
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, 2017

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.)

14000 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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth 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
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 23, 2017, there were 52,158,065 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)

	September 30, 2017 (unaudited)	December 31, 2016 (audited)
Assets		
Current assets:		
Cash and cash equivalents	\$ 12,429	\$ 6,067
Restricted cash	855	3,000
Trade receivables, net	2,663	2,414
Inventories	70,927	74,295
Income tax receivable	2,870	1,670
Other current assets, net	4,675	8,755
Total Current Assets	94,419	96,201
Property, plant and equipment, net	151,388	141,037
Deferred tax assets	17,919	21,391
Long-term restricted cash	-	3,881
Other assets	2,223	2,763
Total Assets	\$ 265,949	\$ 265,273
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 28,406	\$ 20,321
Current portion of long-term debt	8,193	6,286
Income tax payable	157	120
Other accrued liabilities	23,970	33,461
Total Current Liabilities	60,726	60,188
Long-term debt, net	5,689	22,126
Capital lease obligation, net	608	697
Deferred rent	40,372	37,595
Other long-term liabilities	5,043	5,768
Total Liabilities	112,438	126,374
Stockholders' Equity:		
Common stock, par value \$0.0001; authorized: 100,000,000 shares; issued and outstanding: 52,071,789 and 51,607,143 shares, respectively	5	5
Preferred stock, par value \$0.0001; authorized: 10,000,000 shares; issued and outstanding: 0 shares	-	-
Additional paid-in-capital	182,410	185,998
Accumulated deficit	(28,888)	(47,058)
Accumulated other comprehensive loss	(16)	(46)
Total Stockholders' Equity	153,511	138,899
Total Liabilities and Stockholders' Equity	\$ 265,949	\$ 265,273

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,	
	2017	2016	2017	2016
Net sales	\$ 84,421	\$ 78,559	\$ 266,020	\$ 247,543
Cost of sales	27,759	23,400	82,265	73,980
Gross profit	56,662	55,159	183,755	173,563
Selling, general and administrative expenses	52,285	47,361	154,245	142,300
Income from operations	4,377	7,798	29,510	31,263
Interest expense	(505)	(363)	(1,438)	(1,382)
Other income	34	34	132	102
Income before income taxes	3,906	7,469	28,204	29,983
Provision for income taxes	(1,468)	(2,886)	(10,034)	(11,793)
Net income	\$ 2,438	\$ 4,583	\$ 18,170	\$ 18,190
Income per common share:				
Basic	\$ 0.05	\$ 0.09	\$ 0.35	\$ 0.35
Diluted	\$ 0.05	\$ 0.09	\$ 0.35	\$ 0.35
Weighted average shares outstanding:				
Basic	51,757,248	51,426,104	51,638,864	51,388,058
Diluted	52,053,655	51,929,226	52,011,208	51,817,588

See accompanying Notes to Consolidated Financial Statements.

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2017	2016	2017	2016
Net income	\$ 2,438	\$ 4,583	\$ 18,170	\$ 18,190
Currency translation adjustment	22	(2)	30	(10)
Other comprehensive income (loss)	22	(2)	30	(10)
Comprehensive income	\$ 2,460	\$ 4,581	\$ 18,200	\$ 18,180

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	Retained earnings (deficit)	Accumulated other comprehensive income (loss)	Total
	Shares	Amount				
Balance at December 31, 2015	51,437,973	\$ 5	\$ 180,192	\$ (64,985)	\$ (11)	\$ 115,201
Reclassification of impact of ASU 2016-09	-	-	687	(536)	-	151
Balance at January 1, 2016	51,437,973	\$ 5	\$ 180,879	\$ (65,521)	\$ (11)	\$ 115,352
Issuance of restricted shares	73,384	-	-	-	-	-
Stock based compensation	-	-	4,333	-	-	4,333
Stock option exercises	95,786	-	786	-	-	786
Foreign currency translation adjustments	-	-	-	-	(35)	(35)
Net income	-	-	-	18,463	-	18,463
Balance at December 31, 2016	51,607,143	\$ 5	\$ 185,998	\$ (47,058)	\$ (46)	\$ 138,899
Issuance of restricted shares	161,213	-	-	-	-	-
Cancellation of restricted shares	(9,939)	-	-	-	-	-
Stock based compensation	-	-	2,759	-	-	2,759
Stock option exercises	313,372	-	1,417	-	-	1,417
Dividends paid	-	-	(7,764)	-	-	(7,764)
Foreign currency translation adjustments	-	-	-	-	30	30
Net income	-	-	-	18,170	-	18,170
Balance at September 30, 2017	52,071,789	\$ 5	\$ 182,410	\$ (28,888)	\$ (16)	\$ 153,511

See accompanying Notes to Consolidated Financial Statements.

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

	Nine Months Ended	
	September 30,	
	2017	2016
Cash Flows From Operating Activities		
Net income	\$ 18,170	\$ 18,190
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation & amortization	19,395	16,954
Amortization of debt issuance costs	526	416
Loss on disposals of property, plant and equipment	205	420
Deferred rent	2,911	1,767
Stock based compensation	2,759	3,394
Deferred income taxes	3,472	1,065
Changes in operating assets and liabilities:		
Trade receivables	(249)	(594)
Inventories	3,369	3,499
Prepaid expenses and other assets	4,163	(303)
Accounts payable	5,421	3,337
Income tax receivable / payable	(1,163)	(1,188)
Accrued expenses and other liabilities	(9,624)	3,721
Net cash provided by operating activities	<u>49,355</u>	<u>50,678</u>
Cash Flows From Investing Activities		
Purchases of property, plant and equipment	(28,031)	(19,645)
Net cash used in investing activities	<u>(28,031)</u>	<u>(19,645)</u>
Cash Flows From Financing Activities		
Release of restricted cash	6,026	-
Payments of long-term debt and capital lease obligations	(44,672)	(32,132)
Advances on line of credit	30,000	-
Dividends paid	(7,764)	-
Proceeds from exercise of stock options	1,635	620
Employee taxes paid for shares withheld	(217)	-
Security deposits	-	(6)
Net cash used in financing activities	<u>(14,992)</u>	<u>(31,518)</u>
Effect of exchange rate changes on cash	30	(10)
Net change in cash	6,362	(495)
Cash and cash equivalents beginning of period	6,067	10,330
Cash and cash equivalents end of period	<u>\$ 12,429</u>	<u>\$ 9,835</u>
Supplemental disclosure of cash flow information		
Purchases of property, plant and equipment included in accounts payable and accrued expenses	\$ 4,935	\$ 816
Cash paid for interest	1,453	1,483
Cash paid for income taxes, net	7,575	12,981

See accompanying Notes to Consolidated Financial Statements.

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Note 1: Background

The Tile Shop, LLC 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, 2017, the Company had 134 stores in 31 states and the District of Columbia, as well as 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, 2017 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2017.

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, 2016. 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.

Recently Adopted Accounting Pronouncements

In July 2015, the Financial Accounting Standards Board (“FASB”) issued a standard that simplifies the subsequent measurement of inventory. Previously, an entity was 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 required 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. The standard was effective for the Company at the beginning of fiscal 2017. The adoption of this new standard did not have a material effect on the Company’s financial statements.

Accounting Pronouncements Not Yet Adopted

In May 2014, the FASB issued a final standard on revenue from contracts with customers. This new standard introduces a comprehensive revenue recognition model that requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. In 2016, the FASB issued several amendments to the standard, including principal versus agent considerations when another party is involved in providing goods or services to a customer, the application of identifying performance obligations, and the recognition of expected breakage amounts either proportionally in earnings as redemptions occur or when redemption is remote. Upon adoption of the standard, the Company expects to present the gross sales returns reserve as a component of other accrued liabilities and establish a return asset that will be classified as a component of other current assets, net in the Consolidated Balance Sheet. Currently, the Company presents its sales returns reserve net of the value of the return assets as a component of other accrued liabilities in the Consolidated Balance Sheet. The Company continues to assess the impact of other aspects of this standard. As the Company finalizes its assessment, the Company will take steps to finalize its accounting policies, establish new processes and controls when warranted, and ensure information is captured to conform with the disclosure requirements outlined under the new standard. The standard is effective for the Company in fiscal 2018 and provides for either full retrospective adoption or modified retrospective adoption by which the cumulative effect of the change is recognized in retained earnings at the date of initial application. The Company has elected to adopt this standard using the modified retrospective approach.

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.

In August 2016, the FASB issued an accounting standards update with new guidance on how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The amendments in the standards update provide guidance on eight specific cash flow issues. The standards update is effective for the Company in fiscal 2018 and shall be applied to the Company’s financial statements retrospectively. The Company is currently assessing the effect the new standard will have on its consolidated financial statements.

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In November 2016, the FASB issued new guidance on restricted cash on the statement of cash flows. The new guidance requires the classification and presentation of changes in restricted cash and cash equivalents in the statement of cash flows. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning and ending balances shown on the statement of cash flows. The new standard is effective for the Company in fiscal 2018, with early adoption permitted. The guidance should be applied retrospectively after adoption. The Company's restricted cash balance was \$0.9 million as of September 30, 2017. Upon adopting the new standard, the Company anticipates that it will no longer present the release of restricted cash as a financing cash inflow. Instead, restricted cash and long-term restricted cash balances will be included in the beginning and ending cash, cash equivalents and restricted cash balances in the statement of cash flows.

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, 2017 and December 31, 2016:

	(in thousands)	
	September 30, 2017	December 31, 2016
Finished goods	\$ 55,792	\$ 61,949
Raw materials	1,794	2,312
Finished goods in transit	13,341	10,034
Total	<u>\$ 70,927</u>	<u>\$ 74,295</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. The provision for losses related to shrinkage and other amounts was \$0.7 million and \$0.2 million as of September 30, 2017 and December 31, 2016, respectively.

Note 3: Income taxes

The Company's effective tax rate on net income before income taxes for the three months ended September 30, 2017 and 2016, was 37.6% and 38.6%, respectively. For the three months ended September 30, 2017 and 2016, the Company recorded a provision for income taxes of \$1.5 million and \$2.9 million, respectively.

The Company's effective tax rate on net income before income taxes for the nine months ended September 30, 2017 and 2016 was 35.6% and 39.3%, respectively. The improvement in the effective tax rate is attributable to an increase in excess tax benefits recognized in connection with the exercise of stock options during 2017. For the nine months ended September 30, 2017 and 2016, the Company recorded a provision for income taxes of \$10.0 million and \$11.8 million, respectively.

The Company records interest and penalties relating to uncertain tax positions in income tax expense. As of September 30, 2017 and 2016, 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.

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Basic and diluted earnings per share were calculated as follows:

	(dollars in thousands)			
	For the three months ended		For the nine months ended	
	September 30,		September 30,	
	2017	2016	2017	2016
Net income	\$ 2,438	\$ 4,583	\$ 18,170	\$ 18,190
Weighted average basic shares outstanding	51,757,248	51,426,104	51,638,864	51,388,058
Effect of dilutive securities attributable to stock-based awards	296,407	503,122	372,344	429,530
Weighted average diluted shares outstanding	52,053,655	51,929,226	52,011,208	51,817,588
Income per common share:				
Basic	\$ 0.05	\$ 0.09	\$ 0.35	\$ 0.35
Dilutive	\$ 0.05	\$ 0.09	\$ 0.35	\$ 0.35
Anti-dilutive securities excluded from EPS calculation	511,122	347,699	298,721	409,599

Note 5: Other Accrued Liabilities

Other accrued liabilities consisted of the following:

	(in thousands)	
	September 30, 2017	December 31, 2016
Customer deposits	\$ 8,721	\$ 7,742
Sales return reserve	3,230	3,080
Payroll and sales taxes	3,174	2,691
Accrued wages and salaries	2,727	4,962
Shareholder litigation accrual	-	9,500
Other current liabilities	6,118	5,486
Total other accrued liabilities	\$ 23,970	\$ 33,461

Note 6: Long-term Debt

On June 2, 2015, the Company and its operating subsidiary, The Tile Shop, LLC, entered into a credit agreement with Fifth Third Bank, Bank of America, N.A., and Huntington National Bank (as amended, the "Credit Agreement"). On December 9, 2016, the Credit Agreement was amended to permit an additional New Markets Tax Credit Financing arrangement and on February 10, 2017, the Credit Agreement was amended to permit the Company to make certain dividend payments. The Credit Agreement again was amended on July 17, 2017 to adjust the consolidated fixed charge coverage ratio from 2.00:1.00 to 1.50:1.00 to provide greater flexibility in declaring and making dividend payments or other distributions to stockholders. 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 The Tile Shop's leverage ratio. At September 30, 2017 the base interest rate was 4.75% and the LIBOR-based interest rate was 2.73%. Borrowings outstanding consisted of \$13.2 million on the term loan and no outstanding balance on the revolving line of credit as of September 30, 2017. There was \$75.0 million available for borrowing on the revolving line of credit as of September 30, 2017. 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 term loan requires quarterly principal payments as follows (in thousands):

Period	
December 31, 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

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includes financial and other covenants including covenants to maintain certain fixed charge coverage ratios and rent adjusted leverage ratios. The Company was in compliance with the covenants as of September 30, 2017.

The Company has standby letters of credit outstanding related to its workers compensation and medical insurance policies. As of September 30, 2017 and 2016, the standby letters of credit totaled \$1.1 million.

Long-term debt consisted of the following at September 30, 2017 and December 31, 2016 (in thousands):

	September 30, 2017		December 31, 2016	
	Principal	Unamortized Debt Issuance Costs	Principal	Unamortized Debt Issuance Costs
Term note payable - interest at 2.73% and 2.27% at September 30, 2017 and December 31, 2016, respectively	\$ 13,221	\$ (44)	\$ 17,721	\$ (114)
Commercial bank credit facility	-	-	10,000	-
Variable interest rate bonds (1.29% and 0.89% at September 30, 2017 and December 31, 2016), which mature April 1, 2023, collateralized by buildings and equipment	705	-	805	-
Total debt obligations	13,926	(44)	28,526	(114)
Less: current portion	8,230	(37)	6,350	(64)
Debt obligations, net of current portion	\$ 5,696	\$ (7)	\$ 22,176	\$ (50)

Note 7: Fair Value of Financial Instruments

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.

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.

The following table sets forth by Level within the fair value hierarchy the Company's financial assets that were accounted for at fair value on a recurring basis at September 30, 2017 and December 31, 2016 according to the valuation techniques the Company uses to determine their fair values. There have been no transfers of assets among the fair value hierarchies presented.

Assets	Pricing Category	Fair Value at	
		September 30, 2017	December 31, 2016
		(in thousands)	
Cash and cash equivalents	Level 1	\$ 12,429	\$ 6,067
Restricted cash	Level 1	855	3,000
Long-term restricted cash	Level 1	-	3,881

The following methods and assumptions were used to estimate the fair value of each class of financial instrument. There have been no changes in the valuation techniques used by the Company to value the Company's financial instruments.

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- *Cash and cash equivalents:* Consists of cash on hand and bank deposits. The value was measured using quoted market prices in active markets. The carrying amount approximates fair value.
- *Restricted cash:* Consists of cash and cash equivalents held in bank deposit accounts restricted as to withdrawal or that are under the terms of use for current operations. The value was measured using quoted market prices in active markets. The carrying amount approximates fair value.
- *Long-term restricted cash:* Consists of cash and cash equivalents held in bank deposit accounts restricted as to withdrawal and designated for expenditure in the construction of noncurrent assets. The value was measured using quoted market prices in active markets. The carrying amount approximates fair value.

Fair value measurements also apply to certain non-financial assets and liabilities measured at fair value on a nonrecurring basis. Property, plant and equipment is measured at fair value when an impairment is recognized and the related assets are written down to fair value. The Company did not recognize any significant impairment losses during 2017 or 2016. The carrying value of the Company's borrowings under its credit agreement approximate fair value based upon the market interest rates available to the Company for debt obligations with similar risks and maturities.

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, 2017 and 2016 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 for both the three months ended September 30, 2017 and 2016. Total stock-based compensation expense related to stock options was \$1.7 million and \$2.6 million for the nine months ended September 30, 2017 and 2016, respectively. Stock-based compensation expense pertaining to stock options is included in selling, general and administrative expenses in the accompanying Consolidated Statements of Operations.

As of September 30, 2017, the Company had outstanding stock options to purchase 1,920,621 shares of common stock at a weighted average exercise price of \$15.10.

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. Certain awards are also subject to forfeiture if the Company fails to attain its adjusted EBITDA targets. 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. The Company adjusts the cumulative expense recognized on awards with performance conditions based on the probability of achieving the performance condition. Total stock-based compensation expense related to restricted stock was \$0.4 million and \$0.3 million for the three months ended September 30, 2017 and 2016, respectively. Total stock-based compensation expense related to restricted stock was \$1.1 million and \$0.8 million for the nine months ended September 30, 2017 and 2016, respectively. Stock-based compensation expense pertaining to restricted stock awards is included in selling, general and administrative expenses in the accompanying Consolidated Statements of Operations.

As of September 30, 2017, the Company had 198,406 outstanding restricted common shares.

Note 9: New Market Tax Credit

2016 New Market Tax Credit

In December 2016, the Company entered into a financing transaction with U.S. Bank Community, LLC ("U.S. Bank") related to a \$9.2 million expansion of the Company's facility in Durant, Oklahoma. U.S. Bank made a capital contribution to, and Tile Shop Lending, Inc. ("Tile Shop Lending") made a loan to, Twain Investment Fund 192 LLC (the "Investment Fund") 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

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entities (“CDEs”). CDEs are privately managed investment institutions that are certified to make qualified low-income community investments.

In December 2016, Tile Shop Lending loaned \$6.7 million to the Investment Fund at an interest rate of 1.37% per year and with a maturity of December 31, 2046. The Investment Fund then contributed the loan to a CDE, 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 U.S. Bank, net of syndication fees) were used to partially fund the distribution center project.

In December 2016, U.S. Bank also contributed \$3.1 million to the Investment Funds and, by virtue of such contribution, is entitled to substantially all of the tax benefits derived from the NMTCs, while the Company effectively received net loan proceeds equal to U.S. Bank’s contributions to the Investment Fund. This transaction includes a put/call provision whereby the Company may be obligated or entitled to repurchase U.S. Bank’s interest. The Company believes that U.S. Bank will exercise the put option in December 2023 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 U.S. Bank 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 Fund and CDEs contains a variable interest entity (“VIE”). The ongoing activities of the Investment Fund – 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 Fund. Management considered the contractual arrangements that obligate the Company to deliver tax benefits and provide various other guarantees to the structure; 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 Fund, as a VIE, in accordance with the accounting standards for consolidation. In 2016, U.S. Bank’s contributions of \$3.1 million, net of syndication fees, were included in cash, restricted cash, other accrued liabilities and other long-term liabilities in the Consolidated Balance Sheet. The Company incurred \$1.2 million of syndication fees in connection with this transaction, which were classified as other current assets and other non-current assets in the Consolidated Balance Sheet. The Company is recognizing the benefit of this net \$1.9 million contribution 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, 2017, the balance of the contribution liability was \$2.9 million, of which \$0.5 million is classified as other accrued liabilities on the Consolidated Balance Sheet and \$2.4 million is classified as other long-term liabilities on the Consolidated Balance Sheet.

The Company is able to request reimbursement for certain expenditures made in connection with the expansion of the distribution center in Durant, Oklahoma from the Investment Fund. Expenditures that qualify for reimbursement include building costs, equipment purchases, and other expenditures tied to the expansion of the facility. During the nine months ended September 30, 2017, the Company received reimbursements totaling \$6.0 million from the investment fund. As of September 30, 2017, the balance in the Investment Fund available for reimbursement to the Company was \$0.9 million.

2013 New Market Tax Credit

In July 2013, the Company entered into a financing transaction with U.S. Bank and Chase Community Equity (“Chase”, and collectively with U.S. Bank, the “investors”) related to a \$19.1 million acquisition, rehabilitation, and construction of the Company’s distribution center and manufacturing facilities in Durant, Oklahoma. In this transaction, Tile Shop Lending loaned \$13.5 million to the Tile Shop Investment Fund LLC. The investors contributed \$5.6 million to the Tile Shop Investment Fund LLC. The investors are entitled to the tax benefits derived from the NMTC by virtue of their contribution while the Company received the proceeds, net of syndication fees, to apply toward the construction project. 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 determined that this financing arrangement contains a VIE. The ongoing activities of the Tile Shop Investment Fund LLC – 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 Tile Shop Investment Fund LLC. Management

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considered the contractual arrangements that obligate the Company to deliver tax benefits and provide various other guarantees to the structure; the investors 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 Tile Shop Investment Fund LLC, as a VIE, in accordance with the accounting standards for consolidation. In 2013, the investors' contributions, of \$5.6 million, net of syndication fees, were included in cash, restricted cash, other accrued liabilities and other long-term liabilities in the Consolidated Balance Sheet. The Company incurred \$1.2 million of syndication fees in connection with this transaction which were classified as other current assets and other non-current assets in the Consolidated Balance Sheet. The Company is recognizing the benefit of this net \$4.4 million contribution over the seven-year compliance period as it is being earned through the ongoing compliance with the conditions of the NMTC program. As of September 30, 2017, the balance of the contribution liability was \$1.9 million, of which \$0.7 million is classified as other accrued liabilities on the Consolidated Balance Sheet and \$1.2 million is classified as other long-term liabilities on the Consolidated Balance Sheet.

Note 10: Commitments and Contingencies

The Company, was a defendant in a consolidated class action arising in 2013 alleging it failed to disclose certain related party transactions in the Company's SEC filings and press releases. In January 2017, the plaintiffs and the Company agreed to settle the lawsuit for \$9.5 million. The court approved the settlement, and entered an order dismissing the action on June 14, 2017.

The Company also is a nominal defendant in three actions brought derivatively on behalf of the Company by three shareholders in 2015. The plaintiffs allege that the defendant-directors and/or officers 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 Company moved to dismiss the actions, or in the alternative, to stay the actions. Those motions have not yet been decided.

By letter dated May 19, 2016, a shareholder of the Company 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 current stage of the derivative actions, the Company cannot reasonably estimate the possible loss or range of loss that may result. 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.

Note 11: Subsequent Events

On October 17, 2017, the Company declared a \$0.05 dividend to stockholders of record as of the close of business on October 31, 2017. The dividend will be paid on November 14, 2017.

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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, 2016 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 or renovating existing stores, changes to economic or market 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, 2016, 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, 2017, we operated 134 stores in 31 states and the District of Columbia, with an average size of 20,500 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 11 new stores in the first nine months of 2017, and opened 9 new stores in the United States during 2016. Between October 1, 2016 and September 30, 2017, we opened 14 new store locations. We plan to open approximately 15 stores in 2017. 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, 2017, we reported net sales of \$84.4 million and \$266.0 million, respectively. For the three and nine months ended September 30, 2016, we reported net sales of \$78.6 million and \$247.5 million, respectively. The increase in sales for the three and nine months ended September 30, 2017 was primarily due to sales generated by stores opened since September 30, 2016, as well as comparable store sales increases of 1.1% and 2.2%, respectively.

During the three and nine months ended September 30, 2017, we experienced a decrease in the growth rate of comparable store sales compared to 2016. Comparable store sales increased 7.6% during the year ended December 31, 2016. The deceleration in sales at comparable stores for the three and nine months ended September 30, 2017 was due to an increase in competitive activity, increased consumer demand for opening price point offerings, and a significant product transition which caused disruption to our product availability in our stores during the period. In addition, inconsistent execution across certain markets also contributed to a lower conversion rate and lower sales.

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The table below sets forth information about our same store sales growth for the three and nine months ended September 30, 2017 and 2016.

	For the three months ended		For the nine months ended	
	September 30,		September 30,	
	2017	2016	2017	2016
Same store sales growth	1.1 %	5.7 %	2.2 %	9.0 %

For the three and nine months ended September 30, 2017, we reported gross profit of \$56.7 million and \$183.8 million, respectively. For the three and nine months ended September 30, 2016, we reported gross profit of \$55.2 million and \$173.6 million, respectively. The gross margin rate for the three and nine months ended September 30, 2017 was 67.1% and 69.1%, respectively. The gross margin rate for the three and nine months ended September 30, 2016 was 70.2% and 70.1%, respectively. The decrease in the gross margin rate was primarily due to promotional pricing and increased demand for opening price point product. Additionally, sales growth of installation and setting materials, which carry a lower gross margin rate, outpaced the sales performance of other product categories.

For the three and nine months ended September 30, 2017, we reported income from operations of \$4.4 million and \$29.5 million, respectively. For the three and nine months ended September 30, 2016, we reported income from operations of \$7.8 million and \$31.3 million. The decrease in income from operations during the period was primarily driven by a deceleration in comparable store sales growth, a decrease in our gross margin rate and an increase in occupancy costs due to the opening of new stores since October 1, 2016.

Net cash provided by operating activities was \$49.4 million and \$50.7 million for the nine months ended September 30, 2017 and 2016, 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, 2017, we had cash of \$12.4 million and working capital of \$33.7 million compared with cash of \$9.8 million and working capital of \$37.7 million at September 30, 2016.

Year to date free cash flow in 2017 of \$21.3 million enabled an additional \$5.0 million reduction to long-term debt during the third quarter, bringing our net debt position to \$1.5 million at quarter end. See the “Non-GAAP Measures” section below for a reconciliation of these Non-GAAP measures to the comparable GAAP measures.

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.

Same store sales amounts include total charges to customers less any actual returns, and the change in the returns provision related to comparable stores. In general, we consider a new or relocated store in the comparable store sales calculation on the first day of the 13th full month of operation.

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.

Selling, General, and Administrative Expenses Selling, general, and administrative expenses consists primarily of payroll and benefit costs, occupancy, utilities, and maintenance costs, advertising cost, freight expenses to move inventory from the Company’s distribution centers to the Company’s stores, depreciation and amortization.

Pre-opening Costs Our pre-opening costs are those typically associated with the opening of a new stores 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.

Provision for Income Taxes We are subject to income tax in the United States as well as other tax jurisdictions in which we conduct business.

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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 litigation costs. 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 litigation costs, and is net of tax. Net debt equals long-term debt, net, plus the current portion of long-term debt, minus cash and cash equivalents.

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, 2017 and 2016 is as follows:

	(in thousands)			
	Three Months Ended			
	September 30,			
	2017	% of sales	2016	% of sales
Net income	\$ 2,438	2.9 %	\$ 4,583	5.8 %
Interest expense	505	0.6 %	363	0.5 %
Income taxes	1,468	1.7 %	2,886	3.7 %
Depreciation & amortization	6,803	8.1 %	5,770	7.3 %
Special charges: Litigation costs	436	0.5 %	725	0.9 %
Stock-based compensation	989	1.2 %	930	1.2 %
Adjusted EBITDA	<u>\$ 12,639</u>	<u>15.0 %</u>	<u>\$ 15,257</u>	<u>19.4 %</u>

	(in thousands)			
	Nine Months Ended			
	September 30,			
	2017	% of sales ⁽¹⁾	2016	% of sales
Net income	\$ 18,170	6.8 %	\$ 18,190	7.3 %
Interest expense	1,438	0.5 %	1,382	0.6 %
Income taxes	10,034	3.8 %	11,793	4.8 %
Depreciation & amortization	19,395	7.3 %	16,954	6.8 %
Special charges: Litigation costs	1,084	0.4 %	1,827	0.7 %
Stock-based compensation	2,759	1.0 %	3,394	1.4 %
Adjusted EBITDA	<u>\$ 52,880</u>	<u>19.9 %</u>	<u>\$ 53,540</u>	<u>21.6 %</u>

⁽¹⁾ Amounts may not foot due to rounding.

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The reconciliation of free cash flows to net cash provided by operating activities for the three and nine months ended September 30, 2017 and 2016 is as follows:

	(in thousands)	
	Nine Months Ended	
	September 30,	
	2017	2016
Net cash provided by operating activities	\$ 49,355	\$ 50,678
Purchase of property, plant and equipment	(28,031)	(19,645)
Free cash flows	<u>\$ 21,324</u>	<u>\$ 31,033</u>

The reconciliation of GAAP income to Non-GAAP income for the three and nine months ended September 30, 2017 and 2016 is as follows:

	Three Months Ended			Three Months Ended		
	September 30, 2017			September 30, 2016		
(in thousands, except share and per share data)	Pretax	Net of Tax	Per Share Amounts ⁽¹⁾	Pretax	Net of Tax	Per Share Amounts
GAAP income	\$ 3,906	\$ 2,438	\$ 0.05	\$ 7,469	\$ 4,583	\$ 0.09
Special charges: Litigation costs	436	272	0.01	725	445	0.01
Non-GAAP income	<u>\$ 4,342</u>	<u>\$ 2,710</u>	<u>\$ 0.05</u>	<u>\$ 8,194</u>	<u>\$ 5,028</u>	<u>\$ 0.10</u>

⁽¹⁾ Amounts may not foot due to rounding.

	Nine Months Ended			Nine Months Ended		
	September 30, 2017			September 30, 2016		
(in thousands, except share and per share data)	Pretax	Net of Tax	Per Share Amounts	Pretax	Net of Tax	Per Share Amounts
GAAP income	\$ 28,204	\$ 18,170	\$ 0.35	\$ 29,983	\$ 18,190	\$ 0.35
Special charges: Litigation costs	1,084	699	0.01	1,827	1,108	0.02
Non-GAAP income	<u>\$ 29,288</u>	<u>\$ 18,869</u>	<u>\$ 0.36</u>	<u>\$ 31,810</u>	<u>\$ 19,298</u>	<u>\$ 0.37</u>

The reconciliation of long-term debt, net to net debt as of September 30, 2017 is as follows:

	As of
	September 30, 2017
Long-term debt, net	\$ 5,689
Current portion of long-term debt	8,193
Cash and cash equivalents	(12,429)
Net Debt	<u>\$ 1,453</u>

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.

[Table of Contents](#)**Results of Operations****Comparison of the three months ended September 30, 2017 to the three months ended September 30, 2016**

	(in thousands)			
	2017	% of sales	2016	% of sales ⁽¹⁾
Net sales	\$ 84,421		\$ 78,559	
Cost of sales	27,759	32.9 %	23,400	29.8 %
Gross profit	56,662	67.1 %	55,159	70.2 %
Selling, general and administrative expenses	52,285	61.9 %	47,361	60.3 %
Income from operations	4,377	5.2 %	7,798	9.9 %
Interest expense	(505)	(0.6)%	(363)	(0.5)%
Other income	34	0.0 %	34	0.0 %
Income before income taxes	3,906	4.6 %	7,469	9.5 %
Provision for income taxes	(1,468)	(1.7)%	(2,886)	(3.7)%
Net income	\$ 2,438	2.9 %	\$ 4,583	5.8 %

⁽¹⁾ Amounts may not foot due to rounding.

Net Sales Net sales for the third quarter of 2017 increased \$5.9 million, or 7.5%, over the third quarter of 2016, primarily due to an increase in sales generated by new stores and a comparable store sales increase of 1.1%. Net sales for the 14 new stores open less than twelve months were \$5.0 million during the third quarter of 2017. Comparable store sales increased \$0.9 million for the third quarter of 2017 due to an increase in the average order value, which was partially offset by modest declines in traffic and conversion rate.

Gross Profit Gross profit for the third quarter of 2017 increased \$1.5 million, or 2.7%, compared with the third quarter of 2016, primarily due to an increase in net sales. The gross margin rate decreased from 70.2% for the third quarter of 2016 to 67.1% for the third quarter of 2017. The decrease in the gross margin rate was primarily due to promotional pricing and increased demand for opening price point product. Additionally, sales growth of installation and setting materials, which carry a lower gross margin rate, outpaced the sales performance of other product categories.

Selling, General, and Administrative Expenses Selling, general, and administrative expenses for the third quarter of 2017 increased \$4.9 million, or 10.4%, compared with the third quarter of 2016. The increase in selling, general, and administrative expenses was primarily due to an increase in occupancy, compensation, benefit, and advertising costs associated with opening 14 new stores during the period from October 1, 2016 through September 30, 2017. Selling, general, and administrative expenses as a percentage of net sales increased to 61.9% for the third quarter of 2017 compared with 60.3% for the third quarter of 2016. The increase was primarily attributable to an increase in occupancy, compensation, benefit and advertising costs, which outpaced the growth of sales.

Selling, general, and administrative expenses include costs of \$0.4 million and \$0.7 million for the third quarters of 2017 and 2016, respectively, which relate to special charges consisting of litigation expenses.

Pre-opening Costs During the third quarters of 2017 and 2016, we incurred pre-opening costs of \$0.5 million and \$0.2 million, respectively.

Interest Expense Interest expense was \$0.5 million and \$0.4 million for the three months ended September 30, 2017 and 2016, respectively. The decrease in the average debt balance outstanding was offset by a higher interest rate during the third quarter of 2017.

Provision for Income Taxes Income tax provision decreased \$1.4 million for the third quarter of 2017 compared with the third quarter of 2016 due to a decrease in income before income taxes during the third quarter of 2017. Our effective tax rate for the three months ended September 30, 2017 and 2016 was 37.6% and 38.6%, respectively.

[Table of Contents](#)**Comparison of the nine months ended September 30, 2017 to the nine months ended September 30, 2016**

	(in thousands)			
	2017	% of sales	2016	% of sales ⁽¹⁾
Net sales	\$ 266,020		\$ 247,543	
Cost of sales	82,265	30.9 %	73,980	29.9 %
Gross profit	183,755	69.1 %	173,563	70.1 %
Selling, general and administrative expenses	154,245	58.0 %	142,300	57.5 %
Income from operations	29,510	11.1 %	31,263	12.6 %
Interest expense	(1,438)	(0.5) %	(1,382)	(0.6) %
Other income	132	0.0 %	102	0.0 %
Income before income taxes	28,204	10.6 %	29,983	12.1 %
Provision for income taxes	(10,034)	(3.8) %	(11,793)	(4.8) %
Net income	\$ 18,170	6.8 %	\$ 18,190	7.3 %

⁽¹⁾ Amounts may not foot due to rounding.

Net Sales Net sales for the nine months ended September 30, 2017 increased \$18.5 million, or 7.5%, over the nine months ended September 30, 2016. The increase in sales for the nine months ended September 30, 2017 was primarily due to sales generated by stores opened since October 1, 2016, as well as a comparable store sales increase of 2.2%. Net sales for the 14 new stores open less than twelve months were \$13.1 million during the nine months ended September 30, 2017. Comparable store sales increased \$5.4 million for the nine months ended September 30, 2017 due to modest increases in traffic and average order value partially offset by a modest decline in conversion rate.

Gross Profit Gross profit for the nine months ended September 30, 2017 increased \$10.2 million, or 5.9%, compared with the nine months ended September 30, 2016 due to the increase in net sales. The gross margin rate decreased from 70.1% during the nine months ended September 30, 2016 to 69.1% during the nine months ended September 30, 2017. The decrease was primarily attributable to promotional pricing, increased demand for opening price point product and increased sales of lower margin installation and setting materials during the third quarter of 2017.

Selling, General, and Administrative Expenses Selling, general, and administrative expenses for the nine months ended September 30, 2017 increased \$11.9 million, or 8.4%, compared with the nine months ended September 30, 2016. The increase in selling, general, and administrative expenses was primarily due to an increase in occupancy, compensation, benefit, and advertising costs associated with opening 14 new stores during the period from October 1, 2016 through September 30, 2017. Selling, general, and administrative expenses as a percentage of net sales increased to 58.0% for the nine months ended September 30, 2017 compared with 57.5% for the nine months ended September 30, 2016. The increase in selling, general, and administrative expenses as a percentage of net sales was primarily attributable to an increase in occupancy, compensation, benefit, and advertising costs that outpaced the growth of sales.

Selling, general, and administrative expenses include costs of \$1.1 million and \$1.8 million for the nine months ended September 30, 2017 and 2016, respectively, which relate to special charges consisting of litigation expenses.

Pre-opening Costs During the nine months ended September 30, 2017 and 2016, we incurred pre-opening costs of \$1.3 million and \$0.6 million, respectively.

Interest Expense Interest expense was \$1.4 million for each of the nine months ended September 30, 2017 and 2016. The decrease in the average debt balance outstanding was offset by a higher interest rate in 2017.

Provision for Income Taxes Our income tax provision decreased \$1.8 million for the nine months ended September 30, 2017 compared with the nine months ended September 30, 2016 due to a decrease in income before income taxes and our tax rate for the nine months ended September 30, 2017. Our effective tax rate for the nine months ended September 30, 2017 and 2016 was 35.6% and 39.3%, respectively. The decrease in our tax rate was due to increases in excess tax benefits recognized in connection with the exercise of non-qualified stock options and disqualifying dispositions of incentive stock options during the second quarter of 2017.

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Liquidity and Capital Resources

Our principal uses of liquidity have been investments in working capital and capital expenditures. Our principal sources of liquidity are \$12.4 million of cash and cash equivalents at September 30, 2017, 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, paying dividends to our shareholders and general corporate purposes.

On June 2, 2015, we, and our operating subsidiary, The Tile Shop, LLC, entered into a credit agreement with Fifth Third Bank, Bank of America, N.A., and Huntington National Bank (as subsequently amended, the "Credit Agreement"). On December 9, 2016, the Credit Agreement was amended to permit an additional New Markets Tax Credit Financing arrangement and on February 10, 2017, the Credit Agreement was amended to permit us to make certain dividend payments. The Credit Agreement again was amended on July 17, 2017 to adjust the consolidated fixed charge coverage ratio from 2.00:1.00 to 1.50:1.00 to provide greater flexibility in declaring and making dividend payments or other distributions to stockholders. 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 our 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 our leverage ratio. At September 30, 2017 the base interest rate was 4.75% and the LIBOR-based interest rate was 2.73%. Borrowings outstanding consisted of \$13.2 million on the term loan and no outstanding balance on the revolving line of credit as of September 30, 2017. There was \$75.0 million available for borrowing on the revolving line of credit as of September 30, 2017. We can elect to prepay the term loan without incurring a penalty. To the extent we have an outstanding balance on our term loan, the credit agreement requires quarterly principal payments as follows (in thousands):

Period

December 31, 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. We were in compliance with the covenants as of September 30, 2017. We intend to make principal payments due in future periods using cash from operations.

We have standby letters of credit outstanding related to our workers compensation and medical insurance policies. As of September 30, 2017 and 2016, the standby letters of credit totaled \$1.1 million.

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

Capital expenditures were \$28.0 million and \$19.6 million for the nine months ended September 30, 2017 and 2016, respectively. The increase in capital expenditures is primarily due to the accelerated pace of new store openings. We opened 11 and 6 new stores during the nine months ended September 30, 2017 and 2016, respectively. Additionally, we made incremental investments in our distribution facilities and information technology infrastructure. During the first nine months of 2017, capital expenditures included \$17.6 million associated with new store build-outs, remodels of existing stores, and merchandising projects, \$6.4 million for general corporate purposes, including information technology infrastructure projects, and \$4.0 million for distribution facilities.

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Cash flows

The following table summarizes our cash flow data for the nine months ended September 30, 2017 and 2016.

	(in thousands)	
	Nine Months Ended	
	September 30,	
	2017	2016
Net cash provided by operating activities	\$ 49,355	\$ 50,678
Net cash used in investing activities	(28,031)	(19,645)
Net cash used in financing activities	(14,992)	(31,518)

Operating activities

Net cash provided by operating activities during the nine months ended September 30, 2017 was \$49.4 million compared with \$50.7 million during the nine months ended September 30, 2016. The decrease is attributable to payment of the shareholder litigation settlement to an escrow account, which occurred during the nine months ended September 30, 2017, offset by increases in depreciation and amortization.

Investing activities

Net cash used in investing activities totaled \$28.0 million for the nine months ended September 30, 2017 compared with \$19.6 million for the nine months ended September 30, 2016. Net cash used in investing activities in each period was primarily for capital purchases of store fixtures, equipment, building improvements and leasehold improvements for stores opened or remodeled, asset additions in our distribution and manufacturing facilities, information technology infrastructure, and general corporate information technology assets.

Financing activities

Net cash used in financing activities was \$15.0 million for the nine months ended September 30, 2017 compared with \$31.5 million for the nine months ended September 30, 2016. Net cash used in financing activities during the nine months ended September 30, 2017 was primarily for the payments of long-term debt and capital lease obligations of \$44.7 million and an aggregate of \$7.8 million in dividends paid to stockholders, offset by advances on the line of credit of \$30.0 million and the release of restricted cash totaling \$6.0 million.

Cash and cash equivalents totaled \$12.4 million at September 30, 2017 compared with \$6.1 million at December 31, 2016. Working capital was \$33.7 million at September 30, 2017 compared with \$36.0 million at December 31, 2016.

Off-Balance Sheet Arrangements

As of September 30, 2017 and December 31, 2016, 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, 2017, there were no material changes to our contractual obligations outside the ordinary course of business.

Recently Adopted Accounting Pronouncements

In July 2015, the Financial Accounting Standards Board (“FASB”) issued a standard that simplifies the subsequent measurement of inventory. Previously, an entity was 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 required 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. The standard was effective for the Company at the beginning of fiscal 2017. The adoption of this new standard did not have a material effect on the Company’s financial statements.

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Accounting Pronouncements Not Yet Adopted

In May 2014, the FASB issued a final standard on revenue from contracts with customers. This new standard introduces a comprehensive revenue recognition model that requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. In 2016, the FASB issued several amendments to the standard, including principal versus agent considerations when another party is involved in providing goods or services to a customer, the application of identifying performance obligations, and the recognition of expected breakage amounts either proportionally in earnings as redemptions occur or when redemption is remote. Upon adoption of the standard, the Company expects to present the gross sales returns reserve as a component of other accrued liabilities and establish a return asset that will be classified as a component of other current assets, net in the Consolidated Balance Sheet. Currently, the Company presents its sales returns reserve net of the value of the return assets as a component of other accrued liabilities in the Consolidated Balance Sheet. The Company continues to assess the impact of other aspects of this standard. As the Company finalizes its assessment, the Company will take steps to finalize its accounting policies, establish new processes and controls when warranted, and ensure information is captured to conform with the disclosure requirements outlined under the new standard. The standard is effective for the Company in fiscal 2018 and provides for either full retrospective adoption or modified retrospective adoption by which the cumulative effect of the change is recognized in retained earnings at the date of initial application. The Company has elected to adopt this standard using the modified retrospective approach.

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.

In August 2016, the FASB issued an accounting standards update with new guidance on how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The amendments in the standards update provide guidance on eight specific cash flow issues. The standards update is effective for the Company in fiscal 2018 and shall be applied to the Company's financial statements retrospectively. The Company is currently assessing the effect the new standard will have on its consolidated financial statements.

In November 2016, the FASB issued new guidance on restricted cash on the statement of cash flows. The new guidance requires the classification and presentation of changes in restricted cash and cash equivalents in the statement of cash flows. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning and ending balances shown on the statement of cash flows. The new standard is effective for fiscal year 2018, with early adoption permitted. The guidance should be applied retrospectively after adoption. The Company's restricted cash balance was \$0.9 million as of September 30, 2017. Upon adopting the new standard, the Company anticipates that it will no longer present the release of restricted cash as a financing cash inflow. Instead, restricted cash and long-term restricted cash balances will be included in the beginning and ending cash, cash equivalents and restricted cash balances in the statement of cash flows.

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 Annual Report Form 10-K for the fiscal year ended December 31, 2016.

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, 2017 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, 2017 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 was a defendant in a consolidated class action arising in 2013 alleging it failed to disclose certain related party transactions in the Company's SEC filings and press releases. In January 2017, the plaintiffs and the Company agreed to settle the lawsuit for \$9.5 million. The court approved the settlement and entered an order dismissing the action on June 14, 2017.

The Company also is a nominal defendant in three actions brought derivatively on behalf of the Company by three shareholders in 2015. The plaintiffs 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 Company moved to dismiss the actions, or in the alternative, to stay the actions. Those motions have not yet been decided.

By letter dated May 19, 2016, a shareholder of the Company 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 current stage of the derivative actions, the Company cannot reasonably estimate the possible loss or range of loss that may result. 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, 2016.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not Applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable.

ITEM 5. OTHER INFORMATION

None.

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ITEM 6. EXHIBITS

Exhibits

<u>3.1</u>	<u>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 (Reg. No. 333-182482) filed with the Securities and Exchange Commission on July 2, 2012).</u>
<u>3.2</u>	<u>By-Laws of Tile Shop Holdings, Inc. (incorporated by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-4 (Reg. No. 333-182482) filed with the Securities and Exchange Commission on July 2, 2012).</u>
<u>10.1</u>	<u>Third Amendment to Credit Agreement, dated July 17, 2017, among Tile Shop, LLC, Tile Shop Holdings, Inc., Fifth Third Bank, and other parties named therein (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 19, 2017).</u>
<u>10.2*</u>	<u>Tile Shop Holdings, Inc. Stock Restriction Agreement.</u>
<u>31.1*</u>	<u>Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes Oxley Act of 2002.</u>
<u>31.2*</u>	<u>Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes Oxley Act of 2002.</u>
<u>32.1**</u>	<u>Certifications of Chief Executive Officer Pursuant to Section 906 of the Sarbanes Oxley Act of 2002.</u>
<u>32.2**</u>	<u>Certifications of Chief Financial Officer Pursuant to Section 906 of the Sarbanes Oxley Act of 2002.</u>
<u>101.INS*</u>	<u>XBRL Instance Document.</u>
<u>101.SCH*</u>	<u>XBRL Taxonomy Extension Schema Document.</u>
<u>101.CAL*</u>	<u>XBRL Taxonomy Extension Calculation Linkbase Document.</u>
<u>101.DEF*</u>	<u>XBRL Taxonomy Extension Definition Linkbase Document.</u>
<u>101.LAB*</u>	<u>XBRL Taxonomy Extension Label Linkbase Document.</u>
<u>101.PRE*</u>	<u>XBRL Taxonomy Extension Presentation Linkbase Document.</u>

* 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 26, 2017

By: /s/ CHRIS R. HOMEISTER

Chris R. Homeister
Chief Executive Officer

Dated: October 26, 2017

By: /s/ KIRK L. GEADELMANN

Kirk L. Geadelmann
Chief Financial Officer

**TILE SHOP HOLDINGS, INC.
STOCK RESTRICTION AGREEMENT**

This Agreement (the "Agreement") is made this the [_____] day of [____], 20[___], by and between Tile Shop Holdings, Inc. (the "Company"), a Delaware corporation with its principal place of business at 14000 Carlson Parkway, Plymouth, MN 55441 and [____], an individual having an address at [_____] (the "Stockholder"). Capitalized terms used but not otherwise defined herein shall have the meaning ascribed to such terms in the Company's 2012 Omnibus Award Plan (the "Plan"). To the extent that any term of this Agreement conflicts or is otherwise inconsistent with any term of the Plan, as amended from time to time, the terms of the Plan shall take precedence and supersede any such conflict or inconsistent term contained herein.

WHEREAS, the Stockholder is, on the date hereof, an executive officer, employee, or Director of, or a Consultant to, the Company; and

WHEREAS, pursuant to the Plan, the Company wishes to grant a restricted stock award to the Stockholder for [_____] shares (the "Shares") of Common Stock, par value \$0.0001 per share, of the Company (the "Common Stock").

NOW, THEREFORE, for valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the Company and the Stockholder agree as follows:

1. Shares to be Subject to Restriction. The Stockholder agrees that the Shares shall be subject to the risk of forfeiture set forth in Section 2 of this Agreement, to the restrictions on transfers set forth in Section 4 of this Agreement, and to any additional provisions of the Plan applicable to such Shares during the Restriction Period.

2. Vesting.

a. The Shares shall be forfeitable until the risks of forfeiture lapse according to the following schedule: [Vesting schedule to be specified by the Compensation Committee of the Board of Directors. The date and time of day of vesting or process for certification of achievement of performance metrics for vesting should be approved when award is granted and specified in this section.]

b. If the Stockholder ceases to be an executive officer, employee, or Director of, or a Consultant to, the Company for any reason or no reason, with or without cause, the Stockholder shall immediately forfeit all Shares as to which the risks of forfeiture have not lapsed.

c. Notwithstanding the foregoing provisions of this Section 2, in the event of a Change of Control during the Restriction Period, the vesting schedule set forth in this Section 2 may be accelerated in whole or in part at the sole discretion of the Committee.

3. Stockholder Rights. The Stockholder shall have all rights as a stockholder with respect to the Shares subject to forfeiture, including the right to vote, except the Stockholder shall not have the right to receive cash dividends or distributions or any other dividends or distributions specified by the Committee (other than stock dividends or distributions, as contemplated by and subject to Section 7).

4. Restrictions on Transfer. The Stockholder shall not, until the risks of forfeiture lapse, sell, assign, transfer, pledge, hypothecate or otherwise dispose of, by operation of law or otherwise, any of the Shares, or any interest therein, unless and until such are no longer subject to a risk of forfeiture.

5. Effect of Prohibited Transfer. The Company will not be required (a) to transfer on its books any Shares which have been sold or transferred in violation of any of the provisions set forth in this Agreement, or (b) to treat as owner of such Shares, or to pay dividends to, any transferee to whom any such Shares have been so sold or transferred.

6. Restrictive Legend. All certificates representing Shares subject to this Agreement shall bear a legend in substantially the following form, in addition to any other legends that may be required under applicable federal or state securities laws:

“The shares represented by this certificate are subject to a risk of forfeiture and restrictions on transfer set forth in a certain Stock Restriction Agreement between the corporation and the registered owner of this certificate, a copy of which is available for inspection at the offices of the Secretary of the corporation.”

7. Adjustments for Stock Splits, Stock Dividends, etc. Subject to the provisions of Section 15 of the Plan, if from time to time until the risks of forfeiture lapse there is any stock split-up, stock dividend, stock distribution or other reclassification of the Common Stock of the Company, any and all new, substituted or additional securities to which the Stockholder is entitled by reason of its ownership of the Shares will be immediately subject to the risks of forfeiture, the restrictions on transfer and the other provisions of this Agreement in the same manner and to the same extent as the Shares.

8. Severability. The invalidity or unenforceability of any provision of this Agreement will not affect the validity or enforceability of any other provision of this Agreement and each other provision of this Agreement will be severable and enforceable to the extent permitted by law.

9. Binding Effect. This Agreement is binding upon and shall inure to the benefit of the Company and the Stockholder and their respective heirs, executors, administrators, legal representatives, successors and assigns, as applicable, subject to the restrictions on transfer set forth in Section 4 herein.

10. No Rights to Employment. Nothing contained in this Agreement is to be construed as giving the Stockholder any right to be retained, in any position, as an employee of the Company.

11. Notice. All notices required or permitted hereunder must be in writing and are deemed effectively given upon personal delivery or upon deposit in the United States Post Office, by registered or certified mail, postage prepaid, addressed to the other party to this Agreement at the address shown above, or at such other address as one party will designate to the other in accordance with this Section 11.

12. Pronouns. Whenever the context may require, any pronouns used in this Agreement are deemed to include the corresponding masculine, feminine or neuter forms, and the singular form of nouns and pronouns are deemed to include the plural, and vice versa.

13. Entire Agreement. This Agreement constitutes the entire agreement between the parties, and supersedes all prior agreements and understandings, relating to the subject matter of this Agreement.

14. Amendment. This Agreement may be amended or modified only by a written instrument executed by both the Company and the Stockholder.

15. Governing Law. This Agreement shall be construed and enforced in accordance with and governed by the General Corporation Law of the State of Delaware as to matters within the scope thereof, and as to all other matters shall be governed by and construed in accordance with the internal laws of the State of Delaware, without giving effect to the principles of conflicts of laws thereof.

[Next Page is Signature Page]

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first above written.

TILE SHOP HOLDINGS, INC.

By: _____
Name:
Title:

STOCKHOLDER

_____]

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 26, 2017

/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 26, 2017

/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, 2017 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 26, 2017

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, 2017 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 26, 2017

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.
