Crown Crafts

Fourth Quarter FY2022 Conference Call

June 8, 2022 at 2:00 p.m. EDT

CORPORATE PARTICIPANTS

Olivia Elliott – *Chief Executive Officer*

Craig Demarest – *Chief Financial Officer*

PRESENTATION

Operator
Good afternoon, everyone and welcome to the Crown Crafts, Inc. Fourth Quarter Fiscal Year 2022 Conference call. All participants will be in a 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 and then one using a touch tone telephone. To withdraw your question, you may press star and two. Please also note today's event is being recorded.

At this time, I'd like to turn the floor over to Craig Demarest, Chief Financial Officer. Sir, please go ahead.

Craig Demarest
Thank you, Jaime. Welcome to the Crown Crafts Investor Conference call for the fourth quarter and full fiscal year 2022. With me today is Olivia Elliott, the company's President and Chief Executive Officer.

A telephone replay of this call will be available one hour after the end of the call through 4:00 p.m. Central time on September 8. 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 Olivia.

Olivia Elliott
Thank you, Craig. Good afternoon and thank you for joining us for the fourth quarter and full fiscal year 2022 conference call. I want to start by congratulating Randall Chestnut on his retirement after serving as Chairman and CEO of Crown Crafts since 2001, and as part of our management team and a member of the board since 1995. The ongoing strength of our company is a tribute to the legacy that Randall leaves behind. I had the privilege of working with Randall for over 20 years, and I'd like to thank him for all that he did for the company and for me personally as well.

Turning to fourth quarter results, fourth quarter net sales were $25.7 million compared with $21.8 million in the fourth quarter of last year. There were no current quarter sales of Carousel Designs which ceased operations in May of 2021. But if you exclude Carousel from the prior year fourth quarter, sales would have been $20.6 million.

Net sales for fiscal year 2022 were $87.4 million, compared with $79.2 million last year. If you exclude Carousel from both years, net sales for the current year would have been $86.7 million compared with $73.8 million last year, which represents an increase of 17.5% for NoJo and Sassy.

We continue to see a shift in sales due to consumers starting to shop in brick and mortar locations again, but internet based sales still represent almost 30% of our sales. We've also continued to see higher international sales this year with those sales representing 4.2% of current year sales.

Fourth quarter net income was $2.4 million compared with $238,000 last year. Prior year fourth quarter results include an after tax impairment charge of $1.7 million related to Carousel assets. When you exclude the impact of Carousel from both quarters, net income would have been $2.6 million for the current year quarter, or $0.26 per diluted share, compared with $2 million or $0.20 per diluted share last year.

Net income for fiscal year 2022 was $9.9 million, compared with $6.1 million last year. Current year net income included an almost $2 million gain from the forgiveness of the Paycheck Protection Program loan. When you include the impact of the forgiveness of this loan from the current year and Carousel from both years, net income for the current year would have been $9 million or $0.89 per diluted share, compared with $8 million or $0.79 per diluted share last year.

We're very happy with the results of this quarter and for the entire year. We're also happy to have made progress in recovering from some of the headwinds that we've been discussing in prior quarters. Thankfully, Hurricane Ida, the Compton warehouse water damage and the warehouse management system implementation are behind us. We're also seeing signs that the bottleneck of container ships in California has receded and lockdowns in China are beginning to lift somewhat, so the delays that we're seeing now aren't as bad as what we experienced throughout fiscal 2022. We do, however, continue to see increased costs throughout the supply chain, and we pass along these increased costs to our customers whenever we can.

Looking at the balance sheet, we finished the fiscal year with $1.6 million in cash and no borrowings on our revolving line of credit. On May 17, we announced that our board of directors had declared an $0.08 per share cash dividend on the company's common stock that will be paid on July 8, 2022 to shareholders of record at the close of business on June 17, 2022. This represents a 4.9% yield based on yesterday's closing price. We're very pleased that our financial strength allows us to continue this quarterly dividend.

I'm now going to turn it over to Craig to discuss the quarter in more detail and then we will come back and make some closing remarks and take some questions.

Craig Demarest
Thanks, Olivia. I'm going to give financial highlights for a more detailed analysis. Please refer to the company's 10K filed with the SEC this morning.

As Olivia mentioned, net sales were $25.7 million for the fourth quarter of fiscal ‘22 compared to $21.8 million for the fourth quarter of the prior year, an increase of $3.9 million or 17.7%. For the year, net sales were at $87.4 million for fiscal ‘22 compared with $79.2 million for the prior year, or an increase of $8.2 million or 10.4%.

Sales of bibs, bath, developmental toys, feeding, baby care and disposable products increased $9.9 million over the prior year, which was partially offset by a decrease of $1.7 million in the sales of bedding, blankets and accessories, which included a decrease of $3.5 million due to the closure of Carousel Designs in the first quarter of fiscal ‘22. The increase in sales in fiscal ‘22 is partially due to a strong new modular set and higher replenishment orders at a major retailer.

Also, in advance of the expectation that shipments and customers from the company's Compton warehouse would be suspended during the first days of April 2022 due to the company's annual count of inventory, customers were encouraged to place their orders earlier than they ordinarily would have. This resulted in approximately $700,000 being shifted from fiscal year 2023 into fiscal ‘22.

And finally, the results for fiscal ‘22 also include an additional week compared with fiscal ‘21, as the company operated under a 53-week calendar year for fiscal ‘22. These increases were somewhat offset by declines in sales to online retailers as customers have begun to return to stores.

Gross profit increased from $587,000, but decreased from 26.7% of net sales in the prior year quarter to 25% of net sales in the current year quarter. Gross profit decreased from $789,000 and decreased from 30.4% of net sales for the prior year to 26.7% of net sales for the current year. The closure of Carousel resulted in a $2.2 million decrease in gross profit, which in fiscal year 2022 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 was also adversely impacted in fiscal year 2022 by increases in costs across the entire supply chain.

Marketing and administrative expenses decreased from $3.6 million in the prior year quarter to $3.4 million in the current year quarter, and decreased from 16.6% of net sales to 13.2% of net sales over the same period. Marketing and administrative expenses decreased by $1.2 million and decreased from 18% of net sales for fiscal year 2021 to 14.9% of net sales for fiscal '22. The decrease in amount included lower charges incurred by Carrousel of $2.1 million for fiscal year 2022 as compared with fiscal '21.

Other items in fiscal '22 included the almost $2 million gain recognized in the first quarter from the forgiveness of the PPP loan, and other items in the fourth quarter and full year of 2021 include a $2.2 million impairment loss related to the impairment of the assets of Carrousel.

The provision for income taxes is based upon an annual effective tax rate on continuing operations, which was 20.1% in fiscal '22 and 24% in fiscal '21. The current year provision includes no tax expense from the gain on extinguishment of debt, which will be permitted to be excluded from taxable income, the effect of which lowers the effective tax rate for fiscal year '22 by approximately four percentage points.

During the current and prior year, 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 19.5% for fiscal '22 and 21.3% for the prior year.

Net income for the fourth quarter of fiscal '22 was $2.4 million or $0.24 per share, compared to net income of $238,000, or $0.02 per share for the fourth quarter of fiscal '21. Net income for fiscal '22 was $9.9 million or $0.98 per share per diluted share, compared to net income of $6.1 million, or $0.60 per diluted share for fiscal '21.

And with that, I'll turn the call back over to Olivia.

Olivia Elliott
Thanks, Craig.

We're extremely proud of the results for fiscal year 2022. Our entire staff has done an outstanding job of working through this year's many challenges and posting very good results. As we begin fiscal '23, we're excited about our opportunities for continued profitable growth in the future. We've recently presented a new strategic plan to our board of directors, and we look forward to implementing those strategies. The strategies include, among other things, growing our toy category through market share expansion; entering new adjacent product categories, both organically as well as through tuck-in acquisitions; selling directly to consumers; implementing operating cost efficiencies; and making further investments in technology and our organizational structure. We'll implement these strategies without losing focus on cost containment, maintaining our strong balance sheet, and delivering solid returns to our shareholders.

And with that, Jaime, I think we'll take questions before we deliver the final closing remarks.

QUESTIONS AND ANSWERS

Operator
Ladies and gentlemen, at this time, if you would like to ask a question, you may do so by pressing star and then one using a touch tone telephone. If you are using a speakerphone, we do ask that you please pick up your handset prior to pressing the keys to ensure the best sound quality. To withdraw your question, you may press star and two. Once again, that is star and then one to join the question queue. We will pause momentarily to assemble the roster. Once again, to ask a question, you may press star and then one.

Our first question today comes from Tony Chiarenza from Key Equity Investors, Inc. Please go ahead with your question.

Tony Chiarenza
Good afternoon. Thank you so much for taking my question.

My first thought here is, obviously, in terms of your sales you are very concentrated between Walmart and Amazon. I heard you mentioned as part of your new strategic plan is to go directly to consumers. Is this something that you're trying to diversify? Obviously, it's difficult to run a business when Walmart is half your sales. If they decide to cut off a category or cut you off, you're in serious trouble, so what's the plan to diversify the customer base?

Olivia Elliott
So part of that is going direct to consumer. It's something that most everybody is doing in today's day and age and it's something that we really need to get going with. There are, candidly, no more Walmart's or Target's or Amazon's out there where we're going to get 50% of our business, but there are other small customers out there. It may be a million dollars here, $2 million there, there's no smoking gun out there that it's going to be another $30 million dollars in sales. But, internationally can be a good opportunity for us. Part of that is building further our own brands because you don't exactly have licenses that go worldwide. Most of those are the US and Canada only. So building our brand, going internationally, direct to consumer and then everything else will be little bits here or there.

Tony Chiarenza
How would you consider your relationship with Walmart at this point?

Olivia Elliott
We believe we have a really good relationship with Walmart. We service them well, we keep a good eye on our designs, and as long as we bring forth the designs that the consumer wants, then we think our relationship is very good.

Tony Chiarenza
Good. Now, how competitive is the category at Walmart? Would you say how many providers are there that are in your space at this point also go into Walmart?

Olivia Elliott
There's quite a few and there's always competitors that are more than happy to take that shelf space. So, in most of our categories, there are particular set dates and so we're competing at any given point in time with people that want the business.

Tony Chiarenza
And it's just a question of you having the product and having the design that the customer will demand at a particular time?

Olivia Elliott
That and the ability to service the customer. I mean, they have certain requirements for in stock levels and things like that, so it's the entire ability to service them.

Tony Chiarenza
Good. One question, I know you paid a dividend and the dividend is great. I think it's a good show of support to the shareholders. Have you given any thought to a share buyback, given the price of the stock?

Olivia Elliott
We've done share buybacks in the past, and just because of our liquidity, and really, it hasn't really helped things. And so at this point in time, while we discuss it from time to time, dividend seems to be the best answer for us.

Tony Chiarenza
Yes, I think it makes sense. Obviously, since the liquidity is so limited, if you remove more shares on the market, that's only going to make the problem even worse. Hopefully, you grow larger at some point and then you can have more shares and increase liquidity.

Thank you so much for addressing my questions. And good luck, and congratulations on a great quarter.

Olivia Elliott
Thank you very much.

Operator
And our next question comes from Ralph Marash from First Manhattan Company. Please go with your question.

Ralph Marash
Hi, Olivia and Craig.

Olivia Elliott
Hey, Ralph, how are you?

Ralph Marash
Okay. I hope you're both well, too.

So, you certainly seem to have navigated all the difficulties over the last 12 to 18 months very well. And you mentioned increasing costs, which we know everyone faces, but you also mentioned that you seem to be able to pass along those costs, and your gross margin performance would indicate that you're pretty much in line. So is that an accurate impression?

Olivia Elliott
We certainly try to pass them on where we can. We do have some categories that are a little more price sensitive, some of those being things like toddler bedding sets, etc. that we may not be able to pass along the entire price increase, but we do what we can. In most categories, we have passed on that price increase. There was some difficulty in the beginning in trying to get them through, but I think now, in the world that we're in today, everyone's passing on price increases, and it's become a little bit easier to do.

Ralph Marash
Okay. And your comparative inventory numbers seem to indicate that inventory is in pretty good shape, as well. I know for much of the last 18 months or so you've been a little heavy on inventory on purpose, to avoid disruptions. So could you just comment on where your inventory stands now in terms of where you'd like it to be?

Olivia Elliott
We are in really good shape in inventory. The majority of our inventory is current SKU's, so we're not at all worried about it. We did bring in extra inventory in the fall when all of the problems started happening, partially just because we were a little worried about the supply chain, partially because we were trying to get some inventory before price increases took effect. There's probably still a little bit of over inventory in some areas, just because we knew that we can sell through it in a period of time and we knew it was going to be a decent price increase. But for the most part, I think it's at a good level.

Ralph Marash
Very good. Thanks a lot.

Olivia Elliott
Thank you.

Operator
Once again, if you would like to ask a question, please press star and then one.

Our next question comes from John Deysher from Pinnacle. Please go ahead with your question.

John Deysher
Oh, good afternoon. Thanks for taking our questions.

I was just curious. On the direct to consumer initiative that you mentioned, I think that was Carousel's business and I think, if I recall correctly, there were some issues there with fulfillment, advertising being on the search engines. I'm just wondering why you think you should reenter the direct to consumer business when it didn't quite work, at least to us, with Carousel? What's different?

Olivia Elliott
It's really two different models. So Carousel was manufacturing, manufacturing in the US, which was quite expensive. And then often in the vast majority of the products we were selling from Carousel, they were one piece here, one piece there. The consumer was actually designing the product.

Here, we would be selling product that's already in our warehouse, it's finished goods, there's no manufacturing. We're already for many of our .com customers, we're already shipping direct to the consumer on their behalf. So we have the ability to ship direct to consumer, and it's such a different model that we think that it can be successful.

John Deysher
Okay. So the infrastructure is in place already, since you're fulfilling it for your .com customers. How are you going to attract traffic to your website? How do you gain customers?

Olivia Elliott
There's definitely going to have to be some advertising. We have to start by – well, part of it we're going to sell, we're going to do some third party selling on Amazon, so that's how we're going to start out. But

we're also going to get our websites updated and have the ability to sell and there's going to have to be some advertising. Because we're selling direct to consumer, the price can be higher than what we're selling at to our retailers, but there will be a cost associated with it.

John Deysher
Do you expect the profitability to be comparable to the core business right now?

Olivia Elliott
I think that we can be just as profitable on a dollar perspective, maybe even more profitable. Percentages may not be the same because you are going to have a higher advertising cost.

John Deysher
When will you launch this?

Olivia Elliott
We're very much in the early stages of it. So we hope to begin selling direct to consumer sometime in the latter half of this fiscal year, but every little thing you do, a problem pops up that you have to resolve. So, the plan is this fiscal year, but I'm not exactly sure what month it will happen.

John Deysher
Okay, no, we agree. Take your time. And hopefully you will break that out going forward so we can keep track of what you're doing direct to consumer wise.

Olivia Elliott
Great. Thank you very much.

John Deysher
Yes, bye.

CONCLUSION

Operator
And ladies and gentlemen, I’m showing no additional questions at this time. I'd like to turn the floor back over to Olivia Elliott for any closing remarks.

Olivia Elliott
Great. Thank you, Jaime. We want to thank everyone for your continued support and interest in our company. And a special thanks to all of our employees, suppliers and customers. We look forward to talking to you again in mid-August when we release our first quarter results.

Thank you very much.

Operator
Ladies and gentlemen, with that we’ll conclude today's conference call and presentation. We thank you for joining. You may now disconnect your lines.