



Delta Apparel, Inc.
First Quarter Earnings Conference Call
January 23, 2014

Operator: Thank you and good afternoon to everyone participating in the Delta Apparel, Incorporated Fiscal Year 2014 First Quarter Results Conference.

Joining us from Management are Bob Humphreys, Chairman and Chief Executive Officer and Deb Merrill, Vice President, Chief Financial Officer.

Before we begin I'd like to remind everyone that during the course of this conference call, projections or other forward-looking statements may be made by Delta Apparel's Executives. Such statements suggest prediction and involve risks and uncertainties and actual results may differ materially. Please refer to the periodic reports filed with the Securities and Exchange Commission, including the Company's most recent Form-10K. This document contains and identifies important factors that could cause actual results to differ materially from those contained in the projections or forward-looking statements.

Please note that any forward-looking statements are made only as of today and the Company does not commit to update or revise these statements, even if it becomes apparent that any projected results will not be realized.

I will now turn the conference over to Deb Merrill, Vice President and Chief Financial Officer. Please go ahead Mr. Merrill.

Deborah H. Merrill: Good afternoon. Seasonally December's quarter is Delta Apparel's weakest revenue quarter and historically we are pleased when we can make any amount of profit in the quarter. This year net sales reached to 100 million but were below the prior year and weaker than we targeted. We anticipated that we would lose some money in the quarter, however the loss of \$0.20 per share was more of a loss than we wanted.

Although the first quarter results did not meet our goals we did make progress during the quarter on our strategic objectives that should grow sales and earnings overtime. The 6% decrease in revenue during the quarter resulted from sales declines at Softe, Junkfood and The Game all of which we anticipated would be down. While Junk Food and The Game sales were lower than projected we were pleased that Softe sales came in stronger than we expected.

Demand for undecorated tees, which you will recall was weak in the September quarter, continued to be soft through most of the quarter, but we did see some strengthening in demand in December. Good performances from Salt Life with a 30% sales growth, Art Gun with more than a 50% sales growth and in our private label business somewhat offset the sales declines seen in our other businesses.

Sales for Delta's basic segment were 58.6 million in the 2014 first quarter, a slight decrease from the 58.8 million in the prior-year period. Healthy demand for private label products was offset by a 5% decline in undecorated catalog tees, which I will remind you is a comparison against last December in which sales of catalog tees increased over 15%. Sales of catalog tees were bolstered by the Company's new offerings of decorated full package programs using catalog blanks, which have gained traction and nearly doubled from a year ago.

Delta's branded segment had net sales for the fiscal 2014 first quarter of 41.4 million, compared with 47.9 million in the prior year's quarter. Soffe sales declined 16% from the prior year quarter, but as mentioned were slightly better than expected. Soffe products will be back on the shelves at certain mid-tier retailers for spring '14, and we are receiving favorable forecast for increased Soffe sales from several retailers. Of course we will have to see retail traffic patterns and the ultimate sell-through which is key for the forecast to be met.

Junk Food sales were down 27% in the December quarter compared to last year, primarily due to a shift in timing of shipments of our professional sports licensed products which shipped in the September quarter this year but had shipped in the December quarter last year. In addition, general weakness at department stores unfavorably impacted re-orders and chase business during the holiday season.

The Game business, excluding Salt Life, experienced a 15% net sales decline during the December quarter from lower college bookstore sales. This weakness was primarily due to product replenishment challenges, stemming from the closing of the Wendell decoration facility in the September quarter. The sales decline in collegiate apparel was partially offset by double-digit sales growth in The Game's branded headwear and private label corporate headwear programs.

The Company's newest acquisition, Salt Life, had a 30% increase in net sales driven by door growth, product expansion and increased consumer demand. Salt Life products are now on the shelves in over 2,200 retail doors across the United States, a 35% growth in doors from calendar 2012.

Art Gun sales reached nearly \$4 million during the December quarter, a 52% increase over the prior year December quarter. While still a small piece of our overall Company business demand for Art Gun's direct to garment printing is growing, it should allow Art Gun to become more significant in both sales and profits over time.

On a consolidated basis SG&A was 19.8 million or 19.8% of sales compared to 21.9 million or 20.5% of sales in the prior year's quarter. The 70 basis point improvement resulted from a lower mix of branded sales as well as the cost savings initiatives we started last quarter. Partially offsetting these declines were higher legal defense costs incurred in connection with ongoing litigation matters, which increased SG&A as a percentage of sales by about 20 basis points. We anticipate these higher than normal legal costs to continue in future quarters as these matters are worked through.

Capital spending during the quarter was 4 million and primarily related to our manufacturing expansion as well as ongoing enhancements to our information technology infrastructure. Depreciation and amortization, including non-cash comp was 2.5 million in the quarter. We continue to expect cap ex to be approximately 15 million during fiscal 2014 and D&A to be about 10 million.

Total debt at December was 132.8 million, down about 1.9 million from September. Debt is typically (inaudible) to be the highest in the March quarter. We plan to use cash flow to continue paying down debt through the fiscal year. You will notice that our short-term debt increased significantly from September as the 9 million payment on the seller (ph) financing from the Salt Life acquisition is due on September 31, 2014. During the quarter we did not repurchase any of our common stock and instead utilized our free cash flow to pay down debt. There remains 5.9 million authorized by the Board of Directors for our repurchasing program and we will continue to evaluate share repurchases as we progress through fiscal 2014.

Now I would like to talk a little bit about our outlook for the 2014 fiscal year. As I said earlier weakness in the apparel market price drove our first quarter results to be lower than we had anticipated. As we look to the future we see several potential risks that may put additional pressure on our fiscal 2014 outlook. The most significant risk relates to the potential impact of cotton cost. Cotton prices are volatile and they have been on the rise over the last several weeks, increasing by over \$0.10 per pound.

Further adding to the increase in cotton cost is the basis, which is the cost to actually obtain the cotton which has also been steadily increasing due to concerns about the supplies of cotton in the U.S. It is still too early to know what selling prices will reflect these higher raw material cost or what the potential impact on unit volumes maybe.

For the last several quarters demand for undecorated tees has been soft leading to price discounting to drive unit sales. While it is encouraging that since mid-December the market seems to have picked up, it is too early to determine the trend that demand will take as we move into our traditionally strong spring selling season.

Finally, while we have good projections from retailers of their expectations for orders of our branded products the retail environment remains unsettled and the potential level of consumer spending for apparel is undetermined. This illustrates the higher than normal risk to the sales and profitability in our branded business results. While we believe the opportunity remains for the Company to achieve its original goals if certain growth catalysts prove positive and the identified market risk become inconsequential or are successfully mitigated. We remain cautious until the extent of such risk can be determined.

Much of the current uncertainty and speculation regarding consumer spending trend should be clarified as spring products reach retail shelves and the selling season begins. Therefore we should be in a much better position when we report results for our March quarter to either confirm or update our guidance for our fiscal 2014.

I'll now turn the call over to our Chairman and CEO, Bob Humphreys, who will provide more details about our accomplishment and objectives.

Robert W. Humphreys: Thanks Deb and thank all of you for joining us on our conference call.

Due to the seasonality of our business the December quarter is historically our slowest sales period of the year and is one in which we generally did not make much of any money. This remained true for our recent December quarter and was exaggerated somewhat by other internal and external factors. The seasonal slowdown in demand for basic tees began earlier than we had expected, lasted longer than we had anticipated and did not begin to recover until the last few weeks of December. While that late upswing is encouraging it's too soon to determine if demand for basic tees will continue to improve.

Lower consumer demand for apparel appears to be a broad-based problem brought on by continued general caution in the retail margin due to the unsettled economy. This had an effect on several of our businesses as you heard Deb say earlier. Junk Food for instance was considerably weaker in department stores during the quarter but that also is improving as several new programs that were tested in the fall performed well and are being expanded for the spring and summer season. Junk Food continues to expand its international presence driven primarily by programs we have developed with the Gap.

In calendar year 2013, international sales made up approximately 16% of Junk Food's revenue and we see continued opportunities for international growth. Junk Food is also expanding by offering its creative and merchandizing capabilities exactly what Junk Food is known for to retailers who then source the product themselves and pay Junk Food a royalty based on the designs used. This has been a nice source of revenue that strengthens our operating profit while aborting the risk associated with fashion products.

Soffe, while still in a negative sales comp position for the first quarter has shown considerable improvement. We projected revenues to be down in the December quarter but we're pleased that revenue exceeded our expectations. Gross margins improved significantly over the prior year and we expect sequential margin improvement as the year progresses. We're pleased to be back in Kohl's stores for spring and hope to build back more business with Kohl's in the upcoming season.

As we mentioned before, we have received positive feedback from retailers and focus groups on our new spring 2014 line and are encouraged by retailer forecast for increased Soffe business. However, we are tempering our excitement until we see actual sell-through during this quarter. Having said that we believe Soffe will produce positive operating profits in the upcoming quarters and end fiscal 2014 in the black.

We are very pleased with the performance of Art Gun, which has leveraged strong growth since its inception as a start-up company. Art Gun had a very strong holiday season having shipped more than 200,000 uniquely printed shirts in November and December alone. With first quarter revenue growth of more than 50%, we're currently evaluating plans to support its future growth.

Consumer demand for Salt Life products continues to grow across a broad range of demographics. Revenues increased 30% in the December quarter driven from broader retail distribution and product expansion. This growth is even more significant when you consider the December quarter for Salt Life is its seasonally slowest quarter especially with independent resort retailers. We anticipate a strong continuation of Salt Life growth based on the orders shipped in January and orders already booked for the remainder of the quarter.

At the Surf Expo in Orlando this month, the Salt Life exhibit was one of the busiest attended booths at the show. This is just one indicator of the kind of excitement Salt Life is generating among consumers and our retail partners. We are also increasing our consumer marketing spend for Salt Life this Spring. As a part of this more in-store build outs were going on both in department stores and certain key independent shops. While the surfers will have full page articles and ad in SURFER magazine Salt Life is sponsoring Fishtrack where you can track the migratory patterns of Shortfin Mako sharks off the California Coast. We will also continue expanding our sponsorship of fishing tournaments and other ocean related events.

Beyond all of this we are building our grassroots expansion into California and Hawaii, which we believe will be a big opportunity for growth in future years. Salt Life is currently exceeding our expectations for growth and we believe we are on-track to exceed \$30 million in revenue with Salt Life in calendar year 2014.

Ironically some of the actions taken to make our business stronger in the long-term negatively impacted revenue and earnings during the

December quarter. The consolidation of our bookstore business under The Game brand caused some deterioration of revenue. Preparation for new back-to-school offerings are already underway and we will be able to provide improved levels of service for the upcoming season. We should gain much greater efficiency in that business and have already won several new college bookstore programs for the upcoming season, which we should see in our results in our fourth fiscal quarter.

During the first quarter we completed our manufacturing expansion which we expect will increase production levels, reduce costs and provide us with new revenue opportunities through the sale of incremental products. We also completed the modernization of our Fayetteville screen printing operation. This supports us with improved printing technology and increases our capacity. Although both of these initiatives should serve to lower our cost going forward, the start-up expense associated with them unfavorably impacted our results by about \$0.02 per share in the December quarter.

While we had many reasons to be optimistic, excuse me, it is only prudent to balance our optimism against the risk that Deb mentioned earlier. Recent increases in cotton cost, uncertainty in the general economy and retail environment and speculation regarding consumer buying sentiment all present risk to our ability to meet the original goals set out for the year. Nonetheless we believe Delta Apparel is well-positioned with excellent products and brands that consumers desire. We have high customer satisfaction and increasingly efficient operations.

We are committed to key strategic initiatives that include maintaining a cost effective and flexible manufacturing platform, growing our branded apparel businesses organically and through strategic acquisitions and focusing on those markets that show the best promise for profitable growth. These are the areas that exhibited the most encouraging results in our December quarter and which we believe will lead our growth through the upcoming quarters.

Operator, we will be glad to open up the call for questions now.

Operator: Ladies and gentlemen if you have a question today, please press star one on your touchtone telephone. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Once again that is star, one if you have a question today and we'll pause for just a moment.

Our first question comes from Jared Schramm, ROTH Capital Partners.

Jared Schramm: Hi, good afternoon.

Deborah H. Merrill: Good afternoon.

Jared Schramm: You mentioned that you are excited to get back into Kohl's for Spring of 2014, particularly with Softe, how do you expect the offering to look coming for this Spring versus when you were last in Kohl's with the Softe line?

Robert W. Humphreys: Well, it's going to look similar. We are going back in with a good bit of basic products that they selected. But then also some of our new spring '14 offerings.

Jared Schramm: Okay. And do you believe there is potential to expand the line offering throughout the year?

Robert W. Humphreys: Yes. It's going to be spring-summer oriented. So I think we have an opportunity for some Fall business there but then the next big expansion would be for Spring of 2015.

Jared Schramm: Okay. And then you mentioned on the call that the demand for undecorated tees has been soft. Looking at past cycles when would you realistically expect an uptick in soft tee demand?

Robert W. Humphreys: Well, we are right in that period of time now and it has varied year-to-year between early December and late January. Certainly buying patterns have changed and I think it has a lot to do with weather patterns and what retailers want in their stores but it did slowdown a little further than we expected in the Fall. I will say choppy. We have periods of demand and then a slowing up. But we have seen improvement back to the levels that we were anticipating for the last few weeks and we'll just have to see how that plays out in the coming quarters.

Jared Schramm: Okay. Any comment on expanding the Salt Life brand west out of the southeast how the progress is coming along today and also Salt Life performance in the quarter now that fully under ownership of Delta, any alternation there from previous management?

Robert W. Humphreys: Okay. Several questions there. So we are trying to build Salt Life recognition from grass roots level on the West Coast. We started that probably about 18 months ago. We have people on the ground doing both working with customers, a pro-athlete out there, this in the paddle board surf sports and his family we started sponsoring some fishing tournaments. We will do more of that now.

We've got store count in California, I think north of 40 stores now a number of doors in Hawaii and we'll be sponsoring some events over there well, this year as well. But our belief is that we need to build it from a grass roots level just as it was in Florida some years ago. I'm encouraged from friends calling me and seeing Salt Life stickers on vehicles up and down in California coast and in Hawaii so we think that's taken root.

We're more anxious to do it right and do it quickly. As far as things post acquisition, really at the time of acquisition, there really weren't any operating people involved in Salt Life. We were by far the majority of the revenue, well north of 95% of the revenue and we're paying royalties to the Company. There was one employee that works on IP protection that we took in but otherwise from an operating standpoint, no change.

I think one of the key changes though as we had talked about in past calls is we weren't prepared to invest as much as we thought was prudent and brand building in store shops and advertising prior to actually owning the brand. So we got closed well into the December quarter, we are now making our plans and those things you will see rolling out over the next 18 to 24 months.

Jared Schramm: Okay. And then lastly you mentioned some new Fall programs performing well for Junk Food. Could you highlight any of those and as far as expectations going forward as you drag out the rest of the year?

Robert W. Humphreys: Yes, there were several, one with a large specialty store, one with a ladies specialty store brand and one with a mass merchant that ended up in all of their stores, I think north of the 1,000 doors. So those initiated the test, they went well and we see ongoing businesses with all three of those retailers that we have not enjoyed in the past.

And I would say even at the departmental store level the Junk Food products performed well but - and the sell-through was very good but getting the buyers in those areas focused on reorders and that sort of thing with their overall environment was more difficult than it's been in the past.

Jared Schramm: Okay. Thank you for taking my questions.

Robert W. Humphreys: Sure.

Operator: Next up from InvestAlready.com is Brett Moll.

Brett Moll: Yes, how are you guys? I got a couple of questions for you.

Robert W. Humphreys: Okay.

Brett Moll: First off, I know you spoke about the international growth which is great. I was just wondering how you plan on expanding that international growth further going forward?

Robert W. Humphreys: Well, a lot of it is coming from China and the GAP (ph) has been growing rapidly in China. They're going to have additional types of outlets there. So we think we will grow with that. The Junk Food brand is one of our best known brands on the international stage we've been doing business for a while, and we have

demonstrated experience over there and we have the license agreements to give us international distribution rights, which are harder to come by than just having domestic distribution rights.

So we think those things give us the platform. We have learned to navigate how to get our products to China in the right way for the current levels of business. So that certainly gives us a platform to leverage in the future.

Brett Moll: Okay. And then Junk Food brand that's actually one of my favorite brands. I'm surprised to see the sales are down so much. Could you provide a figure of the current revenue of Junk Food at this level right now?

Robert W. Humphreys: Yes, we don't give revenue levels within our segments.

Deborah H. Merrill: But then I will remind you that a significant part of that decline was a shift. If you go back into the September quarter revenue was up double digits in that September quarter. So there was a shift of the timing that the retailers wanted the product between those two quarters. So you really, I think need to look at those together and then it won't show that surprise to you.

Brett Moll: Okay. Last question, I know you guys, a week ago or two weeks ago, you put that \$100 million Shelf Registration offer, is that because you're low on cash, is it a cash concern or what do you plan on doing with that capital that you're raising?

Robert W. Humphreys: Well, we're not raising any capital. It's a shelf that we could take down, it's been approved by the SEC so we have a three year window. So no certain plans at all, but just really a financing flexibility option out in the future where we can go and get pre-approval from the SEC to have that in case some compelling transaction came along.

Brett Moll: Okay. Fair enough. Thank you for your time guys.

Deborah H. Merrill: Thanks.

Operator: Next up is James Fronda, Sidoti & Company.

James Fronda: Hi, guys, how are you?

Deborah H. Merrill: Good, thank you.

James Fronda: Just in terms of the cost related to the manufacturing expansion. Is that any of that going to fall into the next quarter coming up?

Deborah H. Merrill: No, I would say most of that start-up all took place in the December quarter and so the start-up costs are over and then we will be seeing that the cost savings start coming through in the upcoming quarters.

James Fronda: Okay. All right, thank you guys.

Operator: Once again ladies and gentlemen, it's star, one if you have a question.

Next is Jamie Wilen, Wilen Management.

Jamie Wilen: How much were the start-up cost from the December quarter by the way?

Deborah H. Merrill: They impacted our results by about \$0.02 a share.

Jamie Wilen: Okay. On the Soffe side you expect to get in to spring in Kohl's does that mean shipments begin in the March quarter, I assume?

Deborah H. Merrill: Yes, that's correct.

Jamie Wilen: Okay. So and you're looking for positive sales for Soffe beginning in the March quarter?

Robert W. Humphreys: Our current outlook is about flat with last year.

Jamie Wilen: Okay.

Robert W. Humphreys: Though we might be slightly positive or slightly below but the next three quarters we believe will be positive.

Jamie Wilen: Okay, and also...

Robert W. Humphreys: Taken as a whole.

Jamie Wilen: Right. Operating profits you will be beginning to be on the positive side in Soffe in the March quarter?

Robert W. Humphreys: That's our expectation.

Jamie Wilen: Okay. When did Soffe's first losses begin, which quarter of last year?

Robert W. Humphreys: The December quarter–December of last year we had a significant loss at Soffe, so our loss was less this year than last year.

Jamie Wilen: Okay. But that accelerated throughout the year.

Robert W. Humphreys: Yes.

Jamie Wilen: Okay. To the Game for a second, what was the difficulty with the Wendell shutdown that caused you to have some difficulty in servicing accounts?

Robert W. Humphreys: Yes, these book store orders are small runs, generally less than 100 pieces of a particular art work. So just as we were—and we were never necessarily great at doing that at Wendell either. It's a difficult service industry which is why we wanted to get it all under kind of one house and one roof but we have new equipment there. And we're running it at capacity at the time. Now when you put in new equipment you build efficiencies and that sort of thing; so typical start up with new equipment and processes and what have you.

Jamie Wilen: Okay. On the Salt Life side as you say starting to see stickers wherever I travel throughout the country and people tell me about the stickers and seeing their products all over. Are we penetrate the rest of the country are we more in the seasonal surf shops or are you making any progress with any large chains?

Robert W. Humphreys: Well, outside of the southeast right now, we are primarily on seasonal surf shops. We do have some national chains that certainly have our product in the southeast we have some that are testing on the West Coast and we will continue to monitor that. To some degree that can hurt your penetration with the surf shops and more boutiques that don't want to compete with national chains. So we do think it's important to build at the grass roots level and build demand and desire for that product.

Jamie Wilen: And as the brand is growing is the increase totally from new sales as you penetrate geography where you hadn't been before or existing territories gaining in sales as well?

Robert W. Humphreys: No, its existing territories is a big part. We have one of our top two or three retailers the week before Christmas, their out the door sales were up 95%. So that's basically sales increase with doors that were already existing. Now they were just getting started a year ago. So, but anyway, we are seeing more within stores. I was with a number of sales calls on the Spring line and retailers were putting in 30% to 60% more product, more SKUs what have you. So we are encouraged with that.

Jamie Wilen: I assume Salt Life is a higher margin product for the retailers too not just for us?

Robert W. Humphreys: Absolutely.

Jamie Wilen: Okay. And over to Art Gun you did \$4 million this quarter in Art Gun?

Deborah H. Merrill: Correct.

Jamie Wilen: How much seasonality is there to the Art Gun business?

Robert W. Humphreys: Well, it's highly seasonal as we sit here today. And this past calendar year we made a big dent in that. We have some specific strategies that we are working on to build more off holiday season business. So that's the way to dramatically increase its profitability and revenue, our ability to do that. The problem is as you build more business all parts of it seem to be seasonal for the holiday season but we have some ideas and some strategies to offset that. We have built enough business along where it can be positive each quarter from an operator (inaudible).

Jamie Wilen: It's basically counter seasonal to the rest of the light weight charter goods business?

Robert W. Humphreys: Yes.

Jamie Wilen: Okay. And lastly as far as cotton prices, how much—can you talk about any sort of hedging program that we have done what do we have—if cotton prices are going up, the inventory that we carry must be, I would assume at lower price cotton?

Robert W. Humphreys: Well, that's true and cotton was coming down four or five weeks ago, six weeks ago and has taken an about face driven principally from the speculators in the marketplace. So we do have some hedging strategies in place. There are others that we will invoke and watch this. But there has been a run up above our expectations a few weeks ago and I will just remind to everyone the industry does pretty good in the run-ups. It's when they come back down that we can get stuck with high priced cotton. So that's really what we are concerned with and working on strategies of how we mitigate that.

Jamie Wilen: Our inventories up a little bit over last year, is that in finished goods or is that in raw material?

Deborah H. Merrill: Primarily in finished goods.

Jamie Wilen: Are raw materials inventories equivalent to or below year ago now?

Deborah H. Merrill: I'd say they are about equivalent.

Jamie Wilen: Okay. Okay. Thanks fellows. Appreciate it. Nice job.

Robert W. Humphreys: Thank you.

Operator: A final reminder, it's star, one if you have a question.

We will now take a follow up from James Fronda.

James Fronda: Hi, guys. My questions were answered with previous caller. Thank you.

Robert W. Humphreys: Thanks.

Operator: And at this time there are no further questions. I will turn the call back over to our speakers for any additional or closing remarks.

Robert W. Humphreys: Okay. Well, thank you for joining us. And we look forward to updating you on our March quarter in April and we will let you know a lot more about spring business and look forward to discussing that with you. Thank you.

Operator: And ladies and gentlemen that does conclude today's program. Thank you all for your participation.