# Delta Apparel, Inc.

**Fiscal 2023 Second Quarter Earnings Conference Call**

*May 4, 2023*

Good afternoon, ladies and gentlemen, and thank you to everyone participating in Delta Apparel's Fiscal Year 2023 Second Quarter Earnings Conference Call.

Joining us from Management are Bob Humphreys, Chairman and Chief Executive Officer; Justin Grow, Executive Vice President and Chief Administrative Officer; and Nancy Bubanich, Chief Accounting 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 projections and statements suggest prediction and involve risk and uncertainty, 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 annual report on Form 10-K and quarterly reports on Form 10-Q.

These documents identify 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 except as required by law, the Company does not commit to revise or update any forward-looking statements even if it becomes apparent that any projected results will not be realized.

I would now like to turn the call over to Mr. Humphreys. Please go ahead, sir.

**Robert W. Humphreys**

Good afternoon and thank you for joining us today and your interest in Delta Apparel.

We are glad to be with you to discuss our second quarter results which, much like our prior quarter, highlight the resiliency of the Delta Apparel operating model and the diversity of the five distinct market strategies on which we focus. As expected, parts of our business continued to be impacted by the high inventory levels within the mass and other retail supply chains as well as the generally uncertain economic environment, while other businesses in our portfolio continued to grow at notable rates.

Before I take you through a few of our second quarter highlights, I want to recognize our teams throughout Mexico, Honduras, El Salvador and the United States and thank them for continuing to meet the needs of our many customers in what remains a challenging overall apparel market. Our success and resiliency as a Company are, above all, a testament to their daily hard work and dedication.

Turning to our results for the second quarter of our 2023 fiscal year, we are very pleased to report double-digit growth across three of our five go-to-market channels, including record second quarter top and bottom line performance at Salt Life and year-over-year sales growth of 16%, as well as record sales at DTG2Go and year-over-year growth of 18%. In addition to the exceptional top line performance at Salt Life and DTG2Go, we achieved double-digit sales growth in our Retail Direct channel, which is an important and growing vertical channel for Delta Apparel where we provide products directly to brick and mortar and eCommerce merchants, typically either directly to their retail locations or eCommerce fulfillment centers.

Retail Direct is an area of our business, along with our DTG2Go, Salt Life and Global Brands channels, where we sell decorated "consumer ready" products either directly to end-users or to customers close to the retail point-of-sale, often one layer removed. In addition to decoration services, we often provide other value-adding services such as retail packaging, hangtagging, and advance shipping notifications in connection with these sales for which we are paid by the customer. As such, sales of these “consumer ready” products typically carry more consistent margins, and they also allow us to better manage cotton and raw material cost risks with pass-through pricing strategies. These products also turn quicker from an inventory perspective, which reduces working capital. We plan to put more emphasis on these consumer ready channels going forward as we look for ways to optimize our return on the capital we have invest in our business in this higher interest rate environment.

Similar to the dynamic we saw in our first quarter this year, the record top line results at DTG2Go and Salt Life allowed us to offset continuing softness during the quarter in our Delta Direct channel where we sell primarily blank apparel to customers who decorate the product themselves and sell to a variety of retail supply chains. The retail license customer base selling into mid-tier and mass retail continues to be the primary area of softness in our Delta Direct channel due to the well-publicized high inventory levels and lower demand in that supply chain. We are also seeing some related softness within Delta Direct’s regional screenprint customer base but also some growth in areas such as the promotional/ad specialty channel.

We are seeing a similar over-inventoried dynamic in parts of our Global Brands channel where we provide custom decorated product to large multi-national brands and sportswear companies, regional brands, and all branches of the United States armed forces. The sales and production cycles in this channel are longer and the impacts of the high inventory levels across the industry have, as a result, been delayed and manifested to a degree during the second quarter. We are seeing some nice growth in our Military business as well as with several new key branded customers that we look forward to building upon and expanding going forward.

From an overall perspective, our top line performance for the quarter was somewhat below our expectations due primarily to the depth of the ongoing demand issues in our Delta Direct channel’s retail license category. We also anticipated a challenging quarter at the operating level as we continued to work through higher priced inventory units and absorbed the impact of our efforts to reduce plant production capacity to align with the softness in the Delta Direct channel, and in the Global Brands channel to a much lesser degree. These factors significantly impacted our bottom line performance for the quarter, but we believe our decisive action throughout the last three quarters in calibrating production levels and moderating our inventory build have us well-positioned to capitalize on upticks in demand and improve our operating results as we move through the second half of our fiscal year.

Although we have seen some relatively encouraging signs on the demand front in certain parts of our Delta Direct channel recently, including retail licensing, we remain keenly focused on reducing our inventory position. We achieved an inventory reduction of 6% from December and have initiatives in place to make incremental reductions in the coming quarters. We are realizing the results of those initiatives as we progress in our third quarter. Moreover, we continue to see sequential improvement in margins as we cycle through our higher-cost inventory through the back half of the fiscal year.

We have also taken other strategic actions to better optimize our overall cost structure, including significant reductions in our offshore manufacturing workforce coinciding with our efforts to reduce manufacturing output. This includes reduction in production in our Campeche, Mexico facility to reduce the purchase of sourced fabrics. In our DTG2Go business we consolidated the digital production capacity at a legacy, single-purpose facility in Clearwater, Florida into our national footprint of dual-purpose facilities housing DTG2Go digital printing and Delta Direct blank garment distribution under one roof. This further enhances our more efficient on-demand DC model and leverages the unmatched competitive offering provided by our integrated DTG2Go and Delta Direct solution.

Let me now turn the discussion over to Justin, who will go through our business highlights in more detail, and then to Nancy, who will follow up with a review of our financial results. I'll then join them at the end of the call up for questions. Justin?

**Justin M. Grow**

Thanks Bob. Total sales for the quarter were $110.3 million, with three of our five market channels registering double-digit year-over-year growth, including record quarters for both DTG2Go and Salt Life. However, as Bob mentioned, our overall top line performance came in below our expectations due to the continuing softness in our Delta Direct channel, and in our Global Brands channel to some degree.

Our Salt Life Group segment's exceptional performance during the quarter included not only outstanding top-line results but also gross margin expansion and growth in operating income driven primarily by a higher mix of direct-to-consumer sales. Salt Life's overall sales growth of 16% was broadly based across all of its distribution channels, including direct-to-consumer retail and e-commerce channels as well as wholesale, collectively fueling double-digit operating margins.

During the quarter Salt Life opened its 22nd branded retail store in Pembroke Pines, Florida, its 13th store in the Florida market, and just recently opened the brand's 23rd store and first in the state of New Jersey, in Long Branch. The New Jersey store and our high-performing store in Rehobeth Beach, Delaware we opened last year are doing well to date and solidifying Salt Life's growing foothold in the northeast United States. The Salt Life team has plans to further expand the brand's footprint in the northeast market later this year with its first locations in New York, and also plans to open its first location in the Virginia market. We expect to end our fiscal year with approximately 26 Salt Life retail stores in operation.

The team has truly done an excellent job of executing on our branded retail strategy. These retail locations are highly productive and typically average around $500 in sales per square foot and generate four-wall profit in their first year of operations. In addition, these stores serve as great brand awareness builders and models for how to best present the Salt Life product line to maximize both the consumer experience and sales at retail. Same store sales for the quarter in our 16 Salt Life retail stores open at least a full year grew approximately one percent over the prior year quarter.

Sales on the saltlife.com eCommerce site grew 24% during the quarter. The site remains one of our most profitable distribution channels and a key pillar in Salt Life's direct-to-consumer business, shipping to consumers across the country, including many in the Midwest and Western United States outside of Salt Life's traditional southeastern stronghold. The eCommerce channel attracts new customers to the brand and also provides valuable data for future potential retail site locations. We remain encouraged by the continued growth in Salt Life's eCommerce business and see this channel as a key revenue and margin driver for many years to come.

Salt Life's wholesale channel, which accounted for 72% of Salt Life's sales last fiscal year, also grew at a healthy clip during the second quarter. The wholesale channel continues to gain new accounts and remains a key growth and customer acquisition driver for the brand, with product sold in approximately 1,800 retail doors across 48 states and territories outside of the US. We are seeing some of the well-publicized inventory issues among retailers and general uncertainty among consumers impact accounts in our wholesale channel and, due to last year's supply chain delays in our second quarter pushing more sales into our third quarter, we expect wholesale revenue to come in generally flat to slightly down this quarter. Overall, for the full year at Salt Life, we continue to expect double-digit sales growth in the low teens.

We are extremely excited about Salt Life's entry into the multi-billion dollar home furnishings market during the quarter through its new license agreement with Magnussen Home, an industry-leading furniture designer and manufacturer. The new Salt Life Home collection will offer consumers across the country a wide array of coastal-inspired products for living, dining, entertainment, office, sleep and other home spaces, as well as another significant way to connect with the Salt Life lifestyle and brand ethos. We see home goods as a dynamic addition to the current Salt Life license portfolio including branded restaurants and beverages. As our license portfolio expands over time, we expect the royalty income it generates to serve as another significant revenue channel for Salt Life along with branded retail, eCommerce, and wholesale.

Now shifting to our Delta Group segment, the DTG2Go team continued to execute well in posting another strong revenue quarter with year-over-year growth of 18%. DTG2Go continues to be a key sales growth driver for our Delta Group segment and we remain confident in the value creation potential of this business across all of Delta Apparel. The long-term growth opportunity in digital print becomes more and more evident as the traditional decorated apparel market recognizes the customization flexibility, speed-to-customer, and inventory reduction benefits of on-demand digital, which are even more valuable in today's elevated interest rate environment.

We continue to leverage our leadership position as both the highest quality and largest digital printer in the markets we serve as well as the unique advantages we derive from the integration of our digital print operations with our Delta Direct channel's network of blank garment distribution locations across the country. Our nearshore vertical supply chain in Central America and custom fabric and product development expertise also gives us strategic advantages in creating efficiencies and cost benefits for both DTG2Go and customers through the use of internally manufactured Delta Direct blank garments.

The DTG2Go team is laser focused on driving the necessary operational, efficiency and quality improvements in the business and we continue to gain experience scaling up and operating the Polaris printing equipment we recently adopted in four strategic locations across our network in connection with our goal to deliver the highest level of quality possible in the industry - which we call our digital first strategy. We are taking advantage of the relatively lower seasonal demand period in the Spring and early Summer to standardize our fleet of digital first equipment and drive better consistency and quality across these four locations. This initiative includes the upgrade and recalibration of the operating software, ink systems, and production processes across the entire digital first fleet and has been completed in our Phoenix facility with the others to follow.

Our within-spec production rates on the Kornit equipment we use in channels other than digital first are currently the best in our history. We are working to match those rates on the Polaris equipment used to meet the higher print quality standards of our digital first customer base. Printing on purchased garments made outside the Delta Direct platform can be challenging due to the variability of third-party manufacturing processes, so the greater adoption of Delta blanks by our digital first customer base over time will positively impact our within-spec production rates. Larger-sized garments, fleece and certain colors also present challenges on the new equipment.

We recently made adjustments to the breadth of product sizes and colors we provide to our digital first customer base due to quality initiatives implemented to improve consumer satisfaction. We also narrowed the number of locations from which we provide such products as we build process consistency across our digital first platform. We anticipate reincorporating additional products and locations into our service offering as we ramp up for the holiday season.

To further capitalize on the migration to digital print and grow our overall market share, we have developed a B2B portal initially targeting the ad specialty and promotional markets and expect to launch it sometime in our third quarter. Our new portal will allow customers to easily and seamlessly submit order specifications and associated graphics directly into the DTG2Go digital fulfillment network and take advantage of our on-demand service offering for smaller-quantity, quick fulfillment, and replenishment orders that may not be suitable for traditional screenprinting.

We continue to look for new ways to innovate and expand our digital strategies that leverages our unique combination of vertical integration, fulfillment network scale, and strong customer relationships. Our on-demand fulfillment platform is ideally suited to provide the customized decorated apparel products that consumers want based on their individualized interests. We continue to see meaningful sales and margin growth potential at DTG2Go as we further develop pricing strategies, increase output through productivity gains, and grow sales outside of the holiday season. Our team remains keenly focused on driving these key initiatives across our platform and achieving our operating and cost targets during our fiscal fourth quarter.

Moving to our Activewear business and its three go-to-market channels, as Bob mentioned, we continue to see growth from new customers in our Global Brands channel as well as strength in our Military business, but we have experienced some demand softness as brand customers take a more conservative approach to future bookings in the current choppy environment. Sales in our Global Brands channel were down slightly year-over-year as a result. Nonetheless, we view that softness as temporal and continue to see a positive trend from the emphasis large brands and retailers are putting on nearshore sourcing strategies like those we offer from our Central America platform.

The nearshoring trend was evident during the quarter in our Retail Direct go-to-market channel where we provide decorated, full package products to sporting goods and outdoor retailers, farm and fleet stores, department stores and mid-tier and mass retailers. Our Retail Direct team delivered another strong quarter of double-digit growth and we continue to expand our customer base across both brick-and-mortar and e-commerce players in that channel.

We believe our Global Brands and Retail Direct channels are positioned to generate significant long-term growth opportunities across our Delta Group segment going forward. These channels both provide many opportunities for us to sell decorated, fully retail ready products closer to consumers in the commercial flow. As Bob touched on, we plan to continue to place more emphasis on these programs given that we are paid for the value-added services we provide and they bring higher margins and inventory turns compared to channels where we provide blank garments earlier in the commercial flow.

In our Delta Direct channel, we saw dynamics similar to those we experienced in the first quarter of this year, with sales down approximately 38% year-over-year. The softness in our retail licensing channel resulting from mass retailer inventory rightsizing initiatives and a similarly lower demand environment in other channels such as regional screenprint continued, while we saw growth in ad specialty/promotion, eCommerce and specialty retail channels.

Given the continuing soft market for blank tees during the quarter, we once again strategically leveraged our vertical manufacturing structure and operated some of our facilities below full capacity while also building in more production shutdown time. These actions significantly impacted our margins and profitability during the quarter, which Nancy will touch on in more detail, but we believe our continuing efforts beginning in the fourth quarter of last year to reduce our overhead structure, level off our finished goods inventory and match production with demand have been effective and position us to take advantage of opportunities in the market as the year progresses. As Bob mentioned, we are seeing some signs that mass channel demand may be improving, but we will continue to manage the business prudently as higher inventory levels in the channel gradually work down throughout the year.

Let me now pass it over to Nancy for an overview of our financial results.

**Nancy P. Bubanich**

Thanks Justin.

For our fiscal year 2023 second quarter, net sales were $110.3 million, compared to $131.7 million in the prior year second quarter. However, as Bob and Justin mentioned, we did achieve double-digit sales growth across the majority of our five go-to-market channels in what was a much lower demand environment compared to the March 2022 quarter.

Net sales in our Delta Group segment were $91.3 million, compared to $115.3 million in last year's March quarter, with record sales of $12.3 million in our DTG2Go channel and double-digit sales growth in our Retail Direct channel offset by continued softness in Delta Direct's retail license and regional screenprint channels as well as sales slightly below the prior year in Global Brands.

Net sales in our Salt Life Group segment were $19.0 million, which represents 16% growth over the prior year. The double-digit increase was driven by continued growth across both direct-to-consumer channels as well as in wholesale.

Gross margins were 14.7% overall for the quarter compared to 25.5% in the prior year second quarter. The decline is primarily attributable to the production curtailments in our manufacturing platform continuing during the quarter to calibrate output with demand, as well as the high-cost cotton and other input cost from last year that we continued to work through.

Gross margins in the Delta Group segment were 5.5% for the second quarter, a decline from the prior year second quarter gross margins of 21.6% primarily driven by the additional production curtailments as well as higher-cost inventory flowing through sales, including elevated cotton, energy, dyes and chemicals, freight and labor costs.

The Salt Life Group segment's gross margins improved to 59.0% compared to 52.4% in the prior year second quarter. The improvement resulted from a favorable mix of sales, including increased direct-to-consumer retail store and eCommerce sales. Our cost for obsolete and slow-moving inventory also has declined as we are able to move these items through our retail stores in the ordinary course of our business.

Selling, general, and administrative expenses were $19.3 million, or 17.5% of sales, in the quarter, compared to $19.7 million, or 15% of sales, in the prior year. This percentage increase was primarily driven by Salt Life retail store expansion including seven new locations opening since the prior year quarter as well as the deleveraging effect of overall lower sales. We currently expect SG&A as a percentage of sales for the full year to be approximately flat compared to fiscal year 2022.

Our equity investment in the Green Valley Industrial Park in Honduras where our Ceiba Textiles facility is located provided dividends during the quarter of approximately $300 thousand and continues to generate profits recorded in other income that provide an excellent return. These dividends helped to offset other expense including $1.6 million in severance expense incurred in connection with efforts to streamline our manufacturing cost structure in our Activewear business and approximately $1 million incurred in closing the digital print facility in Clearwater that Bob and Justin mentioned.

We experienced an operating loss of $5.3 million for the second fiscal quarter, compared to operating income of $14.4 million in the prior year quarter. Our EBITDA for the quarter, adjusted to add back $4.2 million of collective expenses incurred in curtailing production and streamlining the manufacturing and management cost structure in our Activewear business and closing our digital print facility during the quarter, was $2.6 million, compared to $18.1 million in the prior year period. We note that EBITDA and adjusted EBITDA are non-GAAP measures and that listeners may access a reconciliation of those measures to net income, the most directly comparable GAAP measure, on the investor relations page of our website at www.deltaapparelinc.com.

Interest expense was $3.7 million in the quarter, more than double the prior year second quarter expense of $1.8 million and driven by both higher interest rates and debt levels.

Overall, we incurred a net loss for our second fiscal quarter of 2023 of $7 million, or $1.00 per diluted share, compared to net income of $10.1 million, or $1.44 per diluted share, in the prior year period.

Turning to our balance sheet and liquidity, total inventory at quarter-end was $243.2 million, compared to $197.7 million a year ago when the market was generally in a low inventory position. The year-over-year inventory expansion reflects higher raw material, transportation and labor cost inputs, as well as an increase in units on hand. As previously mentioned, we continue to take proactive measures in our Activewear business to balance our manufacturing output with demand and appropriately manage on-hand inventory. Our inventory decreased sequentially from the December 2022 quarter by almost $16 million and we expect that trend to continue as we progress through the year.

Net debt, including capital lease financing and cash on hand, was $194.3 million at quarter-end, up $9 million from December. We continue to expect incremental decreases in our debt as we progress through the back half of the year.

During the quarter, we invested approximately $2 million in capital expenditures relating to Salt Life retail store openings as well as facility, manufacturing and information technology initiatives.

Now I'll turn the call back over to Bob.

**Robert W. Humphreys**

Thanks Nancy.

The apparel industry has never been more dynamic, and I'm extremely proud of our team's ability to navigate some tough market conditions in parts of our business over the last several quarters. As we look ahead to the remainder of our fiscal year, the decisive actions we've taken since the third quarter of last year to calibrate our manufacturing output and manage down our inventory should put us in good position to take advantage of favorable changes in demand.

With the current environment of rising interest rates and general economic uncertainty, we will continue to focus on managing working capital, reducing inventory and debt levels, and deploying our capital resources where we expect to generate the most positive impact for our shareholders, including the many areas of our business where we provide higher margin decorated products directly to consumers or close to them in the supply chain. These actions will result in a more agile Delta Apparel better equipped to navigate the fluid operating environment and enhance our ability to meet our customers' needs.

Delta Apparel today is a highly diversified apparel company that serves customers in a wide range of markets and channels. We will continue to leverage this versatility and focus on initiatives that position our Company for growth and profitability in the years to come.

And now, operator, you can open up the call for any questions we may have.

**Operator**

Thank you, sir. **(**Operator Instructions). Your first question will come from Dana Telsey at Telsey Group. Please go ahead.

**Dana Telsey**

Good afternoon, everyone. As you think about the current environment of where you are today and the impact on the gross margin from the Delta Group with production curtailment and the higher cost inventory and elevated cotton costs, as we move through the year, how do you unpack the gross margin with each of those items? Do they lessen as we move forward? How much would they lessen? Where do you see inventories get to as we go through the remainder of the year? Thank you.

**Robert W. Humphreys**

Yes, we see sequential improvement by quarter in our third and fourth fiscal quarter, as we have been expecting. Certainly, the March quarter was a difficult quarter from a revenue standpoint. Then we did take a lot of actions to reduce our output and make some permanent reduction in our cost. We have seen a pickup in demand for the last four weeks or five weeks now that looks like it's getting some traction. That's encouraging. We see our inventory sequentially going down as we go through the back half of the year. As Nancy pointed out, we made significant progress in that in the March quarter. That was encouraging.

We're slightly ahead. If you look now at the end of April, our debt is also coming down as we expected and in fact, has been reduced several million dollars more than what our forecasts were for this period of time. We are starting to see the results of those actions that we have taken, both on an income—inventory level and debt level. At this point are encouraged about some improving demand.

**Dana Telsey**

Got it. Bob, when you talk about the improving demand, is it in the wholesale channel? What's your outlook for the T-shirt channel?

**Robert W. Humphreys**

Yes, where we've seen improvement is in the basic undecorated tees that had been impacted so far—largely in the first half of this year. It appears that orders are flowing more freely through the mass channel and people are ordering garments from us.

**Dana Telsey**

Got it. Just on future bookings and cotton prices, when does lower price cotton start to feed into your funnel?

**Robert W. Humphreys**

Yes. Sequentially, we will see lower price cotton going out through cost of sales. Really each month will get a little bit better as we go through the rest of this fiscal year.

**Dana Telsey**

Okay. Do you look at this quarter as the peak level of weakness with the loss? Or how do you frame it go forward?

**Robert W. Humphreys**

Yes. We see our revenue getting closer to the prior year in subsequent quarters, and we see our operating loss narrowing as we go through the next two quarters.

**Dana Telsey**

Thank you.

**Operator**

Your next question comes from Richard Jackson, a Private Investor. Please go ahead.

**Richard Jackson**

Yes, good afternoon. You have higher interest rates, obviously impacting the debt payments. Do you think that you have enough cash on hand and through your availability to carry you through to when times start to get better?

**Robert W. Humphreys**

Yes.

**Richard Jackson**

Okay. Can you give us an update on the Fanatics business?

**Robert W. Humphreys**

Well, it drove our record revenue in that business during the quarter. As Justin pointed out, we're going through all of our locations that have our Polaris equipment in it and resetting those. We're going to slow down production for the next quarter or two. We're also going to eliminate some types of garments that our defect rate is higher than what we want it to be from a cost standpoint and higher what Fanatics wants it to be. These are extra large garments, some colors, some types of silhouettes. It's going to slow down for a couple of quarters, and we think be in a better position to get it to a profit level as we go through holiday.

**Richard Jackson**

Okay. But there's nothing that's changed in their long-term strategic goals with you?

**Robert W. Humphreys**

Yes, I don't think so. They're working on their overall quality as well, and we continue to work with them on that.

**Richard Jackson**

Okay. Then finally, on the licensing, can you give us just a rough idea of what kind of opportunity there could be for the home furnishings. You also have the restaurants and you were talking about beverages at one point.

**Robert W. Humphreys**

Right. Well, the home furnishings is obviously just being developed. There's a, what we think, is a significant minimum guarantee. But long term, obviously, for that to continue, they have to be successful in the marketplace. We're encouraged that we have a good partner there that has stepped up to the table aggressively, but I think it's premature to forecast at this time what the long-term royalty rates would be.

**Richard Jackson**

Okay. What about the restaurants and the possible beverage?

**Robert W. Humphreys**

Yes. The restaurants, there's currently three of them. The restaurant license predates us acquiring Delta Apparel and—I'm sorry, not Delta Apparel, Salt Life. They have a strong license that they can kind of move at their pace, which is not fast. We've tried over the years to encourage a quicker pace, but have not accomplished that to date. It's a minimum, but they do a good job, and it's a great experience and good food. Good branding for Salt Life, but the royalty that we receive does not move the needle for us.

**Richard Jackson**

Do you think there are other areas of opportunity for licensing?

**Robert W. Humphreys**

We believe so, and we get a lot of inquiries, as you might imagine. Again, we're excited about the home furnishings as something that can be meaningful and really has the potential to move the needle for us, but we'll continue to be careful with what we allow people to put the Salt Life brand on.

**Richard Jackson**

Very good. Thank you.

**Operator**

Your next question comes from Samir Patel at Ascella Capital. Please go ahead.

**Samir Patel**

I've got two questions. The first one is strategic. Regarding Delta Group, 12 months to 18 months ago, you had record production levels, were even investing some capital to debottleneck that business. Now you have inventory built up and are having to absorb the cost of low production volumes. You talked about being more agile. Can you go into a little more depth on how you plan to manage in the future for potential demand fluctuations that you don't get in this position again?

**Robert W. Humphreys**

Yes. We have permanently cut out some production. We've taken production out that we are not as vertical on, and we will be limiting products that we source from the outside in some areas. Obviously, with higher interest rates, we need higher returns on our working capital. We'll be careful in style and SKU turns and gross margins associated with that.

**Samir Patel**

Okay. I know Dana and a couple of others asked this, but more directly, when do you expect the Delta Group to return to profitability?

**Robert W. Humphreys**

I think the Delta Group will return to profitability either late this year or early next year.

**Samir Patel**

Okay. Then the bigger picture question is, look, your stock is down 60% over the past year. You trade at a significant discount to liquidation value. You have a lot of debt, which is scaring off investors, particularly in today's environment. We might be heading into a recession. Amidst all this, Salt Life is an extremely popular brand with a lot of growth potential. You could probably sell Salt Life today for over $100 million, which is significantly more than your market cap. I know you've put that business in its own segment for reasons. Maybe talk about when you think is the time to crystallize that value for shareholders.

**Robert W. Humphreys**

Well, I don't think there's a specific time. We have sold a number of businesses over the years and harvested our gains in the businesses and the money we had invested in and that's what drove the investment in Salt Life and some other businesses. We're certainly not adverse to doing that. But we do think our debt levels will be coming down significantly as we go through this fiscal year. We have other assets as well that would garner a premium over their current carrying value on our balance sheet.

I think for people who look through and really see what our assets are, there's a lot of assets on our books that are tangible assets that are not valued from a book value standpoint. Our Board looks at that every board meeting and certainly, every year, we get advice from outside experts on ways to monetize things and provide value to shareholders, and we'll continue to do that.

**Samir Patel**

Okay, thank you.

**Operator**

**(**Operator Instructions). Your next question will come from Jamie Wilen at Wilen Management. Please go ahead.

**Jamie Wilen**

Hey, Bob, I'd like to further discussion for the licensing opportunities. In Home Furnishings, when do you expect that to start to kick in?

**Robert W. Humphreys**

It will start to kick in with shipments next spring.

**Jamie Wilen**

Okay. They'll pay you a royalty against a guarantee and is that the standard? Is that what your kind of standard is going to be as you move forward in licensing, get that or getting some upfront payment with the royalty on everything?

**Robert W. Humphreys**

Yes. We get an upfront payment and a guarantee and it decides who's serious and who's not serious.

**Jamie Wilen**

Got you. Okay. You're getting a lot of inquiries from a lot of different businesses for using the Salt Life name and the Salt Life message, I assume?

**Robert W. Humphreys**

Well, yes. We do get a lot, and we discard a lot. There are not things that we won't Salt Life associated with. Our number one thought around this is do no harm. People have a good idea where there's a market we should be in. That's going to continue, but making mistakes, licensing too many different types of products, can really hurt a brand. In fact, that was one of our fights with how Salt Life was being managed when we acquired it. We thought it was being over licensed into areas that could hurt us, and we culled that as we work through and are now starting to build that back in areas that are proving in the marketplace.

**Jamie Wilen**

As you continue to expand the Salt Life retail chain, when you say New York and New Jersey, are you still going to basically do beachfront stores? Are the stores that you have just opened—is there any significant difference from what their trajectory is versus other stores that you've opened over the last several years?

**Robert W. Humphreys**

Yes. All of these stores will be in either beach towns or in centers that are on interstates that garner people going to or from the beach. That playbook has been working for us, and we'll continue on that. In New York, for example, the two locations are on Long Island that we expect to open.

**Jamie Wilen**

Yes. They're the same size and you expect the same metrics or similar metrics to the other stores that you've opened, I would assume?

**Robert W. Humphreys**

That's correct.

**Jamie Wilen**

Okay. On DTG2Go, as you're moving forward, what is your target operating margin? What is the path that you have to do to get there? How far along are you on that path?

**Robert W. Humphreys**

Our target operating margin is low teens in that business. It's been about two years now since we've had operating margins to that level in the business. Our focus now is efficiency and building a more year-round business that allows us to run the equipment consistently with a consistent workforce and less hiring and then terminating people for holiday and that sort of thing. We've really got to continue to work on the efficiency and having a first quality garment to ship to customers. As Justin mentioned, we're at our best quality goals we've ever been on our (inaudible) equipment, and we have improvement on our Polaris equipment, but it's not yet where we need it to be.

**Jamie Wilen**

What percentage of garments that you're printing are polyester now versus cotton?

**Robert W. Humphreys**

It's a small amount, is polyester.

**Jamie Wilen**

Okay. Then lastly, on inventories. You took a few weeks of production shutdown this quarter. Are you expecting to take any weeks of shutdown in the June quarter?

**Robert W. Humphreys**

No. At the pace that we are seeing orders coming in right now, we're not running completely full, but we don't anticipate additional unplanned weeks of shutdown.

**Jamie Wilen**

Okay. You've reduced your inventory levels by $45 million this year, which is significantly better than some of your publicly held people in the industry. I would assume you're in a little bit better shape than everybody else. But where would you like your inventory levels to be at year-end? Where would you like to carry them as you move the Company forward?

**Robert W. Humphreys**

Yes. We've got about a $25 million further reduction that we expect to make by year-end. Then where they go further, obviously will be dictated to some degree on cotton costs, but we expect inventories to continue to come down at least in units as we progress through next year as well.

**Jamie Wilen**

Good. One last (multiple speakers) go ahead.

**Robert W. Humphreys**

Some of the steps we've taken in manufacturing this quarter will help allow us to do that. But clearly, in a higher interest rate environment, we have to have higher productivity out of our inventory to generate a proper return for our shareholders.

**Jamie Wilen**

Got you. On DTG2Go, what is your current internalization rate? Where do you expect that to head over time?

**Robert W. Humphreys**

It's a little over 50% today, and we expect that to continue to increase and perhaps at a faster rate, and particularly on the Polaris equipment because we are finding and our partners are finding consistency of that product, and how it is made is important to the overall consumer experience when they receive the garment. I don't mean that, that necessarily is a poor quality garment that we might be printing on but in colors where garments were made different ways by different people, different chemistry in the dying process and what have you, then it's going to perform differently when we print on it. The more consistent that we can have the garment the better quality, we actually ship to the end consumer.

**Jamie Wilen**

Okay. Obviously, having a high internalization rate is a great competitive advantage, but I also assume it really helps you manage your inventory and get them down a little bit more quickly as that rate goes up?

**Robert W. Humphreys**

Absolutely. If you didn't get what Justin was saying, after years of talking about it, we are going live on a portal where our wholesale customers can come in and order small quantities of garments for their customers, print it digitally by us and deliver. That's a great opportunity to add another channel of distribution on our digital.

**Jamie Wilen**

Excellent. You're doing a great job of taking these high margin, high-growth businesses and moving them to the next level. I appreciate it, Bob. Thanks.

**Operator**

There are no further questions from the telephone. I will turn the conference back to Bob Humphreys for any closing remarks.

**Robert W. Humphreys**

Well, thank you all for joining us today, and we look forward to continuing to work on the behalf of our shareholders and look forward to speaking to you after our third quarter results. Thank you.

**Operator**

Ladies and gentlemen, this does conclude your conference call for this afternoon. We would like to thank you all for participating and ask you to please disconnect your lines.