| | 2016 | 2015 |
| Net cash provided by operating activities | \$ 50,678 | \$ 51,381 |
| Purchase of property, plant and equipment | (19,645) | (12,196) |
| Free cash flows | <u>\$ 31,033</u> | <u>\$ 39,185</u> |

The reconciliation of Non-GAAP net income to GAAP net income for the three and nine months ended September 30, 2016 and 2015 is as follows:

| (in thousands, except share and per share data) | Three Months Ended | | | Three Months Ended | | |
|---|--------------------|-----------------|-------------------|--------------------|-----------------|-------------------|
| | September 30, 2016 | | | September 30, 2015 | | |
| | Pretax | Net of Tax | Per Share Amounts | Pretax | Net of Tax | Per Share Amounts |
| GAAP income | \$ 7,469 | \$ 4,583 | \$ 0.09 | \$ 6,197 | \$ 3,761 | \$ 0.07 |
| Special charges: | | | | | | |
| Shareholder and other litigation costs | 725 | 445 | 0.01 | 162 | 98 | 0.00 |
| Non-GAAP income ⁽¹⁾ | <u>\$ 8,194</u> | <u>\$ 5,028</u> | <u>\$ 0.10</u> | <u>\$ 6,359</u> | <u>\$ 3,859</u> | <u>\$ 0.08</u> |

⁽¹⁾ Amounts may not foot due to rounding.

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| (in thousands, except share and per share data) | Nine Months Ended September 30, 2016 | | | Nine Months Ended September 30, 2015 | | |
|---|---|------------|----------------------|---|------------|----------------------|
| | Pretax | Net of Tax | Per Share Amounts | Pretax | Net of Tax | Per Share Amounts |
| GAAP income | \$ 29,983 | \$ 18,190 | \$ 0.35 | \$ 20,295 | \$ 11,910 | \$ 0.23 |
| Special charges: | | | | | | |
| Shareholder and other litigation costs | 1,827 | 1,108 | 0.02 | 952 | 558 | 0.01 |
| Write-off of debt issuance costs | - | - | - | 194 | 115 | 0.00 |
| Non-GAAP income ⁽¹⁾ | \$ 31,810 | \$ 19,298 | \$ 0.37 | \$ 21,441 | \$ 12,583 | \$ 0.25 |

⁽¹⁾ Amounts may not foot due to rounding.

Our management does not consider these non-GAAP measures in isolation or as an alternative to financial measures determined in accordance with GAAP. The principal limitations of these non-GAAP financial measures are that they exclude significant expenses and income that are required by GAAP to be recognized in our consolidated financial statements. In addition, they are subject to inherent limitations as they reflect the exercise of judgments by management about which expenses and income are excluded or included in determining these non-GAAP financial measures. In order to compensate for these limitations, management presents non-GAAP financial measures in connection with GAAP results. We urge investors to review the reconciliation of our non-GAAP financial measures to the comparable GAAP financial measures and not to rely on any single financial measure to evaluate our business.

Results of Operations

Comparison of the three months ended September 30, 2016 to the three months ended September 30, 2015

| | (in thousands) | | | |
|--|----------------|---------------------------|-----------|------------|
| | 2016 | % of sales ⁽¹⁾ | 2015 | % of sales |
| Net sales | \$ 78,559 | | \$ 72,404 | |
| Cost of sales | 23,400 | 29.8 % | 21,691 | 30.0 % |
| Gross profit | 55,159 | 70.2 % | 50,713 | 70.0 % |
| Selling, general and administrative expenses | 47,361 | 60.3 % | 44,047 | 60.8 % |
| Income from operations | 7,798 | 9.9 % | 6,666 | 9.2 % |
| Interest expense | (363) | (0.5)% | (503) | (0.6)% |
| Other income | 34 | 0.0 % | 34 | 0.0 % |
| Income before income taxes | 7,469 | 9.5 % | 6,197 | 8.6 % |
| Provision for income taxes | (2,886) | (3.7)% | (2,436) | (3.4)% |
| Net income | \$ 4,583 | 5.8 % | \$ 3,761 | 5.2 % |

⁽¹⁾ Amounts may not foot due to rounding.

Net Sales Net sales for the third quarter of 2016 increased \$6.2 million, or 8.5%, over the third quarter of 2015. Comparable store sales increased \$4.1 million due to an increase in the volume of transactions, as well as an increase in the average transaction size. Net sales for the nine new stores open less than twelve months were \$2.1 million during the third quarter of 2016.

Gross profit Gross profit for the third quarter of 2016 increased \$4.4 million, or 8.8%, compared to the third quarter of 2015, primarily due to the increase in net sales. The gross margin rate increased from 70.0% for the third quarter of 2015 to 70.2% for the third quarter of 2016. The increase in the gross margin rate was primarily attributable to improvements in shrink, damage, and other inventory control process improvements.

Selling, General, and Administrative Expenses Selling, general, and administrative expenses for the third quarter of 2016 increased \$3.3 million, or 7.5%, compared to the third quarter of 2015. The increase in selling, general, and administrative expenses was primarily due to an increase in occupancy costs of \$1.2 million, compensation and benefit costs of \$0.6 million, advertising costs of \$0.4 million, and shipping and transportation costs of \$0.3 million as a result of opening nine new stores during the period from October 1, 2015 through September 30, 2016, and an increase in variable compensation associated with an 5.7% increase in comparable store sales for the third quarter of 2016. Selling, general, and administrative expenses as a percentage of net sales decreased to 60.3% for the third quarter of 2016 compared to 60.8% for the third quarter of 2015. The decrease in selling, general, and administrative expenses as a percentage of net sales was primarily due to a maturing store base that has higher net sales levels, which outpaced the growth of selling, general, and administrative expenses.

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Selling, general, and administrative expenses include special charges of \$0.7 million and \$0.2 million for the third quarter of 2016 and 2015, respectively, which consists of shareholder and other litigation expenses.

Pre-opening Costs Our pre-opening costs are those typically associated with the opening of a new store and generally include rent expense, payroll costs and promotional costs. We expense pre-opening costs as incurred and include these costs in selling, general and administrative expenses. During the third quarter of 2016 and 2015, we incurred pre-opening costs of \$0.2 million and \$0.1 million, respectively.

Interest Expense Interest expense decreased \$0.1 million for the third quarter of 2016 compared to the third quarter of 2015. The decrease is primarily due to the decrease in the debt balance over the last twelve months.

Provision for Income Taxes Income tax provision increased \$0.5 million for the third quarter of 2016 compared to the third quarter of 2015 due to higher income before income taxes in the third quarter of 2016. Our effective tax rate for the third quarter of 2016 and 2015 was 38.6% and 39.3%, respectively. The improvement in the three month effective tax rate is due to an increase in incentive stock option exercise activity classified as a disqualifying disposition to the option holder that gives rise to a deduction for us. Our tax rate also benefitted from a decrease in non-deductible incentive stock-based compensation expense in 2016 combined with a reduction in the level of state tax rate changes that triggered unfavorable deferred tax adjustments in 2015.

Comparison of the nine months ended September 30, 2016 to the nine months ended September 30, 2015

| | (in thousands) | | | |
|--|----------------|---------------------------|------------|------------|
| | 2016 | % of sales ⁽¹⁾ | 2015 | % of sales |
| Net sales | \$ 247,543 | | \$ 221,073 | |
| Cost of sales | 73,980 | 29.9 % | 68,096 | 30.8 % |
| Gross profit | 173,563 | 70.1 % | 152,977 | 69.2 % |
| Selling, general and administrative expenses | 142,300 | 57.5 % | 130,678 | 59.1 % |
| Income from operations | 31,263 | 12.6 % | 22,299 | 10.1 % |
| Interest expense | (1,382) | (0.6)% | (2,101) | (0.9)% |
| Other income | 102 | 0.0 % | 97 | 0.0 % |
| Income before income taxes | 29,983 | 12.1 % | 20,295 | 9.2 % |
| Provision for income taxes | (11,793) | (4.8)% | (8,385) | (3.8)% |
| Net income | \$ 18,190 | 7.3 % | \$ 11,910 | 5.4 % |

⁽¹⁾ Amounts may not foot due to rounding.

Net Sales Net sales for the nine months ended September 30, 2016 increased \$26.5 million, or 12.0%, over the nine months ended September 30, 2015. Comparable store sales increased \$19.9 million during the nine months ended September 30, 2016 due to an increase in the volume of transactions, as well as an increase in the average transaction size. Net sales for the nine new stores open less than twelve months were \$6.6 million during the nine months ended September 30, 2016.

Gross profit Gross profit for the nine months ended September 30, 2016 increased \$20.6 million, or 13.5%, compared to the nine months ended September 30, 2015, primarily due to the increase in net sales. The gross margin rate increased from 69.2% for the nine months ended September 30, 2015 to 70.1% for nine months ended September 30, 2016. The increase in the gross margin rate was primarily attributable to improved collection of customer delivery revenue, a decrease in the level of discounting, and inventory control process improvements.

Selling, General, and Administrative Expenses Selling, general, and administrative expenses for the nine months ended September 30, 2016 increased \$11.6 million, or 8.9%, compared to the nine months ended September 30, 2015. The increase in selling, general, and administrative expenses was primarily due to an increase in compensation and benefit costs of \$5.9 million, occupancy costs of \$2.5 million, and shipping and transportation costs of \$1.2 million as a result of opening nine new stores during the period from October 1, 2015 through September 30, 2016, and an increase in variable compensation associated with a 9.0% increase in comparable store sales for the nine months ended September 30, 2016. Selling, general, and administrative expenses as a percentage of net sales decreased to 57.5% for the nine months ended September 30, 2016 compared to 59.1% for the nine months ended September 30, 2015. The decrease in selling, general, and administrative expenses as a percentage of net sales was primarily due to a maturing store base that has higher net sales levels, which outpaced the growth of selling, general, and administrative expenses.

Selling, general, and administrative expenses include special charges of \$1.8 million and \$1.0 million for the nine months ended September 30, 2016 and 2015, respectively, which consists of shareholder and other litigation expenses.

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Pre-opening Costs Our pre-opening costs are those typically associated with the opening of a new store and generally include rent expense, payroll costs and promotional costs. We expense pre-opening costs as incurred and include these costs in selling, general and administrative expenses. In the nine months ended September 30, 2016 and 2015, we incurred pre-opening costs of \$0.6 million and \$0.3 million, respectively.

Interest Expense Interest expense decreased \$0.7 million for the nine months ended September 30, 2016 compared to the nine months ended September 30, 2015. The decrease is primarily due to the decrease in the debt balance in 2016.

Provision for Income Taxes Income tax provision increased \$3.4 million for the nine months ended September 30, 2016 compared to the nine months ended September 30, 2015 due to higher income before income taxes in the nine months ended September 30, 2016. Our effective tax rate for the nine months ended September 30, 2016 and 2015 was 39.3% and 41.3%, respectively. The improvement in the nine month effective tax rate is due to an increase in incentive stock option exercise activity classified as a disqualifying disposition to the option holder that gives rise to a deduction for us. Our tax rate also benefitted from a decrease in non-deductible incentive stock-based compensation expense in 2016 combined with a reduction in the level of state tax rate changes that triggered unfavorable deferred tax adjustments in 2015.

Liquidity and Capital Resources

Our principal uses of liquidity have been investments in working capital and capital expenditures. Our principal sources of liquidity are \$9.8 million of cash and cash equivalents at September 30, 2016, our cash flow from operations, and borrowings available under our credit facility. We expect to use this liquidity for opening new stores, purchasing additional merchandise inventory, maintaining our existing stores, reducing outstanding debt, and general corporate purposes.

On June 2, 2015, we and our operating subsidiary, The Tile Shop, LLC, as well as certain other of our subsidiaries, entered into a credit agreement with Fifth Third Bank, Bank of America, N.A., and Huntington National Bank (the "Credit Agreement"). The Credit Agreement provides us with a \$125.0 million senior secured credit facility, comprised of a five-year \$50.0 million term loan and a \$75.0 million revolving line of credit. The Credit Agreement is secured by virtually all of our assets, including but not limited to, inventory, receivables, equipment and real property. Borrowings pursuant to the Credit Agreement bear interest at either a base rate or a LIBOR-based rate, at our option. The LIBOR-based rate will range from LIBOR plus 1.50% to 2.00%, depending on The Tile Shop's leverage ratio. The base rate is equal to the greatest of: (a) the Federal funds rate plus 0.50%, (b) the Fifth Third Bank "prime rate," and (c) the Eurodollar rate plus 1.00%, in each case plus 0.50% to 1.00% depending on The Tile Shop's leverage ratio. At September 30, 2016 the base interest rate was 4.00% and the LIBOR-based interest rate was 2.03%. Borrowings outstanding were \$23.4 million on the term loan as of September 30, 2016. We can elect to prepay the term loan without incurring a penalty. The term loan requires quarterly principal payments as follows (in thousands):

Period

| | |
|--------------------------------------|----------|
| December 31, 2016 to June 30, 2017 | \$ 1,250 |
| September 30, 2017 to June 30, 2018 | 1,875 |
| September 30, 2018 to March 31, 2020 | 2,500 |

The Credit Agreement contains customary events of default, conditions to borrowings, and restrictive covenants, including restrictions on our ability to dispose of assets, make acquisitions, incur additional debt, incur liens, make investments, or enter into transactions with affiliates on other than terms that could be obtained in an arm's length transaction. The Credit Agreement also includes financial and other covenants, including covenants to maintain certain fixed charge coverage ratios and rent adjusted leverage ratios. In addition, except with respect to pro rata payments made by The Tile Shop or other subsidiaries to Holdings or any other equity owner of such entity, the Credit Agreement prohibits the payments of cash dividends. We were in compliance with the covenants as of September 30, 2016.

We believe that our cash flow from operations, together with our existing cash and cash equivalents, and borrowings available under our credit facility will be sufficient to fund our operations and anticipated capital expenditures over at least the next 12 months.

Capital expenditures paid in the nine months ended September 30, 2016 were \$19.6 million. Approximately \$13.1 million was for new store build-out, remodels of existing stores, and merchandising projects, and approximately \$4.5 million was for our information technology infrastructure in stores. The remainder was for distribution facilities and other general corporate purposes.

Our future capital requirements will vary based on the number of additional stores, distribution centers, and manufacturing facilities that we open and the number of stores that we choose to renovate. Our decisions regarding opening, relocating, or renovating stores, and whether to engage in strategic acquisitions, will be based in part on macroeconomic factors and the general state of the U.S. economy, as well as the local economies in the markets in which our stores are located. We plan to open an additional four new stores and relocate one additional store during the remainder of 2016. Total capital expenditures are expected to be approximately \$30 million in 2016.

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Cash flows

The following table summarizes our cash flow data for the nine months ended September 30, 2016 and 2015.

| | (in thousands) | |
|---|-------------------|-----------|
| | Nine Months Ended | |
| | September 30, | |
| | 2016 | 2015 |
| Net cash provided by operating activities | \$ 50,678 | \$ 51,381 |
| Net cash used in investing activities | (19,645) | (12,187) |
| Net cash used in financing activities | (31,518) | (30,304) |

Operating activities

Cash provided by operating activities during the nine months ended September 30, 2016 was \$50.7 million, compared to \$51.4 million during the nine months ended September 30, 2015. The decrease is primarily attributable to an \$8.6 million decrease in cash flows attributable to the change in income tax receivable/payable balances, partially offset by a \$6.3 million increase in net income, compared to the prior year.

Investing activities

Net cash used in investing activities totaled \$19.6 million for the nine months ended September 30, 2016, compared to \$12.2 million for the nine months ended September 30, 2015. Net cash used in investing activities in each period was primarily for capital purchases for new store build-outs, remodels of existing stores, merchandising projects, information technology in stores, distribution facilities, and other general corporate purposes.

Financing activities

Net cash used in financing activities was \$31.5 million for the nine months ended September 30, 2016, compared to \$30.3 million for the nine months ended September 30, 2015. Cash used in financing activities during the nine months ended September 30, 2016 was primarily for payments of long-term debt and capital lease obligations of \$32.1 million. At September 30, 2016, we were in compliance with our debt covenants. We intend to make principal payments due in future periods using cash from operations.

Cash and cash equivalents totaled \$9.8 million at September 30, 2016, versus \$10.3 million at December 31, 2015. The Company had working capital of \$37.7 million at September 30, 2016, compared to working capital of \$47.5 million at December 31, 2015.

Off-balance sheet arrangements

As of September 30, 2016 and December 31, 2015, we did not have any “off-balance sheet arrangements” (as such term is defined in Item 303 of Regulation S-K) that could have a current or future effect on our financial condition, changes in financial condition, net sales or expenses, results of operations, liquidity, capital expenditures or capital resources.

Contractual arrangements

As of September 30, 2016, there were no material changes to our contractual obligations outside the ordinary course of business.

New Accounting Pronouncements

Recently Adopted Accounting Pronouncements

In February 2015, the Financial Accounting Standards Board (“FASB”) issued a new accounting standard that will modify current consolidation guidance. The standard makes changes to both the variable interest entity model and the voting interest entity model, including modifying the evaluation of whether limited partnerships or similar legal entities are variable interest entities or voting interest entities and amending the guidance for assessing how relationships of related parties affect the consolidation analysis of variable interest entities. The standard was effective for us as of the beginning of fiscal 2016. The adoption of this new standard did not have a material effect on our financial statements.

In April 2015, the FASB issued a standard that requires debt issuance costs related to a recognized debt liability be presented in the Consolidated Balance Sheet as a direct deduction from the carrying amount of that debt liability. We adopted the provisions of this

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statement in the first quarter of 2016 and prior periods have been retrospectively adjusted. The adoption of this standard resulted in a \$0.1 million reduction of other current assets, net, a \$0.3 million reduction of other assets, a \$0.3 million reduction of the current portion of long term debt, and a \$0.1 million reduction of long term debt in the Consolidated Balance Sheet for the period ended December 31, 2015.

In March 2016, the FASB issued a standard that amends and simplifies the accounting for stock compensation. The guidance addresses various stock compensation aspects including accounting for income taxes, classification of excess tax benefits on the statement of cash flows, forfeitures, minimum statutory tax withholding requirements, and classification of employee taxes paid on the statement of cash flows when an employer withholds shares for tax withholding purposes, among other things. In order to simplify the accounting for stock-based compensation, we made a change in accounting policy to account for forfeitures when they occur, and as a result, we recognized a \$0.7 million cumulative-effect reduction to retained earnings under the modified retrospective approach. During the three months ended September 30, 2016, we recognized an adjustment to reduce additional paid-in capital and share-based compensation by \$0.1 million to account for current year forfeiture activity.

We elected prospective transition for the requirement to classify excess tax benefits as an operating activity in the Consolidated Statement of Cash Flows. The adoption did not have a material impact on the amounts reported in the Consolidated Statement of Cash Flows for the nine months ended September 30, 2016. Additionally, we will prospectively recognize all excess tax benefits and tax deficiencies as income tax expense or benefit in the Consolidated Statement of Operations as a discrete item in the period in which awards vest. The adoption did not have a material impact on the amounts reported in the Consolidated Statement of Operations for the three and nine months ended September 30, 2016. We applied the modified retrospective method to recognize the cumulative effect of previously unrecognized excess tax benefits in opening retained earnings. The adoption did not have a material impact on the amounts reported in the Consolidated Balance Sheet for the year ended December 31, 2015. We also retrospectively applied the requirement to present employee taxes paid when an employer withholds shares for tax-withholding purposes as a financing activity in the Consolidated Statement of Cash Flows. The adoption did not have a material impact on the amounts reported in the Consolidated Statement of Cash Flows for the nine months ended September 30, 2016 and 2015.

Accounting Pronouncements Not Yet Adopted

In May 2014, the FASB issued a final standard on revenue from contracts with customers. The new standard sets forth a single comprehensive model for recognizing and reporting revenue. The new standard is effective for us in fiscal year 2018 and permits the use of either a retrospective or a cumulative effect transition method. We are currently assessing the impact of implementing the new guidance on our consolidated financial statements.

In August 2014, the FASB issued a standard requiring an entity's management to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern within one year after the date of the financial statements. The guidance also sets forth a series of disclosures that are required in the event the entity's management concludes that there is substantial doubt about the entity's ability to continue as a going concern. The new standard becomes effective for us in the annual financial statements for fiscal 2016 and requires an ongoing evaluation at each interim and annual period thereafter. We are currently assessing the effect the new standard will have on our consolidated financial statements.

In July 2015, the FASB issued a standard which simplifies the subsequent measurement of inventory. Currently, an entity is required to measure inventory at the lower of cost or market, whereby market can be replacement cost, net realizable value, or net realizable value less an approximately normal profit margin. The changes require that inventory be measured at the lower of cost and net realizable value, thereby eliminating the use of the other two market methodologies. Net realizable value is defined as the estimated selling prices in the ordinary course of business less reasonably predictable costs of completion, disposal, and transportation. Currently, we apply the net realizable value market option to measure inventories at the lower of cost or market. These changes become effective for us in fiscal 2017. We are currently assessing the effect the new standard will have on our consolidated financial statements.

In February 2016, the FASB issued a standard that primarily requires organizations that lease assets to recognize the rights and obligations created by those leases on the Consolidated Balance Sheet. The standard is effective in 2019, with early adoption permitted. We are currently assessing the effect the new standard will have on our consolidated financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in our primary risk exposures or management of market risks from those disclosed in our Form 10-K for the fiscal year ended December 31, 2015.

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ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We have established disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934, as amended, (the “Exchange Act”), is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and that information relating to the Company is accumulated and communicated to management, including our principal officers as appropriate to allow timely decisions regarding required disclosure. Our Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2016 and have concluded that such disclosure controls and procedures were effective as of the end of the period covered by this Quarterly Report on Form 10-Q.

Changes in Internal Control over Financial Reporting

No changes to our internal control over financial reporting occurred during the quarter ended September 30, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act).

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company, two of its former executive officers, five of its outside directors, and certain companies affiliated with the directors, are defendants in a consolidated class action brought under the federal securities laws and now pending in the United States District Court for the District of Minnesota under the caption Beaver County Employees' Retirement Fund, et al. v. Tile Shop Holdings, Inc., et al. Several related actions were filed in 2013 and subsequently consolidated. The plaintiffs are three investors who represent classes consisting of (1) all purchasers of Tile Shop common stock between August 22, 2012 and January 28, 2014 (the "class period"), seeking to pursue remedies under the Securities Exchange Act of 1934; and (2) all purchasers of Tile Shop common stock pursuant and/or traceable to the Company's December 2012 registration statement, seeking to pursue remedies under the Securities Act of 1933. Six firms who were underwriters in the December 2012 secondary public offering are also named as defendants. The plaintiffs allege that during the class period, defendants failed to disclose certain related party transactions in the Company's SEC filings and press releases. The plaintiffs assert claims under Sections 11, 12(a)(2), and 15 of the Securities Act of 1933, and under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. In addition to attorneys' fees and costs, the plaintiffs seek to recover damages on behalf of class members. Discovery has closed, and the parties are in the process of briefing and arguing dispositive motions.

The Company also is a Defendant in three actions brought derivatively on behalf of the Company by three shareholders in the Court of Chancery for the State of Delaware ("Delaware Chancery Court"). Two of the actions were filed in 2015 and then consolidated (the "Consolidated Actions"). On July 31, 2015, the plaintiff-shareholders in the Consolidated Actions filed a consolidated complaint. The consolidated complaint names as defendants six members of the Company's Board of Directors and a former employee of the Company. The third action (the "Third Action") was filed on or about September 28, 2016 against seven members of the Company's Board of Directors, a former officer, and a former employee. All of the complaints track many of the same factual allegations as have been made in the above-described federal securities class action. They allege that the defendant-directors and/or officer breached their fiduciary duties by failing to adopt adequate internal controls for the Company, by approving false and misleading statements issued by the Company, by causing the Company to violate generally accepted accounting principles and SEC regulations, by engaging in or approving alleged insider trading, and by permitting the Company's primary product to contain illegal amounts of lead. The complaints also allege claims for insider trading and/or unjust enrichment. The complaints seek damages, disgorgement, an award of attorneys' fees and other expenses, and an order compelling changes to the Company's corporate governance and internal procedures. In 2015, the defendants moved to dismiss the Consolidated Actions, or in the alternative, to stay the Consolidated Actions pending resolution of the Beaver County Employees' Retirement Fund action described above. Subsequently, upon agreement of the parties, the Court entered an Order staying the Consolidated Actions. Recently the Company moved to dismiss the newly-filed Third Action, or in the alternative, to stay the Third Action until resolution of the Beaver County Employees' Retirement Fund action described above, or until the Company's Board of Directors takes action on the demand described below. That motion has not yet been decided.

By letter dated May 19, 2016, a shareholder of the Company, through his attorney and prior to filing the Third Action, demanded that the Board of Directors investigate alleged breaches of fiduciary duty related to the same matters described above, and take action against certain present and former officers and directors of the Company. The Board of Directors has appointed a committee of two independent directors to investigate and evaluate the matters raised in the demand letter, and to recommend to the Company's Board of Directors what actions, if any should be taken by the Company with respect to the matters raised in the demand letter.

Given the uncertainty of litigation and the preliminary stage of these cases, the Company cannot reasonably estimate the possible loss or range of loss that may result from these actions. The Company maintains directors and officers liability insurance policies that may reduce the Company's exposure, if any. In the event the Company incurs a loss, the Company will pursue recoveries to the maximum extent available under these policies.

The Company is also, from time to time, subject to claims and disputes arising in the normal course of business. In the opinion of management, while the outcome of such claims and disputes cannot be predicted with certainty, the Company's ultimate liability in connection with these matters is not expected to have a material adverse effect on the results of operations, financial position, or cash flows.

ITEM 1A. RISK FACTORS

There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2015.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

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ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not Applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit No. Description

| | |
|---------|--|
| 3.1 | Certificate of Incorporation of Tile Shop Holdings, Inc. (incorporated by reference to Exhibit 3.1 to the Company's Registration Statement on Form S-4 filed with the Securities and Exchange Commission on July 2, 2012). |
| 3.2 | By-Laws of Tile Shop Holdings, Inc. (incorporated by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-4 filed with the Securities and Exchange Commission on July 2, 2012). |
| 31.1* | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes Oxley Act of 2002. |
| 31.2* | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes Oxley Act of 2002. |
| 32.1** | Certifications of Chief Executive Officer Pursuant to Section 906 of the Sarbanes Oxley Act of 2002. |
| 32.2** | Certifications of Chief Financial Officer Pursuant to Section 906 of the Sarbanes Oxley Act of 2002. |
| 101.INS | XBRL Instance Document. |
| 101.SCH | XBRL Taxonomy Extension Schema Document. |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document. |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document. |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document. |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document. |

* Filed herewith

** Furnished herewith

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SIGNATURES

Pursuant to the requirements 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.

TILE SHOP HOLDINGS, INC.

Dated: October 27, 2016

By: /s/ CHRIS R. HOMEISTER

Chris R. Homeister
Chief Executive Officer

Dated: October 27, 2016

By: /s/ KIRK L. GEADELMANN

Kirk L. Geadelmann
Chief Financial Officer

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**TILE SHOP HOLDINGS, INC.
EXHIBIT INDEX**

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| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document. |

* Filed herewith

** Furnished herewith

CERTIFICATIONS

I, Chris R. Homeister, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Tile Shop Holdings, Inc.;
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 registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant 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 registrant, 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant'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
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant'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 registrant'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 registrant's internal control over financial reporting.

Dated: October 27, 2016

/s/ CHRIS R. HOMEISTER
Chris R. Homeister
Chief Executive Officer

CERTIFICATIONS

I, Kirk L. Geadelmann, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Tile Shop Holdings, Inc.;
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 registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant 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 registrant, 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant'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
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant'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 registrant'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 registrant's internal control over financial reporting.

Dated: October 27, 2016

/s/ KIRK L. GEADELMANN
Kirk L. Geadelmann
Chief Financial Officer

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Tile Shop Holdings, Inc. (the "Company") on Form 10-Q for the period ending September 30, 2016 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Chris R. Homeister, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ CHRIS R. HOMEISTER

Chris R. Homeister
Chief Executive Officer

October 27, 2016

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Tile Shop Holdings, Inc. (the "Company") on Form 10-Q for the period ending September 30, 2016 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Kirk L. Geadelmann, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ KIRK L. GEADELMANN

Kirk L. Geadelmann
Chief Financial Officer

October 27, 2016

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.
