

Crown Crafts, Inc.

Third Quarter FY 2022

February 9, 2022 at 11:00 a.m. Eastern

CORPORATE PARTICIPANTS

Craig Demarest – *Chief Financial Officer*

Randall Chestnut – *Chief Executive Officer*

Olivia Elliott – *President and Chief Operating Officer*

PRESENTATION

Operator

Good morning, and welcome to the Crown Crafts Incorporated Third Quarter Fiscal Year 2022 Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star then one on your telephone keypad. To withdraw your question please press star then two. Please note this event is being recorded.

I would now like to turn the conference over to Craig Demarest, Chief Financial Officer. Please go ahead.

Craig Demarest

Thank you, Gary. Welcome to the Crown Crafts investor conference call for the third quarter of fiscal year 2022. With me today are Randall Chestnut, the company's Chief Executive Officer and Olivia Elliott, the company's President and Chief Operating Officer.

A telephone replay of this call will be available one hour after the end of the call through 4 pm Central time on February 16, 2022. Also, a web replay of this call will be available for 90 days, and can be accessed by visiting our website at www.crowncrafts.com.

Before we begin, I would like to remind listeners of the cautionary language regarding forward-looking statements contained in the press release. That same language applies to comments made in today's conference call.

I will now turn the call over to Randall.

Randall Chestnut

Craig, thank you very much and good morning to everyone on the phone, on the call, and thank you for joining us for the third quarter fiscal 2022 conference call. As Craig said, with me in the conference room today is Olivia Elliott and Craig.

We're happy with the results of the quarter but we did confront many notable challenges during the quarter, and management responded promptly to these challenges. At the beginning of the quarter, our offices and warehouse in Compton, California experienced an overhead water main leak, which damaged most of the office area. There was only minor damage to the warehouse, which allowed us to continue shipping, but much of the office, and particularly the design area, we were unable to work from the office for several weeks. This was following the impact of Hurricane Ida, which did considerable damages to our Gonzales, Louisiana office. So the past few months have not been kind to us from a water standpoint.

Along with many US companies, we continued to experience increase in costs of our product as well as delays and extra costs associated with importing goods from Asia. We have passed along some of these increased costs to our customers whenever we can.

We have experienced labor shortages and higher turnover in the warehouse operations during the past few quarters. This has become worse recently due to the increasing COVID cases that we've experienced in Compton.

Our Board of Directors declared a quarterly cash dividend of \$0.08 per share yesterday, which was announced this morning to be paid on April 8, 2022 to shareholders of record as of the close of business on March 18, 2022.

Before I turn the call over to Olivia and Craig, I'd like to concrete congratulate Olivia Elliott on her recent promotion announced this morning to CEO effective March 1st. I've worked with Olivia for more than 20 years and believe her contributions during that time make her the right person to lead the company into the future. Olivia, congratulations.

Olivia Elliott

Thank you.

Randall Chestnut

Now I'll turn the call over to Olivia and then she'll turn it back to Craig who will give more color to the financials. Thank you.

Olivia Elliott

Thank you, Randall. I'm really excited to have the opportunity to continue to work with our outstanding team and I look forward to a bright future for the company.

I'm going to touch on the third quarter results at a very high level then I'll turn the call over to Craig to go into more detail. Third quarter net sales were \$22.7 million compared with \$19.5 million last year. Carousel Designs didn't affect the current quarter but for the prior-year quarter if you exclude Carousel, which ceased operations in May 2021, net sales for last year would have been \$18.4 million which represents an increase of 23.8% for NoJo and Sassy. Net sales for the first nine months of fiscal year 2022 were \$61.7 million compared with \$57.3 million last year. If you exclude Carousel from both years, net sales for the current year-to-date period would have been \$61 million compared with \$53.2 million last year, which represents an increase of 14.6% for NoJo and Sassy.

Internet-based sales represented more than 25% of our current year sales and we also continued to see higher international sales this year, with those sales representing almost 5% of year-to-date sales.

Third quarter net income was \$2.4 million compared with 2.1 million last year. Once again Carousel did not affect the current year quarter and when you exclude the impact of Carousel from the prior-year quarter net income would have been \$2.2 million last year or \$0.22 per diluted share compared with \$0.24 this year.

Net income for the first nine months of fiscal year 2022 was \$7.5 million compared with \$5.8 million last year. When you exclude the impact of the forgiveness of the Paycheck Protection Program loan from the current year and Carousel from both years net income for the nine-month period of the current year would have been \$6.3 million or \$0.63 per diluted share, compared with \$5.9 million or \$0.58 per diluted share last year.

As Randall mentioned, we continue to feel the impact of rising product and freight costs which impacted our gross margin this quarter.

On the balance sheet side, we finished the quarter with \$2.1 million in cash and no debt. Overall, it's been a very good quarter for us.

And now I'll turn it over to Craig.

Craig Demarest

Thanks, Olivia. I'll only give financial highlights. For a more detailed analysis, please refer to the company's form 10Q filed with the SEC this morning.

As Olivia mentioned, net sales were \$22.7 million for the third quarter of fiscal 2022 compared with \$19.5 million for the third quarter of the prior year, an increase of \$3.3 million or 16.8%. Sales of bedding, blankets and accessories increased by \$349,000, which is net of a decrease of \$1.1 million due to the closure of Carousel. Sales of bibs, toys and disposables increased by \$2.9 million over the same period.

Net sales were \$61.7 million for the first nine months of fiscal 2022 compared with \$57.3 million for the same period of the prior year, an increase of \$4.3 million or 7.6%. The increase in sales is primarily due to \$6 million higher sales of bibs, toys and disposables partially offset by a decrease of \$1.7 million in sales of bedding and blankets, including a decrease of \$3.5 million due to the closure of Carousel. The increases in sales during the comparable three- and nine-month periods are partially due to a strong new modular set and higher replenishment orders at a major retailer and are somewhat offset by declines in sales to online retailers as consumers have begun to return to stores.

Gross profit increased slightly in amount but decreased from 31.6% of net sales in the prior-year quarter to 27.1% of net sales in the current year quarter. The increase in the gross profit amount is net of the effect of the closure of Carousel, which recognized a gross profit of \$319,000 in the prior-year quarter. Gross profit decreased from \$1.4 million and decreased from 31.9% of net sales for the prior-year nine-month period to 27.4% of net sales for the same period in the current year. The closure of Carousel resulted in a \$2.2 million decrease in gross profit, which in the current year nine-month period included the sale of inventory below cost and the recognition of charges of \$334,000 associated with the settlement with a supplier of a commitment to purchase fabric and \$265,000 associated with the liquidation of Carousel's remaining inventory upon the closure of the business. The company's gross profit has also been adversely impacted in both the three- and nine-month periods of the current year by continuing increases in costs across the entire supply chain.

Marketing and administrative expenses decreased by \$326,000 and decreased from 17.6% of net sales in the prior-year quarter to 13.6% of net sales in the current year quarter. Marketing and administrative expenses decreased by \$978,000 and decreased from 18.5% of net sales for the prior-year nine-month period to 15.6% of net sales for the same period in the current year. The decrease in amounts for the current year periods include lower charges incurred by Carousel of \$494,000 for the three-month period, and \$1.3 million for the nine-month period.

Other items in the nine-month period ended December 26, 2021 include a \$1.985 million gain from the forgiveness of the PPP loan.

The current year-to-date provision for income taxes is based upon an estimated annual effective tax rate from continuing operations of 20% compared with 23.7% in the prior year. The current year-to-date provision includes no tax expense from the gain on extinguishment of debt, which will be permitted to be excluded from taxable income, which lowers the effective tax rate for fiscal year 2022 by approximately four percentage points. During the current and prior-year nine-month periods, the company recorded discrete reserves for unrecognized tax liabilities, as well as entries associated with excess tax benefits or shortfalls arising from the vesting of non-vested stock and the exercise of stock options. The effective tax rate from continuing operations combined with the effect of the discrete income tax items resulted in an overall provision for income taxes of 19.4% for the current year-to-date period and 23.7% for the prior year.

Net income for the third quarter of fiscal 2022 was \$2.4 million or \$0.24 per diluted share, compared to net income of \$2.1 million or \$0.21 per diluted share for the third quarter of fiscal 2021. Net income for the first nine months of fiscal 2022 was \$7.5 million or \$0.74 per diluted share, compared to net income of \$5.8 million or \$0.57 per diluted share for the same period in fiscal 2021.

I will now turn the call back over to Randall.

Randall Chestnut

Craig, Olivia, thank you very much, Gary, if you will come back in and give the instructions for anyone interested and entering the Q&A section, we'll begin.

QUESTIONS AND ANSWERS

Operator

We will now begin the question-and-answer session. To ask a question you may press star then one on your telephone keypad. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question please press star then two. At this time, we will pause momentarily to assemble our roster.

Our first question is from Linda Bolton Weiser with D.A. Davidson. Please go ahead.

Griffin

Alright, thank you. This is Griffin on for Linda. So I guess my first question is can you comment a little bit more on the freight price fluctuations you saw during the quarter? Just any more color there would be great.

Olivia Elliott

I mean, we really haven't given any details about what kind of impact it's had. But I mean, as I'm sure you're aware, it's pretty much across the board for all companies right now that freight costs have increased, I think product cost is rising from China, both because of raw materials and their labor costs. And then just the amount of time that it's taking and the detention at the ports. etc., has definitely impacted gross margin.

Griffin

Okay, great. And then were you able to recapture any of the retailer orders that were cancelled last quarter due to the shutdown from the system glitch?

Olivia Elliott

Yes, we were. We spent the entire third quarter, probably halfway through we were able to catch up with most of those orders. So yes, you can see the impact of that in the numbers.

Griffin

Okay, great. And then can you just say what the labor turnover rate that you're seeing? How are you trying to mitigate this going forward?

Olivia Elliott

That's a tough one. So, overall in California right now, I mean, it's definitely a tough labor market. We've been combating it with temps and in a lot of cases we end up hiring the temps. But more importantly, I think the impact has been COVID and so we've had a lot of outages just due to people being sick. So it's definitely been tough, but we're doing our best to make sure that we are fully staffed and are able to get temp workers in there to help us while we have those outages.

Griffin

Sure, yes. I mean, can you talk about the current state of the consumer in your industry compared to kind of historical levels of demand?

Olivia Elliott

The consumer demand is largely based on, in our industry, designs, and we continue to have great designs and product development coming from the company. So we feel like our products are still popular. It's definitely a little bit different in that we're talking more to the consumer, their social media, online sales. There's been a good switch to online sales, though, it's kind of dialed back a little bit because last year during COVID that was the primary source of sales. We're seeing some movement back to brick-and-mortar, but still, the online sales and what the consumer sees is definitely different than it used to be in the past.

Griffin

Great. And then my last question here is for Olivia. With your transition into the CEO position, can you give us your initial vision for Crown Crafts?

Olivia Elliott

We don't really do any forward-looking statements or anything like that so that's a tough one to tell you what our vision is, because that would imply our strategy for the future.

Griffin

Okay, well, thank you very much. Appreciate it.

Operator

The next question is from Justyn Putnam with Atlanta Investment Group. Please go ahead.

Justyn Putnam

Good morning. I was curious, excluding Carousel, are there any other expenses during the quarter that you would characterize as unusual or non-recurring?

Olivia Elliott

No. Other than Carousel, nothing in this quarter. We had the forgiveness of the Paycheck Protection loan in the first quarter, but that obviously wasn't [background noise]. And then otherwise, it's other than the increased costs that we've talked about and the cost of sales, no, there's nothing unusual.

Justyn Putnam

Okay, so then with Carousel, you mentioned a couple of expense items in the queue, inventory, you had to sell below cost, and then supplier commitment that you had to fulfill. It looks like in the queue, though, those numbers, I think they're in aggregate around \$600,000 and it looks like maybe you're talking about those being nine months of figures. Was any of those costs in the current quarter?

Olivia Elliott

No, all of that was in the first quarter.

Justyn Putnam

All that was in the first quarter. Okay, great.

And then my last question is regarding the large order you got from a major retailer during the quarter. How would you characterize that order? Is that an order that's pulling forward some sales or were they trying to replenish inventory to make up from past quarters? How would you characterize that and also how material is that order?

Olivia Elliott

We really haven't given that number so I'm not going to give you the number. It's probably a little bit of both. It's hard to tell what they're doing but definitely, we've experienced some shortages just because of the time it takes to get through the port. So in a big way, they were trying to replenish their shelves due to outages.

Justyn Putnam

Okay. Is it material though? Is it unusual in size and scope or is it normal and what you see periodically?

Olivia Elliott

I mean, it, I'm going to say it's more normal than anything. I mean, order patterns can vary. It was a bigger order than what they would normally place at that time, but we have shifts all the time.

Justyn Putnam

Okay, great. That's my questions. Thank you very much.

Olivia Elliott

Thank you.

Operator

Again, if you have a question, please press star then one. The next question is from Max Batzer with Wynnefield Capital. Please go ahead.

Max Batzer

Well, my question takes the form of a comment. I'd like to congratulate you, Olivia, and thank you very much for all the great work you guys have done down there. It's the end of an era and the beginning of a new one but the continuity in the management has been great. As you guys know, we historically have been institutional holders and I've been a personal holder for a long time. And I just wanted to say thanks a lot. You guys have done a great job in a very, very tough industry. And that's all I had to say, so continue the good work and thanks.

Olivia Elliott

Thank you very much, Max.

Randall Chestnut

Thank you, Max. Good to hear from you.

Operator

The next question is from Dennis Scannell with Rutabaga Capital. Please go ahead.

Dennis Scannell

Yes, good morning, and I'll add my congratulations to Olivia. Hey, just a couple of quick things. So on the SG&A line, your operating expenses, that's about as low that I've seen in many years and actually as a percent of sales, it's actually the lowest I think I've ever seen. So just curious, were there any unusual add-backs? It didn't seem like Craig called out anything but I'm just trying to clarify that.

And I know this gets into forward-looking statements, but how do we think about this going forward? Is this a good run rate going forward? So whatever you can give me in terms of direction there will be great.

Olivia Elliott

So it's two things. For the most part G&A or fixed cost, I mean, you have a little bit of commissions in there, but that's pretty much a low number. So as sales go higher, you're going to see that percentage

go down. Also Carousel, a lot of their costs were in the advertising, which was the selling costs. And so without Carousel, you see the advertising costs going down a good bit.

Dennis Scannell

Okay, got it. Great. Thank you. And then the retail order that was larger than normal, at least in the most recent quarter, was that all on the bedding side?

Olivia Elliott

Actually, no, it was along the bib side.

Dennis Scannell

Okay. Great. Great. And, obviously, since your fiscal 2016, we've seen real struggles on the bedding side of your business after the pediatricians came out against, proposed or encouraged folks to do the naked bed thing, and so on. But we've seen some really nice momentum in that segment. Can you talk a little bit about that? Do you think you're gaining share? Do you think there is more momentum on that side of the business?

Olivia Elliott

So I won't answer is there more momentum. But yes, we actually have done very well in gaining a little bit of market share. Our designs there have really gotten a lot of traction and we've also decided to expand some of our other into adjacent categories a lot with the decor and the accessories. Because obviously, if you're not going to have the bumpers and things like that in the crib anymore, our goal is to pretty much decorate the entire nursery. So we've looked at what other items we can add into the mix in order to gain more share.

Dennis Scannell

Got it. Excellent. Well, it's nice to see the sales moving in the right direction there. And then finally, in the quarter, were there any lost sales due to inability to get product in from Asia and to your customers? Or is your fulfillment where you would hope to be recognizing that there may be some delays and lead times are longer, but you're still filling what you can?

Olivia Elliott

We're still filling what we can. I mean, there are some delays but as soon as we can get the product in, it's going right back out the other door, and we're doing our best just to keep up with the momentum.

Dennis Scannell

Okay, great. Thank you very much, and good luck.

Olivia Elliott

Thank you.

CONCLUSION

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Randall Chestnut for any closing remarks.

Randall Chestnut

Gary, thank you very much and thanks to everyone on the call. We're extremely proud of the results for the third quarter of FY22. Management has done an outstanding job working through all the challenges and posting very good results. We'd like to thank everyone for their continued support and interest in the

company and a special thanks to all employees, suppliers, and of course, customers.

Management looks forward to talking with you again in mid-June when we release the fourth quarter and full year fiscal 2022 results. Thank you very much.

And with that, it concludes our conference today. Have a good day.

Olivia Elliott

Thank you.

Craig Demarest

Thanks.

Operator

The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.