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ETD.N - Q4 2024 Ethan Allen Interiors Inc Earnings Call

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CORPORATE PARTICIPANTS

Matthew McNulty *Ethan Allen Interiors Inc - Chief Financial Officer, Senior Vice President, Treasurer*

Farooq Kathwari *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

CONFERENCE CALL PARTICIPANTS

Taylor Zick *KeyBanc Capital Markets, Inc. - Analyst*

Cristina Fernández *Telsey Advisory Group - Analyst*

Budd Bugatch *Water Tower Research LLC - Analyst*

PRESENTATION

Operator

Good afternoon, and welcome to the Ethan Allen fiscal 2024 fourth quarter analyst conference call. (Operator Instructions) Please note this conference is being recorded. It is now my pleasure to introduce your host, Matt McNulty, Senior Vice President, Chief Financial Officer, and Treasurer. Thank you. You may begin.

Matthew McNulty - *Ethan Allen Interiors Inc - Chief Financial Officer, Senior Vice President, Treasurer*

Thank you, operator. Good afternoon and thank you for joining us today to discuss Ethan Allen's fiscal 2024 fourth-quarter and full-year results.

With me today is Farooq Kathwari, our Chairman, President and CEO. Mr. Kathwari will open and close our prepared remarks, while I'll speak to our financial performance midway through. After our prepared remarks, we will then open the call for your questions.

Before we begin, I'd like to remind the audience that this call is being recorded and webcast live under the News and Events tab on the Investor Relations page of our website. A replay of today's call will also be made available on our Investor Relations website. There you will find a copy of our press release, which contains reconciliations of non-GAAP financial measures referred to on this call and in the press release. We believe the non-GAAP presentation better reflects underlying operating trends and performance of the business.

Our comments today may include forward-looking statements that are subject to risks and uncertainties that could cause actual results to differ materially. The most significant risk factors that could affect our future results are described in our annual report on Form 10-K. Please refer to our SEC filings for a complete review of those risks. The company assumes no obligation to update or revise any forward-looking matters discussed during this call.

With that, I'm pleased to now turn the call over to Mr. Kathwari.

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Well, thank you, Matt, and thanks for participating in our fourth quarter and fiscal year June 30, 2024, meeting.

As stated in our press release, we are pleased to report strong performance in this post-pandemic period. Despite lower demand and reduction in high backlogs, we did well. We had strong gross margins of 60.8% and despite lower sales had an adjusted operating margin of 13.1%. We continue to generate strong cash and ended with cash and equivalent of \$195.8 million up from \$172.7 million last year. Our inventory rates have been reduced by 12.5% since June 30, 2019, and the headcount also reduced by 28% June 2019.

Now we know this after multiple years of high demand during the pandemic period, consumer is much more focused on quality, value and service and provides an opportunity for enterprises like us that have relevant products, strong talent, providing service and also to have good healthy cash positions.

After Matt provides an overview of our financial results, I will review our initiatives going forward. Matt?

Matthew McNulty - *Ethan Allen Interiors Inc - Chief Financial Officer, Senior Vice President, Treasurer*

Thank you, Mr. Kathwari. Our financial results for the full-year and fourth quarter ended June 30, 2024, were highlighted by double-digit operating margins, disciplined expense management, strong operating cash flow and a robust balance sheet. As we operate in a post-pandemic period defined by challenges within the home furnishings industry, our operations produced positive financial results, which I will now discuss.

Our fiscal 2024 consolidated net sales totaled \$646.2 million which included fourth quarter sales of \$168.6 million, our highest level of quarterly delivered sales during the fiscal year. The reduction in net sales when compared to the prior year are reflective of lower delivered unit volumes, lower backlog and a strong prior year comparable.

Overall demand patterns began to show signs of improvement during the just completed fourth quarter. Retail segment orders for the quarter were down 1.3% while wholesale written orders increased 0.4% as our wholesale segment benefited from improving orders within our contract business. We ended the fiscal year with wholesale backlog of \$53.5 million nearing historical norms and pre-pandemic level. We improved customer lead times and reduced the number of weeks of backlog.

For the fiscal 2024 year, our consolidated gross margin was 60.8%, a 10-basis point improvement over last year. In the just completed fourth quarter, consolidated gross margin was also 60.8%, our 13th consecutive quarter that gross margin has exceeded 58%. When compared to last year, our quarterly consolidated gross margin was impacted by fewer delivered sales and higher inbound freight partially offset by change in sales mix, lower raw material input costs, reduced headcount, and a disciplined promotional level.

For the 2024 fiscal year, our adjusted operating margin was 12.1%, down from 16.9% last year. Improved fourth quarter adjusted operating margin of 13.1% reflects lower headcount and strong expense management. Our SG&A expenses decreased 4.9% and equaled 47.7% of net sales, up from 45.1% last year due to lower sales volume relative to fixed costs.

Compared to our pre-pandemic 2019 fourth quarter, our adjusted operating margin improved 450 basis points due to our focus on streamlining our vertically integrated enterprise. On a full-year basis, adjusted EPS was \$2.49. For the quarter, our adjusted EPS was \$0.70. Our effective tax rate was 25.3% percent for the full-year and 25.1% for the quarter, which varies from the 21% federal statutory rate primarily due to state taxes.

Now, turning to our liquidity. We ended our fiscal year with a robust balance sheet including cash and investments of \$195.8 million and no outstanding debt. We generated \$26.2 million of cash from operating activities during the just completed quarter, bringing our full year amount up to \$80.2 million. We also reduced our inventory levels by \$7.2 million. Capital expenditures were \$9.6 million for the full fiscal year, including \$2.1 million during the fourth quarter as we continue to invest capital in manufacturing, retail, technology and infrastructure. We also continued our practice of returning capital to shareholders in the form of cash dividends.

This past April, our Board increased the regular quarterly cash dividend by 8.3% to \$0.39 per share, which was subsequently paid in May and brought our total fiscal 2024 dividends paid to \$50.3 million. Also, as just announced in our earnings release, our Board declared a special cash dividend of \$0.40 per share in addition to our regular quarterly cash dividend, both of which will be paid in August. This recent action marks the fourth consecutive year we have paid a special cash dividend.

In summary, our vertically integrated business delivered positive fiscal 2024 operating results during a period marked by industry-wide soft demand and challenging headwinds. We achieved these results and generated strong cash flows while protecting our margin gains through disciplined investments and solid execution.

We're building a fundamentally stronger company, protecting our profitability, and enhancing our operational efficiencies. As we move into fiscal 2025, we will continue to carefully manage our expense structure while investing in growth initiatives that we believe will further our business. We remain cautiously optimistic as our balance sheet has us well-positioned.

With that, I will now turn the call back over to Mr. Kathwari.

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

All right. Thank you, Matt. Matt provided a good overview of our financial results for the fiscal fourth quarter and year ended June 30, 2024.

I will now briefly discuss our strategic priorities as follows. First is talent, continued development of strong talent is critical to our vertically integrated structure. We are pleased with strong leadership talent in all areas of our enterprise, which includes manufacturing, retail, logistics, marketing, merchandising, technology and finance.

In marketing, we continue to provide innovative marketing both in content as well as the mediums we utilize. While overall marketing expenditures equal to 2.8% of sales, much lower than the 4% of sales we had five years back, the ability to utilize technology in marketing is a game changer. For example, we now reach over 9 million households every two weeks with our 36-page digital magazine.

We also continue to quarterly mail our printed magazines. And, this past quarter also mailed our 2024 Style Book. The interaction on social media by our interior designers is extremely important. Utilizing technology at all levels is key to our vertical integration, which involves manufacturing, producing efficiently about 75% of our products in our North American facilities.

Also, many years back, we operated over 30 manufacturing plants in the United States and today the number is 10 in North America. Now technology has helped us retain strong talent in all areas of our business and especially in manufacturing where we have reduced headcount by 28% since 2019. Our national and retail logistics is very important for our vertically integrated company. We are unique as we deliver our products what we call a white glove service to our clients in North America at one delivered price.

Many years back, we operated 10 national distribution centers for our North American retail and now one major facility with a smaller backup provides this service. Our retail logistics has also been greatly made smaller, more efficient. Today, we have 22 service centers that deliver great service to our clients throughout North America.

Now combining technology with talented associates has been critical resulting in very professional service in all areas of our business. It has also resulted in lower headcount. For example, 10 years back, we had a total headcount of 5,000 associates and now it is 3,400, a reduction of 32%.

Now, providing superior service is key to our vertical integration. We are an interior design-based network and last year we further enhanced by a number of initiatives, including the launch of what we call the interior design destination concept. This initiative provides great projection throughout our enterprise, reduces the size of our interior designers and helps provide superior service by interior designers.

Having consistent offerings shown in our design centers has helped productivity and service at all levels from retail to manufacturing to logistics. Now, since our start over 92 years back, we continue to be a socially responsible enterprise. That is in all areas of our enterprise whether it is from manufacturing to logistics to retail and other areas as well.

Now finally, we are very pleased that we were recently named again as America's Premium Retailer by a study conducted by Newsweek.

And with that good news, I'd like to open it up for any questions or comments.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Taylor Zick, KeyBanc Capital Markets.

Taylor Zick - KeyBanc Capital Markets, Inc. - Analyst

I just wanted to start and ask about the cadence of written orders during the quarter. You obviously saw some pretty strong sequential improvement in 3Q to 4Q. So could you talk a little bit more about what led to that improvement? And then, maybe if you have any comments on how July is trending so far?

Farooq Kathwari - Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer

All right. Well, you're talking about fourth quarter. Now in fourth quarter, we had, I think, somewhat consistent business throughout the quarter and obviously somewhat stronger towards the end. And I think it also -- it reflected to a great degree our -- the work of our interior designers. They make tremendous amount of contacts and then the social media is tremendously important. So, I would say that Matt is that correct, with our business was somewhat consistent throughout the quarter?

Matthew McNulty - Ethan Allen Interiors Inc - Chief Financial Officer, Senior Vice President, Treasurer

Yes, that is correct. It was fairly consistent with little bit of a heightened demand around the Memorial Day week in May there was a little bit of elevated written.

Taylor Zick - KeyBanc Capital Markets, Inc. - Analyst

Got you. And then, maybe just one on the cost side as well. You, Farooq and Matt, you've done a great job kind of controlling the costs and structurally reducing the overhead over the past three years. But curious what kind of levers you have left if demand does stay any more challenged. Obviously, you've seen an improvement. But what else can you do on the cost side to kind of maintain some of these margins?

Farooq Kathwari - Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer

Well, this question about constant reinvention that is, it is something that you've got to get into the system, everybody's mind. So it starts with that mindset. And then, technology has played an important role in all areas of our business. As we mentioned, today we have about -- our headcount is at 2.5% versus 4% four years or five years back, tremendous reduction in headcount, but more qualified people. So initiatives of this technology -- but technology is only good if you got good people.

So we have used technology in our retail network, less people as I mentioned. We have technology in our manufacturing, in our logistics. So technology has been tremendously important, which has also resulted in less people. Our headcount is lower as I mentioned. So, I would say the first starts with an attitude, then it starts with the fact that people have to -- you've got to have stronger people, and you've got to have technology.

Taylor Zick - KeyBanc Capital Markets, Inc. - Analyst

Understood. And if I could squeeze one last in and I think I'll head back towards the written orders. Is there anything else you can share on the improvement in written orders? Have you seen the refocus on the home continue in most recent fourth quarter? Has traffic increased? Any thoughts on conversion or financing and anything like that to kind of help us handicap this pretty good improvement?

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Yes. I think that when you take a look at our written orders, we discussed it -- our written orders and just, when you take a look at it -- do we share the written orders?

Matthew McNulty - *Ethan Allen Interiors Inc - Chief Financial Officer, Senior Vice President, Treasurer*

Yes, we do.

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

They were down 1.3%. That is really incredible that with all the challenges being faced by the country and problems. So, we held up our retail business. And, I think that as we go forward, it looks like we're going to be holding it up to the previous year, even though there are a lot of challenges. Again, challenges relating to economic challenges, political challenges, but I believe that we have that opportunity.

Operator

Cristina Fernández, Telsey Advisory Group.

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Hello, Cristina. How are you?

Cristina Fernández - *Telsey Advisory Group - Analyst*

Good. How are you, Farooq? Hi, Matt. Yes, I wanted to follow-up on Taylor's question about demand. I guess if you take a step back and think about the industry and particularly furniture demand, I mean, do you think overall it's getting better, like we've reached a point where demand has bottomed? Or do you see it as more specific to Ethan Allen and some of the -- I don't know if it's like as you said either product or marketing or your designers that allow you to do a lot better than some other players this the past couple of months?

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Well, it's also a factor that, I mean there are a lot of many great companies in our industry, and I think well, and most likely will do well. Our focus has been whereby we have focused on one brand, one program, one level of quality, and close to 70% made in our own workshops right here in North America.

All of those things have been affected in terms of for our profitability. It's amazing we have less headcount than we have had last year or even certainly four years back. So, I think this question of combining great talent in when we look at for instance let us say North America, North America is where we manufacture the product.

We deliver our products at one cost nationally. The other area that has been very important and critical has been our interior design network. That interior design network is very stable. It's less because of the fact of over a period of time we have less people, but very qualified people, talented people.

So those elements of that is vertical integration from making, manufacturing, delivering our product. Think of this, when I did this 20 years back, people thought I was crazy that we will deliver our product at the same price in New York and in San Francisco, Miami and Texas, it can't be done. Well, it can be done, but you have vertical integration to make it happen.

So I think all of those factors are important. I think that our interior designer network is less, but very talented and qualified. Combining interior designers with technology is as I said earlier is a game changer. So those things differentiate us. We have one level of quality. We produce the programs of products and consumer is tougher. They're much more careful who's that they're buying from. Last two, three years back that was not the case.

So all I would say those companies that have some of the ingredients I'm talking about most likely will do well.

Cristina Fernández - *Telsey Advisory Group - Analyst*

Thanks. And, my second question, I wanted to see if you could expand on your strategic plans for fiscal year '25, particularly as it relates to your showroom? Do you plan to expand the number of showrooms? And also in marketing, should we think about sort of like 3% of sales being a good guidepost for the upcoming fiscal year? Thanks.

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

In terms of our retail design centers, it has remained pretty consistent. We have today -- we have 142 design centers that we operate, and we own. Pre-COVID, we're 144. So, we have overall when you take a look at it, we have design centers, we have about 40 that are operated by our -- 30 that are operated by our independent retailers with an average association of 40 years with us, families.

So I think that we are very careful and where we're going to bring in. So we -- this last year, I think we only brought in two or three new design centers. I think going forward, it will be most likely three to five, but not a large number. Our focus is to make sure we improve what we have. And also in this last year as you know, we reduced the size of our design centers. We reduced -- some of our design centers were 20,000 square feet in the well. I said no, the max size is 12,500 and we are the newer ones we're getting is anywhere from 6,000 to 8,000 or 9,000 square feet.

So I think that our focus really is having -- and then the other thing we did was, we're -- you might say, we call them the interior design concept, we redesigned all our design centers with one great look. 10 years, 5 years back people in New Jersey thought they were very different than in Long Island, forget California or Florida. All our design centers today, especially the company operated one, have one image.

Now other thing that we are doing is now we have been developing a lot of also new products. Again, we have to be cautious that we only bring in product because we don't sell it to anybody else, it's all through our own network. But we have been adding new products and as we have the ability to make the product, it is coming into our design centers. And by next April, around that time we will have another major introduction of new products, which we are developing right now.

Cristina Fernández - *Telsey Advisory Group - Analyst*

And last question, can you talk about the state department contract? Just how did that progress this quarter? Are you seeing any more demand? Do you expect it to be a little bit of a pause here with potentially a change in administration?

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Yes, that's a good question. But with this conflict in the Middle East, it did have an impact where the State Department focus was on a lot of other factors, security. What we have seen in the last two or three months, they're starting to focus back on the home. So we're starting to get good orders now. So it looks like that we will have a good business with the State Department in fiscal year.

Operator

Budd Bugatch, Water Tower Research.

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Hello, Budd. How are you?

Budd Bugatch - *Water Tower Research LLC - Analyst*

I'm well, Farooq. How are you? Thank you for taking my question.

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Well, look at it -- I've been only doing it for 30 years, 35 years now, your questions.

Budd Bugatch - *Water Tower Research LLC - Analyst*

A longer time than that, Farooq, yes, that's correct. Let's talk a little bit about the dichotomy of sales between wholesale and retail there. The retail sales still down about 20%. How do they parse out between domestic and international?

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Matt is here, but I would say that international was much more impacted during this COVID period the last year. Then good news is, they're starting to get back. In fact, many of our international design centers have also been repositioned with this interior design concept and they're having ribbon cuttings all over -- in many parts of the world. But I think that our written business was down -- well, if you take a look at it this last quarter, it was down only 1.3% in the retail division, while our international most likely were down close to 30% -- what is it in here I'm looking at it, 30%, right?

So international is coming back. It was impacted in this COVID period to a great degree, all kinds of issues. But the good news is they're coming back, Budd.

Matthew McNulty - *Ethan Allen Interiors Inc - Chief Financial Officer, Senior Vice President, Treasurer*

Yeah. And Budd just to add, this is Matt here. You are right that wholesale sales were down 20% while retail was down 7%. A lot of the drive for that or the difference is on our contract business and international business. As Mr. Kathwari alluded to, our fiscal second and third quarters, the State Department was slow, conflict in the Middle East and other factors that delayed the purchases. So the subsequent delivered of those orders didn't happen as fast as the fourth quarter for us.

So that definitely was a lot weaker than the retail division sales side of things now. We're seeing some improvement in there as we talked about on State Department business. So, we should see those two numbers or metrics retail sales and wholesale sales more aligned.

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

But having said all of that really, this wholesale orders were down 9% considering all those problems that we are talking about. So it's not too bad, Budd I think they'll come back.

Budd Bugatch - *Water Tower Research LLC - Analyst*

Well, I'm concerned about the wholesale as it impacts the partner stores and you're right the international side of it was I think week over the first couple of quarters of the year and most of that's Asia. Is that the weakness we're seeing in the international?

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Yeah, that's right. Yeah.

Budd Bugatch - *Water Tower Research LLC - Analyst*

Okay. And you gave us the wholesale backlog of I think of \$53.5 million. Did I miss you're giving us the retail backlog at quarter end?

Matthew McNulty - *Ethan Allen Interiors Inc - Chief Financial Officer, Senior Vice President, Treasurer*

We do not publicly disclose the retail backlog, but its typically it's a little under two times the customer deposits on our balance sheet.

Budd Bugatch - *Water Tower Research LLC - Analyst*

That's what you told me last quarter as well. I was giving you the opportunity to see if you wanted to make a change to that.

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Budd, we have given you more information than we give to anybody else, but anyway, go ahead, Budd.

Budd Bugatch - *Water Tower Research LLC - Analyst*

I'm not so sure I do agree with that Farooq. I agree with you that you are an incredible businessman, and you run the business with a great deal of discipline, but the amount of information that's a topic of another conversation.

The \$34 million or so I think of the investments, you included that into the cash and investments side of the business. Can you talk a little bit about what that investment is or what those investments are?

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

You're talking about treasuries or what?

Yes. All our, Budd, we have close to \$200 million in cash, frankly any extra cash we put in US Treasuries.

Operator

Thank you. There are no further questions at this time. I'd like to turn the floor back over to Mr. Kathwari for closing comments.

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

All right, well, thanks very much. Well, good to have you all on this call. We've gone through lot of challenges, but I always felt the challenges create opportunities. We are positioned well. We have strong product programs and in the next year we're going to now introduce more new products because we held that back. Our have retail network is strengthened. We have repositioned all our redesigned centers. We have a strong manufacturing base both in North America and a little bit.

And then as I said earlier, technology has played a tremendously important role. Combining great talent with technology is what it's all about. And I think as we move forward, continuing with these initiatives of strong product programs, strong talent, providing great service, and then finally, be a socially responsible company.

We have been recognized by many organizations and I'm happy that as I said in the Newsweek for the second time named us as America's number one retailer -- furniture retailer. Thanks very much. And any questions, please let us know.

Operator

This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.

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