# Delta Apparel, Inc.
**Fiscal First Quarter 2016 Results**
**Earnings Conference Call**
*February 8, 2016*

## C O R P O R A T E P A R T I C I P A N T S

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

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

## C O N F E R E N C E C A L L P A R T I C I P A N T S

**David King,** *ROTH Capital Partners*

**Jamie Wilen,** *Wilen Investment Management*

## P R E S E N T A T I O N

**Operator:**

Thank you and good afternoon to everyone participating in Delta Apparel's Fiscal 2016 First Quarter Conference Call. Joining us from Management are Bob Humphreys, Chairman and Chief Executive Officer; and Deb Merrill, Chief Financial Officer and President, Delta Basics.

Before we begin I would 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 10-K. 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 or update—sorry, commit to update or revise these statements even if it becomes apparent that any projected results will not be realized.

Today's call is being recorded. I'll now turn the call over to Delta's CFO, Deb Merrill, who will provide the details of the Company's fiscal 2016 first quarter ended January 2, 2016.

**Deborah H. Merrill:**

Thank you and good afternoon. Delta Apparel's had a very good first quarter despite continued instability in the retail marketplace. Our net sales for the quarter increased 2.5% after adjusting our first quarter 2015 sales attributed to The Game, which we sold in March of last year. Our net sales for the 2016 first quarter were $90.2 million and all of our business units, with the exception of Soffe experienced net sales growth. Overall gross margins expanded 450 basis points over the prior year's first quarter and operating profit rose to $2.2 million or 2.5% of sales, a $5.4 million improvement over the comparable 2015 period.

Our net income in the 2016 first quarter was $681,000 or $0.09 per diluted share, a $0.62 improvement from the prior year December quarter. Net sales for our basics segment grew 6.7% to $61.5 million from $57.7 million in the prior year's first quarter with all business units contributing to grow with solid margins. Gross margins in the basics segment expanded 990 basis points over last year's first quarter, coming in at 17%. The gross margin expansion was driven by a number of key things including a favorable mix of products sold, continued manufacturing efficiencies and a suitable balance between selling prices and raw material prices.

The Activewear business achieved 6.2% net sales growth with both Delta catalog and the private-label business contributing. The 7% increase in Delta catalog resulted from 4% higher volume coupled with improved average prices driven from a more favorable mix of products sold. Our catalog full package programs continue to expand providing our customers this value-added service not only bolsters our net sales, but also creates a stronger relationship with our customers. Our new fashion basics, including fleece, snow heather and softspun programs did very well, further contributing to the growth in the catalog business.

Our private-label business experienced 5% growth in the 2016 first quarter, primarily driven by new customers that we began business with in the second half of fiscal 2015. These include large international brands and trendy, fast-growth regional brands. Art Gun experienced 14% growth for the quarter, primarily driven by new customers brought on during the prior year. Art Gun's historic high-growth trend was hindered during the quarter as Art Gun experienced the growing pains typical of a young, vibrant business and was challenged by the high-volume holiday demand.

Fiscal 2016 first quarter net sales for our branded segment were $28.7 million compared with $35.7 million in the prior year period, which still included sales of The Game product. On a comparative basis, after removing the prior year's sales of The Game product, our branded segment's net sales were down just $1.7 million. This was primarily due to a $2.3 million sales decline in our Soffe brand. As anticipated, Salt Life returned to its traditional, high double-digit growth, with sales improving 21.2% over the prior year's first quarter. Salt Life's growth resulted from strong demand for its long-sleeve tees and Salt Life lifestyle designs. Junk Food's net sales grew slightly, driven by continued double-digit growth in specialty stores and e-retailers, offset by a sales decline in a large retail customer.

Total selling, general and administrative expenses were $16.9 million in the fiscal 2016 first quarter, down from $18.5 million in the prior year first quarter. As a percent of sales, SG&A was 18.7%, a 120 basis point reduction from 19.9% in the last year's first quarter. We continue to benefit from our recent strategic cost restructuring and continued focus on spending controls.

Capital spending during the quarter was $3.4 million, the majority of which related to payments for our textile manufacturing expansion, which includes the addition of open-width fabric capability. Depreciation and amortization including non-cash compensation was $2.9 million in the quarter. We mentioned in our fiscal 2015 year-end earnings call that because of our strong sales in the September quarter, our inventory levels were below typical levels at the time, which would allow us to increase our manufacturing output and help to reduce our product cost. Our inventory levels at the end of the first quarter continued to be low, about $16 million than a year ago and we expect to continue to run at higher production levels through the remainder of the year. Our balance sheet is stronger than a year ago and we believe it will continue to strengthen as the year progresses.

During the quarter we repurchased 68,000 shares of Delta stock at an average price of $16.34 per share for a total cost of $1.1 million. Considering Delta's trailing 12 month earnings, strong balance sheet and from our perspective unrecognized intrinsic value we believe our stock is considerably undervalued and view such repurchases as one of the best investments we can make at this time. Our remaining authorization for stock repurchases was $11.5 million at January 2. We believe our strong first quarter and the momentum we are seeing in a number of areas point to a significant improvement in our financial results compared to the prior year March quarter and solid performance throughout the back half of the fiscal year.

Now our Chairman and CEO, Bob Humphreys will provide you with some more details on our business.

**Robert W. Humphreys:**

Thanks, Deb, and thank you all for joining us on our conference call today. The past several quarters have been difficult for many businesses operating in the retail apparel marketplace. From unusually bad weather to the persistent weakness of the economy and associated lowering of discretionary consumer spending, all had a dampening effect on the business sector. Despite those headwinds, I'm proud to say that Delta Apparel has shown its inherent strength based on diversified channels of distribution and broad customer base that allows the Company to operate profitably in a difficult business condition. I'm particularly pleased with how well most of our business units performed in the fiscal 2016 first quarter and more importantly, how we are positioned to navigate the remainder of the year.

This actually should come as no surprise since we've spent several quarters implementing our strategy to make Delta a more nimble and responsive Company that as our first quarter has shown can operate profitably through a broad range of economic challenges. Over the past several quarters, we have improved our margins, reduced SG&A costs and dramatically improved operating profit, net income and earnings per share. Earnings for the trailing 12-month period, after excluding The Game, on the sale of The Game business totaled $1.20 per diluted share.

We are seeing positive momentum as we head into the spring selling season and we anticipate this will be reflected in our results for the March quarter and continuing to the back half of the year. We are transforming our Activewear business with new garments and fabrications to be responsive to current fashion trends. Snow heather fleece is one of our new fashion basics that's getting exciting response from retailers. We are also introducing a new racerback tank top along with several other new products in an enhanced color pallet for spring. Most of these products are internally produced, further leveraging our manufacturing platform. The expansion of our manufacturing operations in Honduras with open-width finishing is well underway. All of the equipment has been installed and we began production this month. We expect our investment in this expansion to yield additional savings of over $2 million, which will show up as about a $500,000 savings in our fiscal 2016 results.

In addition to the cost savings we achieve by leveraging internal capacity instead of sourcing this fabric, having this type of equipment in our facility provides us with the flexibility to venture into other fabric categories to meet the growing needs of our customer base.

Our first quarter saw Salt Life's growth return to its historical rate above 20%. There is much excitement around our new spring product line, which is shipping to retailers now. Based on our strong order backlog, our growth for the March quarter is expected to be even stronger. Salt Life's new distribution center, which we moved to Fayetteville, North Carolina, is now fully operational to support the anticipated growth of this business. Efficiencies gained from this transaction should become evident as we move through the remainder of this fiscal year.

We are looking forward to the opening of a new flagship Salt Life retail store in San Clemente, California this summer. We are excited to be putting our footprint in San Clemente, one of the most iconic surf and beach lifestyle towns in California. The store will showcase Salt Life's products to consumers and demonstrate merchandizing techniques for other retailers who carry the Salt Life line. In addition to the store in San Clemente, we'll also be retailing our Salt Life products on Abbot Kinney Boulevard in Venice, California with an in-store shop within our Junk Food store. Abbot Kinney Boulevard is an internationally renowned shopping destination, with fashion minded consumers who come there for new and distinctive products. We are uniquely positioned to have two great brands, Junk Food and Salt Life, that we believe offer products these customers are looking for.

While Junk Food's sales growth was modest during the quarter, the sales trends point to a strengthening Junk Food business model. During the December quarter Junk Food continued to trend at double-digit growth with specialty shops and e-retailers bringing it back to the heritage of the Junk Food brand. This strong growth was offset by reduced sales with one major retailer. Although this hurt our growth, the fact that we can more than offset the decline with a broadening of the customer base shows the strength of the Junk Food brand and its creative team.

The Soffe business, while not yet performing to our expectations did experience double-digit growth in the independent sporting goods channel, a great source of authenticity for the brand. Growth was also seen within category leading retailers including Dick's and a new consumer segment within Amazon. We continue to add sales personnel to reach new market segments and reengage dormant customers. We also continue to have success on our consumer website, soffe.com where we saw double-digit growth in the December quarter. The new B2B website that we mentioned last quarter is expected to launch in the coming month. This new platform will personalize the customer experience and better facilitate their business with Soffe.

Overall, we are encouraged about the momentum that we have been seeing in our business and the opportunities ahead of us for growth. We remain diligent on our cost controls, process improvements and other initiatives to further strengthen our bottom line. As Deb mentioned, we are continuing to repurchase our stock. We believe this is a great investment given our strong balance sheet, steady growth and the unrecognized intrinsic value we see in our Company much of which is intangible asset that do not show up in our book value.

Looking forward, we hope consumer spending on apparel improves in the near term, although realistically, we believe we will be operating in a weak economy and modest sales growth environment. The good news is we believe we have already taken the steps necessary to be able to continue to grow our business and operate profitably under these conditions. We expect our earnings in the March quarter will show strong improvement over the prior year's second quarter earnings adjusted for the gain on the sales of The Game business and we remain cautiously optimistic about the remainder of the fiscal year.

Operator, you can now open up the call for any questions there may be out there.

**Operator:**

Thank you. If you would like to ask a question please signal by pressing star, one on your telephone keypad. If you're using a speakerphone please make sure your mute function is turned off to allow your signal to reach our equipment. Again press star, one to ask a question. We will take our first question from Dave King with ROTH Capital Partners.

**David King:**

Thanks. Good afternoon, Bob and Deb.

**Deborah H. Merrill:**

Hi, good afternoon.

**David King:**

I guess, first off, congrats on a nice quarter. Then in terms of my questions, it looks like your private-label business was up pretty nicely or a little bit more than I expected this quarter, particularly given I think some of the challenges that maybe at, one of your key customers. Can you just talk about what might be driving that improvement? How you are feeling about your portfolio of customers at this point? Anything to be on the lookout for there?

**Robert W. Humphreys:**

Yes, so I'd say, private-label and customers who are asking us to do more value-adding processing, so screen printing, retail ready put up, etc., etc. is good. We had some questions going into this year about would we have growth there and I think our general answer was we didn't think so, because we were challenged capacity-wise last year. But we really got more business in our traditionally weaker time of the year. So that's allowed us to get ahead of that curve.

So we did have strong growth in private-label. The open-width finishing equipment will give us more capability for that going forward. Kind of phase one is to replace fabric we were buying on the outside. That will use about 40% to 50% of that capacity, but then it gives us additional capacity to expand that business and also to add new fabric capabilities that we can offer. So there is a number of things we think kind of driving that whole private-label platform, but all-in-all, it has been solid for us.

**David King:**

Okay and then is there anything to worry about in terms of specific customers? I mean, have you seen any – I think there is one customer in particular I think that had some challenges. So I am just wondering if you guys—have you seen any of that or you're just not expecting to see any weakness there at this point. It seems like it didn't show up.

**Robert W. Humphreys:**

Yes, I think, we are not expecting to see that and that's the business we actually have the longest order backlog in. So we tend to see that sooner than our (inaudible) business and we've got a longer than normal backlog than we would have this time a year and I think if you look at the customer base in totality, it's a very strong brand alignment and so those people are selling products.

**David King:**

Okay, that's great. Then, on the branded side, that looked really strong. I mean, I guess, apart from Soffe, maybe can you talk about that business a bit? How close you think you might beat to a bottom there? Especially from of the success that you are having in the independent channel and kind of like e-commerce as well. A little color on that would be helpful.

**Robert W. Humphreys:**

Yes, so you know, we are encouraged about the pieces of Soffe that I'll say, are associated with a more current economy and how consumers are ultimately getting product announced on our e-commerce site. It continues to grow. We had good growth last year and then comped that with nice growth in the December quarter. Their e-retailer business, those I think where consumers are buying online has grown nicely over the last couple of years. We've had good sell-through at some major national department stores and then when you look at a little bit more older economy business where Soffe used to be strong, that business is—continues to be difficult and I'd say the military business is kind of a flat business where trip levels are and what have you so.

But we are encouraged that the points that do align with how consumers are buying now, they are recognizing the Soffe brand and are buying that product and expect to start seeing some better sales comp out of Soffe.

**David King:**

Okay, interesting. That's helpful. Then, I guess, lastly from me, on the SG&A. I think the reduction there was really encouraging. Can you just talk about the big drivers there? Was that all driven by some of the cost savings initiatives that are ongoing? Then how should we be thinking about the run rate going forward?

**Deborah H. Merrill:**

I would say on that a couple of things. First, some of that is again continued improvement from the actions we took last year where not all of those actions had been taken all in the first quarter, but we got those all completed by the second quarter. So, some of that is attributed to that, and to some extent, with The Game business in operations last year had some SG&A costs that we were able to take out with the sale of that business. On an ongoing basis, I would say that that we have ongoing just regular cost control initiatives in place. No big additional initiatives, but just ongoing, watching those costs and as we can drive some top line growth, we'll be able to leverage that base of fixed cost that we have and continue to see percentage-wise improvements in our SG&A.

**David King:**

Okay, that helps. Thanks very much and good luck for the rest of the year.

**Deborah H. Merrill:**

Thank you.

**Operator:**

Once again, ladies and gentlemen, if you would like to ask a question, please press star, one. We'll now go to Jamie Wilen with Wilen Investment Management.

**Jamie Wilen:**

Hi, great quarter fellas. Given you're expecting top line growth for the remainder of the year and you said your production levels are going to be higher. Would you expect gross margins to be moving up from these levels? You had a nice gross margin improvement in the quarter but, where do you think that will shake out for the year?

**Robert W. Humphreys:**

Yes. Gross margins should continue to slightly increase with the things that you said and the seasonality of our branded business, which will get into their stride in the second and third quarter.

**Jamie Wilen:**

Okay, and then on the flip side, your SG&A as a percentage of sales, you are expecting to keep them—keep SG&A dollars kind of in check and continue to be a falling part of—as a percentage of sales, correct, there too?

**Deborah H. Merrill:**

That is correct.

**Jamie Wilen:**

Okay, fantastic. The buyback program that you have, you only bought back 60,000 shares in the quarter. Why so little and have you bought back any subsequent through the end of the quarter?

**Deborah H. Merrill:**

We have bought back; we have continued to repurchase our shares and we anticipate repurchasing through the remainder of the year. Certainly, we balance that with other needs within the business and we certainly don't want to make that over powering and potentially hinder other areas. But we do expect to continue that repurchase through the remainder of the year.

**Jamie Wilen:**

Okay, could you tell us how much you repurchased subsequent to the end of the quarter?

**Deborah H. Merrill:**

We don't. That gets reported at the end of each quarter. So we are really not releasing post-quarter end information. But it has continued since then.

**Jamie Wilen:**

So you are basically purchasing on a daily basis whatever you can?

**Deborah H. Merrill:**

That is correct.

**Robert W. Humphreys:**

Yes, and we do that under the Safe Harbor program which when you follow all those rules, it limits how much you can purchase in any one day.

**Jamie Wilen:**

Got you. On the Salt Life side, where is the—you've got 20% plus growth, where is it coming from? Is it geographical regions? Are you—is it a certain blend of retailers? Have you picked up any national accounts or is it just kind of evenly spread throughout the world?

**Robert W. Humphreys:**

Well, I think there is two or three drivers. One is kids' products where we expanded our product line. That's been a big driver of the growth. I think our marketing programs, like for example, in December, I think there were 780,000 minutes watched on the Salt Life channel.

Our Facebook page continues to grow, Twitter, what have you. So we are continuing our consumer engagement and that's allowing more products to be sold in existing doors. We continue to do these store build-outs that we've been speaking about where pre-build out is Salt Life products displayed for sale and post build-out there's nice fixtures and there it's more orderly and we see a big pop in sales where we do that. So it's a combination of those things. We've got a great spring line, certainly, the largest order backlog we've ever had in Salt Life's history. We've got new retailers coming on board. We've got a national retailer that's going to open some doors this spring in California.

We had our Stand Up Paddleboard Championship in California last fall, I guess, it was late summer and that got a lot of notoriety out there. We had product for sale. We sold out quickly. So I think that's helping getting a little traction in California. So and I'll have to say that, the fastest growing piece of it is on saltlife.com, our e-commerce business is on fire.

**Jamie Wilen:**

Okay, and opening up a retail store on the West Coast, on the East Coast, you have and you kind of used it as a way to bring new retailers in to show what they could do in addition to having hopefully profitable stores. Is that the same goal in the west coast?

**Robert W. Humphreys:**

Exactly.

**Jamie Wilen:**

Okay.

**Robert W. Humphreys:**

Our Head Designer for Salt Life actually lives in San Clemente and we are going to probably have some visual design studio stuff. We'll have some fun, interesting, interactive stuff there. But we think it will do fine as a retail store and then again showing how to merchandize and display products for the West Coast customer and also get feedback and make sure that we have the right product, aesthetics designed and fabrics and all that they are looking for.

**Jamie Wilen:**

Okay. You're not going to have a bunch of retail stores, because I assume you don't want to compete with your retailers?

**Robert W. Humphreys:**

Well, that's true. That's part of the story. We are not currently in the retail business other than for branding purposes. Right now, California is a big state and we don't have enough retailers out there. So I don't think we really have a problem with competing with them and in fact most of them would probably encourage more retail stores, by us just to help as a brand building exercise. We really think that the California market is a great kind of omni channel market for Salt Life where we are getting some notoriety. We have a lot of customers coming to our e-commerce site. So if over the next few years we have seven to 12 strategic stores that are helping build the brand and paving for themselves and supporting that omni channel marketplace it will be beneficial to us.

**Jamie Wilen:**

Excellent, and from what you've learned at Salt Life, you get incredible bang for the buck in your marketing program online. How do you translate that or are you translating that to Soffe, to Junk Food, to your other brands?

**Robert W. Humphreys:**

Well, we are certainly sharing ideas and learning from what happens with the Salt Life products. So we actually have our annual meeting this week in Duluth. We've got our leaders from all of our business units and for more cross-pollination on those things. So we continue to learn, we got in a little over a year ago a head of our e-commerce marketing, which has been a huge hit for us and has really helped learn best practices and lever how to get consumers to our e-commerce sites and further build that consumer engagement.

**Jamie Wilen:**

Okay, last two questions. Art Gun, you talked about, you've kind of had too much demand during the fourth quarter. So the business was a little challenged. How will you overcome that? How much growth is there? Are you now positioned manufacturing capability wise to be able to handle an expanded business and enjoy additional profits from that?

**Robert W. Humphreys:**

I'm going to let Deb take that one.

**Deborah H. Merrill:**

Yes, Jamie, I think that you are right. We were challenged by having more business in a very short holiday period that encompasses about a three week period where we will work to run three to four times as much through that facility as we do for the remainder of the years. So that—for the remainder of the year and so that creates a challenge in being able to lift up back quickly to support those sales in that limited period of time and that's where we had some growing pains as our business has grown and then we've been expected to grow it that much quickly over that short period of time. So we certainly had some lessons that we've learned. We've put things in place already in anticipation of continued growth and being able to service that in the holiday season next year. I think we've got a broader base of customers that we gained throughout last year, and continue to gain new customers already in January so far. So I think that there is a lot of growth opportunity in that business.

When you are running one-off shirts, customized product throughout that facility, and as many as we do run, you've got to be all prepared for that and on target with that. We believe that we have put the things in place to be able to grow throughout this rest of this fiscal year and be prepared for next year's holiday season.

**Robert W. Humphreys:**

Couple of things to add to that, Jamie, that I think are important and kind of exciting, one is, it's amazing to me that every one of those orders is a complete e-commerce transaction. There is no stores anywhere, and when you add it all up it's gotten to be a lot of revenue kind of "at that retail level to that customer." So it's just fun to see that and it's fun to be a part of that and learn more about the e-commerce world. Then secondly, our partners and us are learning how to sell more to those consumers in the non-holiday season. So they've learned how to promote their products, have special items and special sales. So I think we are going to see less seasonality in that business as we continue to mature it.

**Jamie Wilen:**

Art Gun will be a $15 million business this year?

**Robert W. Humphreys:**

Should be.

**Jamie Wilen:**

With operating margins in double-digits.

**Robert W. Humphreys:**

Yes.

**Jamie Wilen:**

Okay. Excellent, outstanding results. Well done, fellas. Thank you.

**Robert W. Humphreys:**

Thank you.

**Deborah H. Merrill:**

Thanks.

**Operator:**

Once again it is star, one to ask a question. I'm showing no additional questions at this time.

**Robert W. Humphreys:**

Okay, well, thank you all for joining us and we'll look forward to discussing the March quarter in just a few months. Thank you.

**Operator:**

This concludes today's conference. Thank you for your participation.