Delta Apparel, Inc.
Fiscal Fourth Quarter and Full Year 2015 Results
Earnings Conference Call
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CORPORATE PARTICIPANTS

Deborah H. Merrill, *Vice President, Chief Financial Officer and Treasurer*

Robert W. Humphreys, *Chairman and Chief Executive Officer*

CONFERENCE CALL PARTICIPANTS

Jamie Wilen, *Wilen Management*

Nick Meyers, *ROTH Capital Partners, LLC*

PRESENTATION

Operator:

Thank you, and good afternoon to everyone participating in the Delta Apparel Incorporated Fiscal 2015 Fourth Quarter and Year-End Results Conference Call. Joining us today from Management are Bob Humphreys, Chairman and Chief Executive Officer; and Deb Merrill, Vice President and 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 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 Form 10-K. This document contains and identifies important factors that could cause actual results to differ materially than 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'll now turn the conference over to Delta's CFO, Deb Merrill, who will provide the details of the Company's fiscal fourth quarter.

Deborah H. Merrill:

Thank you. Thank you to all of you that are joining us on the call this afternoon. I'm very pleased to tell you that Delta ended its fiscal year with a very strong fourth quarter. Even more significantly, it was preceded by a strong third quarter and a decent second quarter, each of which showed solid sequential improvement.

Net sales for the 2015 fourth quarter increased to $120.2 million from a $114.9 million in the prior year period. Adjusting for the prior year fourth quarter sales of the Game product, net sales grew 12.7%. As a reminder, we sold the Game business in the second quarter of fiscal year 2015.

Gross margins improved in all of our business units, expanding 300 basis point from last year's fourth quarter and 80 basis points sequentially from the June quarter. EBIT grew to $5.1 million or 4.3% of sales, driving net income to $4.2 million or $0.53 per diluted share in our fourth quarter, compared to a net loss of $765,000 or $0.10 per diluted share in the 2014 fourth quarter.

EPS for the 2015 fourth quarter would have been higher by about $0.02 per share, had it not been for the bankruptcy filing of one of our long-term private-label customer.

Our basic segment was the primary driver of our fourth quarter sales growth, increasing 21.1% to $74.4 million compared with $61.4 million in the prior-year period.

Activewear sales increased 19.6%, driven by a 9% increase in catalog business and a 46% increase in private label. New products such as fleece, Delta-Dri and snow heathers, as well as solid growth in full package Delta programs drove catalog growth during the quarter. Expanded programs with current customers and new customer growth were the drivers for the increase in private label business during the quarter.

Art Gun continued its rapid growth with a 60% increase in net sales driven by new customer launches and expanded product lines with existing customers. While Art Gun's expanded customer base benefited the Company's overall performance, it has even greater significance going forward as we move through 2016.

In the branded segment, sales were $45.8 million compared to $53.5 million in the prior year. However, after adjusting for the revenue contributed by the Game products in the prior year, net sales grew 1.4%. We saw sales growth in most of our business units and gross margins expanded in all business units.

Salt Life increased net sales by 10% during the fourth quarter. In the prior year fourth quarter, there were some large shipments to non-strategic retailers as we closed out old categories of product. We did not have the need to repeat this in the current quarter. Salt Life's sales grew 38% over the prior year when adjusted for the close-out in the prior period.

Junk Food sales grew 7% in the fourth quarter, primarily driven by growth in boutiques and within the large retail group. We anticipate that much of Junk Food's growth in the next few quarters will be driven by boutiques and specialty stores as they look to Junk Food as a creative engine to drive traffic to their stores.

Soffe is still not performing up to what we believe is its potential. It has solid growth in the independent sporting goods channel, but not enough to offset a decline with big-box sporting goods retailers and department stores. That resulted in an 11% decrease in net sales for the quarter. Soffe is intensifying its focus on the independent sporting goods channel and expects to launch a new B2B website to accommodate this channel in early calendar year 2016.

Our strong second half results more than offset our weaker first half numbers, giving us sales growth for the full fiscal year of 2.5% after making the adjustment for the Game sale. On an unadjusted basis, net sales were $449.1 million in fiscal 2015 compared to $452.9 million in fiscal 2014.

Total EBIT for fiscal 2015 was $16.1 million. Net income was $8.1 million, or a $1 per diluted share, compared with a net loss for fiscal 2014 of $960,000, or $0.12 per diluted share.

SG&A costs in the fourth quarter were down 330 basis points to 17.7% of sales, compared with 21% of sales in the prior year's fourth quarter.

For the full year, we had a $5.2 million decrease in SG&A or as a percentage of sales 18.1% in fiscal '15 compared with 19% in the prior year. The decrease primarily was driven from lower fixed salary costs due to our headcount realignment. This was offset somewhat by higher marketing costs and incentive based compensation.

Total capital spending for fiscal 2015 was $7.8 million with $3.5 million occurring during the fourth quarter. We expect total capital spending for fiscal 2016 to be approximately $10 million.

Depreciation and amortization including non-cash compensation was $11.4 million for the full year and $2.9 million for the fourth quarter.

During the quarter, we repurchased 109,636 shares of Delta stock at an average cost of $15.15 per share for a total cost of $1.7 million. This brings the total spent during fiscal 2015 on share repurchases which we resumed in June to $2.1 million.

This past week, we announced that our Board of Directors has authorized an additional $10 million for our share repurchase program, bringing our total remaining open authorization to 11.7 million. We expect to continue the open market repurchase of our stock in fiscal 2016, as we believe that the intrinsic value as a Company is significantly higher than its current share price range.

Our total debt at fiscal year-end was a $102.2 million, down 21% from $129.9 million a year ago. This was driven by our strong back half operating results, a $13.8 million inventory reduction and modest capital spending along with the proceeds from the Game—the sale of the Game business in March.

We believe our strong fourth quarter and particularly the sequential improvement during the second half of the year point to a significant improvement in our financial results compared to the prior year in the December quarter and solid performances throughout the year.

Now our Chairman and CEO, Bob Humphreys, will provide you with some of the finer details of our quarter and year.

Robert W. Humphreys:

Thanks, Deb, and thanks to all of you for joining us on the call this afternoon. We made a great deal of progress throughout fiscal 2015, progress that made our operations more efficient and our financial results stronger. We had 7% net sales growth in the back half of the year.

Gross margins for fiscal 2015 expanded by 80 basis points over the prior year, even after overcoming the imbalance of selling prices with cotton costs in the first two quarters. We reduced SG&A costs for the year by $5.2 million resulting principally from the headcount realignment that we did a year ago. EBIT was up substantially, and we had earnings per share totaling a $1.08 for the final two quarters of our fiscal year.

Our strong second half was not a stroke of luck or the result of any improvement in the retail marketplace. To the contrary, the marketplace continues to struggle across many tiers and sales channels of apparel distribution.

In our opinion, Delta's financial improvement is the result of our effective execution of the strategic initiatives that we began in our fiscal 2014 fourth quarter. These activities have generated a growth trend that we predicted back then and that we see continuing in fiscal 2016, despite persistent softness in the retail marketplace.

Much of Delta's revenue expansion over the past 15 years has come from organic growth through weak economic conditions. Our investments in e-commerce, better merchandising and expanded sales and marketing force, and consumer outreach with our brands has returned us to a position where we can demonstrate profitable growth even in a weak retail environment. We did this by making some difficult choices and taken deliberate action to change our approach to the marketplace.

As we enter 2015, we have already completed the reorganization of our key business functions. We had streamlined our administrative workforces and delayered our management structure. We lowered product cost and capital requirements by improving supply chain and manufacturing efficiency.

We initiated a comprehensive rationalization analysis of all of our business units, which resulted in the sale of the Game in fiscal 2015 second quarter along with a choice to not seek renewal of our Kentucky Derby license.

The sale of the Game worked well for us as well as for the buyer, allowing us to focus resources on more strategic areas of our business that have the greatest potential for future growth. We expanded our screen-printing operations in El Salvador to service our growing private label and full package businesses. This contributed greatly to the 20% growth in our Delta activewear business in the fourth quarter.

We began expanding our Honduran textile operations and added new equipment which reduces our reliance on purchased fabric and gives us the capability of producing open-width goods that many of our customers now require. This expansion should be completed in the first half of fiscal 2016. We anticipate that this expansion will generate a $2 million annualized savings, of which about $500,000 should flow through our operating income for our 2016 financial results.

We've also made further investments in our e-commerce business that have added new functionality to all of our site, such as product reviews, abandoned cart outreach, and other aspects that improve their customer experience. We strengthened Art Gun with all new equipment that expands these capabilities and increases capacity. We have begun to use Art Gun's advanced capabilities to augment Junk Food's online business to facilitate cross-selling with other business units.

Overall, sales grew 57% on our website with direct-to-consumer sales increasing 40%. This, coupled with Art Gun's 23% sales increase, demonstrates the benefits that accumulate with the investments we're making in e-commerce. While Soffe is not yet meeting our expectation, it did show growth in the independent sporting goods channel and on its website, with soffe.com sales growing 25% during fiscal 2015.

Soffe is intensifying its focus on the independent sporting goods channel and expects to launch a new B2B website to accommodate that in early calendar year 2016. We'll continue to work to stabilize Soffe and return it to solid growth.

In the 2015 fourth quarter, we completed the move of Salt Life's distribution center from Phoenix City, Alabama to Fayetteville, North Carolina. As we have previously reported, although the move should ultimately increase efficiency, reduce cost and improve customer satisfaction, it caused a disruption in our shipping that temporarily slowed Salt Life's growth.

I'm happy to say that demand for Salt Life's product remains very strong and the business unit is experiencing continuing customer expansion. With the move now complete, we'll be ready to shift spring 2016 orders to a highly efficient and cost-effective distribution channel.

From the reactions we're seeing on our spring 2016 line, and new customer and geographic expansion opportunities we're working on, we expect Salt Life to continue to—at its historical growth rate for fiscal 2016. Looking ahead, we'll be operating in a difficult retail environment, but regardless Delta Apparel is positioned to have further sales and profit growth in 2016.

We're introducing exciting new performance and lifestyle products across our different brand and have enhanced our core business line as well. Our manufacturing facilities continue to gain efficiencies, improve quality and lower costs.

We ended fiscal 2015 with lower than expected inventory, so we're now increasing production output which will drive further manufacturing cost savings. In addition to this, we have reduced our fixed costs and have further strengthened our balance sheet. Overall, we're anticipating a solid performance for Delta Apparel in fiscal 2016.

Operator, if you'll open up the lines to questions, Deb and I'll be glad to have—answer any questions that you might have.

Operator:

Yes, sir. Thank you. Ladies and gentlemen, if you wish to ask a question, please signal by pressing star, one on your telephone keypad. Please make sure your mute function is disengaged to allow your signal time to reach our equipment. Once again, that is star, one to ask a question. We will pause for just a moment to allow everyone the opportunity to signal for questions.

As a reminder, it is star, one at this time. It looks like we have Jamie Wilen with Wilen Management. Please go ahead.

Jamie Wilen:

Nice quarter, fellows. Just wanted to start with a few things. SG&A was down significantly and—were all those costs taken out throughout the course of the year or when you started fiscal 2015 was that basically done? As you look to 2016 with, I guess, you have $0.5 million from the Honduras, are there any in total cost savings left that you can count on 2016?

Robert W. Humphreys:

Not all of those costs were out as we started the fiscal year, but I'd say by the end of the first quarter we had all the SG&A type costs out. Each year we have aggressive manufacturing cost savings from anything from capital expenditures to improvements in processes and waste and what you have and this year is no different from that. The early indications are that we're in good shape and excited about that. We had a really strong performance out of our manufacturing plant in the fourth quarter of fiscal 2015 and believe that momentum will continue into fiscal '16. Then with sales being a little bit ahead of plan in the fourth quarter that makes inventories a little bit under plan and so we're actually increasing our output beyond what we were expecting four, five months ago and of course that carries more fixed costs through and just gains manufacturing efficiency. So we're excited about some of those things on the front.

Jamie Wilen:

Okay. You've also increased your capital expenditures for next year by about a third. What's—what are they going into and how come the increase?

Robert W. Humphreys:

Well, probably the single biggest part of that is the continuation and completion of our open-width finishing project that we've been talking about for some time, but some of that cost will actually roll through as cap ex in fiscal '16. Then beyond that is the continuation of expansion in screen-printing and some dyeing capacity. Then, in addition to that, so it's easy to kind of go through the manufacturing sites, but we do make substantial investments in our e-commerce sites and IT in general really each year now.

Jamie Wilen:

On Salt Life, you were talking about returning to historical growth rates, is that—when you say historical are we looking at the 25% to 30% growth rates of what we usually…

Robert W. Humphreys:

Yes, I think 20% to…

Jamie Wilen:

What does that refer to?

Robert W. Humphreys:

Yes, 20% to 25%.

Jamie Wilen:

Okay. Additional geographic expansion, I thought you were pretty much in the entire country. Where are you headed to next?

Robert W. Humphreys:

Well, how about more density where we are and…

Jamie Wilen:

Okay.

Robert W. Humphreys:

We've got some—a few new doors coming in Hawaii. We got some—new doors coming in California. We've got a couple of pretty much nationwide retailers that are talking to us seriously about initiating a test and so we continue to see more density, more doors where there's—have been fringe areas before and people have proven out the concept. So we see further expansion in both the doors and then we've had tremendous improvement in sell-through in some doors, we've seen some of that over the holiday season that is really encouraging and people are buying a bigger part of our lines. So good stuff going on there. Plenty to do to plan it all and to execute it all and get it sourced in bulk but we think we're making good progress on that.

Jamie Wilen:

Okay. The strength of the business is equal between your existing core markets in the southeast or was more of the growth headed toward the newer markets now?

Robert W. Humphreys:

No, if anything particularly new product line, new categories, in what we consider our core markets not just Florida, but Florida through Texas and up the lower part of the East Coast have been really strong. So good stuff there.

Jamie Wilen:

Okay. Lastly, within the comments of the press release you talked about even greater significance of Art Gun in the future. What do you mean by that?

Deborah H. Merrill:

What we're talking about there is a customer expansion that as we expanded customer base throughout '15 then that means we're starting FY16 with those customers and still new ones in the pipeline. So we just continue to see both growth with new customers as well as as we are coming up with new product lines and people are doing broader product lines online. We see that momentum continuing into FY16, so the work done throughout the year in '15 we're now starting with that work already done to start '16 and then can leverage off of that as the year progresses.

Jamie Wilen:

Okay. So Art Gun should be a 20% plus grower in 2016 as well?

Robert W. Humphreys:

Yes.

Jamie Wilen:

Okay. Very good.

Robert W. Humphreys:

Now I think—did you quote our growth in the fourth quarter or did you…?

Deborah H. Merrill:

Yes, the fourth quarter growth in Art Gun was a 60% growth.

Jamie Wilen:

Right.

Deborah H. Merrill:

We'd had—besides the first quarter we had had anywhere from 20% to 40% growth in all of the other quarters. So yes, we would certainly expect a 20% growth rate for that in '16 as well.

Jamie Wilen:

Okay. I'll hop back in the queue.

Operator:

As a reminder, it is star, one if you do have a question.

We next move to Nick Meyers with ROTH Capital Partners

Nick Meyers:

Hello, good afternoon, guys. How are you doing?

Robert W. Humphreys:

Good. How are you?

Nick Meyers:

I'm doing very well. Congratulation on a good quarter.

Robert W. Humphreys:

Thank you.

Nick Meyers:

Obviously, I'm going to be asking some questions for Dave King. So it looks like on your gross margin you guys have been benefiting the last few quarters from the cotton price decline. Is there any potential for further improvement to gross margin going forward?

Robert W. Humphreys:

Well, I think some of that improvement has been aligning cotton costs with where pricing is in the marketplace. That has pretty much stabilized over the last couple of quarters both in pricing and on the cotton input side. So I think that part of it we're seeing. There are other efficiency gains and cost improvement that we think will continue to allow us to grow our gross margins across our business. Some of its mix, some of its product, some of its manufacturing improvements, but we do expect to continue to slightly improve sequentially our gross margins.

Nick Meyers:

Perfect. Then on to basics, you guys have been benefiting from your value add services last couple of quarters. Is there any plans to expand these services and how should we think about this part of the business going forward?

Robert W. Humphreys:

Yes, we were just talking about one of the big cap ex projects that we have on order as we speak as additional screen-printing capacity is going to modernize some aspects of it. We are increasing our selling capacity in the plants that then do those value adding services. So we do expect a continuation in that.

Nick Meyers:

Okay, perfect. Last one, I know you guys have talked about SG&A a little bit already, but do you guys have any new initiatives for the future that you haven't already mentioned and how can we think about the run rate going forward for next year?

Robert W. Humphreys:

I think our run rate is about where it will be. It will be influenced. We'll still be whittling away at some areas of consolidation, but really the heavy listing has been done on that and we're happy with our organizational structure now and feel like that is aligned properly and then I think the other big influencer of that is our performance incentives and just how we perform as a Company; we are heavily incentive based so our compensation expense is pretty variable with our results, so.

Nick Meyers:

Okay, perfect. I think that'll be it for me. I appreciate it.

Robert W. Humphreys:

Thank you.

Operator:

We do have a follow-up from Jamie Wilen with Wilen Management.

Jamie Wilen:

Yes, just a couple of quickies. Your tax rate, you expect next year would be around where?

Deborah H. Merrill:

I would say in the low 20% range.

Jamie Wilen:

Okay. Shares outstanding at year-end were?

Deborah H. Merrill:

Just under 8 million. I can circle back around with you on that exact number, but 7.9 million…

Robert W. Humphreys:

Here it is.

Deborah H. Merrill:

That's weighted average not ending.

Robert W. Humphreys:

Were you asking weighted average or ending, Jamie?

Jamie Wilen:

No just ending.

Deborah H. Merrill:

Ending is 7.8 million.

Jamie Wilen:

Seven point eight. Your book at year-end was?

Robert W. Humphreys:

It's a little over $18 a share.

Jamie Wilen:

Wow, incredible to be able to buy back stock like that.

Robert W. Humphreys:

Yes.

Jamie Wilen:

Last question regarding private label, incredible growth this year. Obviously, you've picked up some additional customers throughout the year, but what's your outlook for the private label business in 2016?

Robert W. Humphreys:

My expectation as we sit here right now would be about flat. Quiksilver is one of those accounts and as Deb said, they filed bankruptcy. During the year, we had managed through that very carefully and only had a minor write-off with it, but obviously their business is challenged with that. We have customers—on a regular basis, different people have different strategies and sometimes they'll license out a category, and so we may lose some business and then we gain some business. So anyway, as we sit here right this minute, I expect it to be about flat. We ran very hard to get out what we got out last year and if we can do that again and then build a foundation for further growth, then that'll be a pretty good year.

Jamie Wilen:

Okay. I applaud your strategy to buy back a bunch of stock this year, especially below book and with the outlook that you have, it looks like an incredible opportunity. Well done.

Robert W. Humphreys:

Well, thank you. We certainly hope so.

Operator:

As a reminder, it is star, one. Star, one will place you into the queue at this time.

There are no further questions. I'd like to turn the conference back over to Management for closing remarks.

Robert W. Humphreys:

Okay. Well, thank you all for joining us today and we look forward to finishing up our Q1 here in just a couple of weeks and reporting those results to you in February, and hope you all have a great holiday season.

Operator:

Ladies and gentlemen, that does conclude today's conference. We do thank you for your participation. You may now disconnect. Have a great rest of your day.