Delta Apparel, Inc.

Fourth Quarter Fiscal Year 2012 Earnings Conference Call

September 5, 2012

Operator:

Thank you. And good afternoon to everyone participating in the Delta Apparel, Incorporated Fourth Quarter Fiscal Year 2012 Earnings Conference Call. Joining us 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 and other forward-looking statements may be made by Delta Apparel's executives. Such 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 Form 10-K. This document contains and identifies important factors that could cause actual results to differ materially than those contained in the projections and 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 call over to Delta's Vice President and Chief Financial Officer, Deb Merrill, who will provide the detail of the Company's fiscal fourth quarter.

Deb Merrill:

Thank you. As you read in our press release, Delta marked its ninth consecutive year of record revenues in fiscal 2012. We're very proud of that achievement especially considering the huge challenges that we face throughout the entire year. What we had predicted as early as our first quarter that we would reach a new record for annual sales, we did so with a proviso that certain conditions would make that goal difficult to achieve. Those conditions included higher energy and transportation cost, a very weak and sluggish economy, and most challenging, extreme volatility in the price of cotton. Although net sales increases and expanded market share in several of our divisions enabled us to maintain our record of revenue growth, they were not enough to entirely offset the negative effect these conditions had on our bottom line. Needless to say, we're not happy with that.

While net sales for the 2012 fiscal year increased approximately 3% to 489.9 million from 475.2 million in fiscal 2011, we had a net loss for the year of 2.4 million or $0.29 per diluted share. This compares to net income for fiscal 2011 of 17.3 million or $1.98 per diluted share. The net loss was primarily due to the 16.2 million inventory markdown in our Basics segment, which we took in the second quarter, and aggressive action to get ahead of the negative effect that cotton prices were having on our industry. Gains and net sales for the year, which occurred in both our business segments, were primarily driven by record revenues in The Game, Junkfood, FunTees and Art Gun businesses. These were somewhat offset by Delta Catalog and Soffe businesses, which continued to feel the effects of cotton price volatility and customer destocking.

Branded segment sales for fiscal 2012 advanced to 235.2 million, a 6.1% increase over 2011 sales of 221.7 million. The Game and Junkfood both registered strong sales gains of about 25% over the previous year's sales. Art Gun, while currently representing less than 1% of our total sales, grew over 200% year-over-year. Revenues in our Soffe brand, being challenged by the department store channel, declined about 9% during the year.

Net sales for the Basics segment were 254.7 million in fiscal '12, compared to 253.5 million in fiscal 2011. The slight increase was driven by the private label business, which grew almost 20% during 2012, offset by a decrease in the Catalog business during the fiscal year.

The FunTees business enjoyed solid profitability improvements resulting from the new customer gains and improved manufacturing performance. Cotton price volatility and inventory destocking, which negatively affected net sales in the Catalog business, also caused significant margin erosion in that business. Despite this, units shipped in our fourth fiscal quarter were up 8% over the same period in 2011, and we're seeing that trend continue in fiscal '13.

While cotton prices fell to more normal levels in the fourth quarter, some residual effects still remained. Increased retail prices, reflecting the high cost of cotton earlier in the year, hampered sell-through, and department store inventories have not reduced as rapidly as expected. Therefore, replenishment orders were lower than anticipated for the fourth quarter, primarily in the Soffe product line.

For the fiscal '12 fourth quarter, net sales were 135.4 million, compared to 137.6 million in the 2011 fourth quarter. Net income for the quarter was 4.8 million or $0.55 per diluted share, compared to 8.5 million or $0.97 per diluted share in the fourth quarter of 2011. Sales in the Branded segment were 57.9 million in quarter four versus 60.6 million in the 2011 fourth quarter. The good gains experienced by The Game, Junkfood and Art Gun in the recent quarter were offset by the previously mentioned softness that continued in the Soffe line. Basics segment sales for the 2012 fourth quarter were up slightly to 77.5 million from 77.1 million in the prior year fourth quarter. The results were due to excellent gains in the FunTees business offset by lower pricing in the Catalog business.

SG&A expenses as a percent of sales improved both in our 2012 fourth quarter and full fiscal year. SG&A was 17% of sales for the quarter, compared to 18.8% in the prior year period. For the full year SG&A was 18.4% of sales, compared to 19.3% in the prior year.

We had tax benefit in our fourth quarter of 1.8 million driven from the reduction in our overall effective tax rate for the full year is up 76.4%. The tax rate was impacted by the inventory markdown during the year, lowering our U.S. taxable income while maintaining profits in the offshore taxable and tax-free jurisdiction.

Capital spending during the quarter was 1.5 million which brings the total to 7 million for the full year. Depreciation and amortization, including non-cash compensation, was 2.5 million in the quarter and 9.2 million for the full year.

Total debt at June was approximately 114 million. That represents a reduction in total debt of about 18 million during our fourth quarter, slightly better than the 15 million reduction we projected at last quarter's conference call. We expect our debt levels will continue declining during the upcoming fiscal year. We remain committed to strategically reducing the capital used in the business to improve return on capital and reduce the leverage on the business. That being said, we will invest strategically in opportunities that may arise to further grow our business.

We continued our open market stock repurchases. During the fourth fiscal quarter we purchased 25,000 shares for a total of $354,000. As of the fiscal year-end, we had 5.8 million remaining authorized by our Board for stock repurchases. Our decisions regarding repurchases are based on a number of factors; including current leverage, stock valuation, and future business opportunities for the capital.

During fiscal 2012, Delta's profitability was diminished by high cost cotton and other unusual costs that we voluntarily incurred to better position the Company for the future. Most of this is behind us now, and as the retail marketplace continues the rationalization of inventory and begins to replenish, we believe that we will return to the earnings track on which we had been running through fiscal 2011.

I'll now turn the call over to our Chairman and CEO, Bob Humphreys, for some remarks on the previous year and strategies going forward.

Bob Humphreys:
Thanks, Deb. I'm very pleased Delta was able to deliver yet another record sales year and take important steps to position ourselves for continued growth in the future. Unfortunately, the volatility in cotton prices and disruption this caused in retail markets and ultimately consumer demand, didn't allow us to meet our profit objectives for the year. But now as market demand and raw material cost return to more traditional levels, we anticipate renewed growth and stronger margins in both of our business segments in fiscal year 2013. Rest assured, we are not simply waiting around for conditions to improve, but rather, various strategies have been initiated and other aggressive plans are being—under evaluation to better leverage our business and accelerate our growth. For example, during fiscal 2012, we completed moving all of our branded business to the same ERP system; as a result we are experiencing improved service efficiencies in apparel ordering, warehousing and distribution processes.

We expect to also benefit from lower IT cost over time. In 2013, we will be completing additional IT initiatives to streamline our systems and add (ph) a strong B2B platform for our Soffe customers. Many other strategies we initiated during 2012 fiscal year should accrue benefits through 2013 and beyond. In the past year we began moving the FunTees private label business on to our existing software platform used in the Delta Catalog business and expect to complete the conversion in the first half of fiscal 2013. This consolidation will allow us to better manage our inventory flow and gain further synergies which should improve our operating margins.

We expensed almost $2 million in the second half of the fiscal year to balance manufacturing capacity with demand; although our unit sales of undecorated tees were up over 8% from the fourth quarter of the prior year and unit sales at FunTees were up over 10% in the prior year. These curtailments allowed us to reduce our inventories in an orderly manner, free up excess working capital, reduce our commitment to higher cost cotton and better position us to meet our objectives for fiscal 2013.

We are also in the process of moving several (inaudible) of the private label business through our El Salvador facility to better serve customers through an enhanced and efficient process development process. Concurrently, we are further modernizing our decoration equipment with the objective of expanding capabilities while lowering our production cost. We believe the cost of these initiatives, much of which were recognized in the third and fourth quarters of 2012, will be more than offset by the long term benefits and efficiencies that will begin to be realized in fiscal year 2013.

While Soffe had strong shipments to the military channel in our fourth quarter, we were disappointed in the replenishment business from our retail partners, especially in the department store channel. Some of this was caused by the general difficulties in the mid-tier market combined with higher cost products working their way through the supply chain to the end consumer. We see this channel being challenging for some time to come and are taking steps to expand our sales management and merchandising expertise to better service this market and develop business channels previously unserved by Soffe. In the upcoming year, we expect to further invest in our Soffe brand as well as other sports related brands of Intensity and XT46.

Despite the challenges of 2012, we saw positive results in several of our businesses. The gain driven by our Salt Life business and increased shipments of motorsports related products recorded strong sales gain and improved profitability. Junkfood also turned in excellent performance and achieved record revenue driven primarily by strong branding activities and continued growth in our sports licensed products. In addition, the Art Gun business achieved excellent gains tripling net sales for the year with vastly improved margins both in the fourth quarter and for the full year. FunTees made great strides during fiscal 2012 reporting record sales and operating profits for the year.

We're also encouraged with the performance of our Salt Life store that was opened in Jacksonville, Florida in May. It's performing well and meeting our goal of providing a ground zero location for Salt Life where consumers and our retail partners can do the—and see the product's merchandising away (ph) that tells the Salt Life lifestyle story.

Looking ahead to 2013, we believe cotton prices have stabilized somewhat and there should be an abundant world supply of cotton over the next year. Therefore, we are remaining short on future cotton commitments in order to remain in the most flexible position possible regarding future raw material cost. While demand was tempate (ph) during our fourth quarter of fiscal 2012, we have seen solid sales for most of our products as we begin fiscal 2013 and expect to achieve record revenue in 2013 despite the need to comp higher selling prices from the prior year that were driven from higher cotton prices.

Our inventories are well balanced and we're making continued progress on our commitment to improve service levels across the many markets we serve. While we are still operating our manufacturing facilities at less than full capacity, we made further efficiency gains over the past year which we believe will improve operating margins as we progress through the next quarters.

We also anticipate margin improvement as we gain traction with our strategies of leveraging our creative talent and retail relationships across our various operating units. We estimate that our capital spending in 2013 will be on par with fiscal 2012 at about $7 million; most of which will focus on screen print modernization and expansion, branding and point of sales displays for branded products.

Our objective for 2013 is to achieve organic growth in all business units and we believe we are well positioned to do so. Our product development, merchandising and marketing efforts combined with our diverse customer base across many channels of distribution will be the catalyst that should help us achieve this goal and drive us towards a 10th consecutive year of record revenue. I feel confident that Delta will make significant gains in fiscal 2013 but since there are many unknowns that are outside of our control we remain cautiously optimistic.

By way of guidance, we believe Delta will reach the milestone of over $400 million in sales with an expected range of 500 to $510 million in net sales for fiscal year 2013. Net income should be in the range of $1.65 to $1.80 per diluted share. We expect a strong start to the year with record sales in our first quarter and earnings in line with what we achieved in last year's first quarter which was also a record for our Company. While we're delighted to see a strong start to the year, we have some amount of flexibility built in our plan to manage through the choppy economy and weak consumer demand that has been with us for some time now.

Kevin, at this time I'll turn it back over to you and open up for questions.

Operator:
And ladies and gentlemen, if you'd like to ask a question at this time, please press star, one on your phone. If you are using a speakerphone, please make sure your mute function is disabled. Again, it's star, one if you would like to ask a question. And we'll pause for a moment to give everyone a chance to signal.

And once again, it is star, one if you have a question. Star, one.

And we'll take our first question from Jamie Wilen with Wilen Management.

Jamie Wilen:
Hi, fellows. First—I want to sort of start with the thing you said at the end, the first quarter coming up off fiscal 2013 you expect bottom line to be near the record levels of last year?

Bob Humphreys:
That's correct.

Jamie Wilen:
Okay. On similar volumes (cross talking)...

Bob Humphreys:
Well...

Jamie Wilen:
Higher volumes with lower pricing?

Bob Humphreys:
Yes, slightly higher sales dollars, higher unit sales, lower average selling prices.

Jamie Wilen:
Okay. Yet, your forecast doesn't really maintain that same type of level moving forward. Any particular reason why you expect the first quarter to be so strong and then so cautious beyond that?

Bob Humphreys:
Well, as we sit here today we're, you know, eight, nine weeks through our first quarter so obviously that gives us some visibility and we have been encouraged with demand for our products and our customers' enthusiasm. And then I'd say, you know, outside of that it's just general concern about the economy and fuel prices and that sort of thing that we have seen create, you know choppy times for us over the last, you know, couple of years and we do have some downtime built into our forecast so that we could take out production if we need to to balance our inventories.

Jamie Wilen:
Okay. As—given the level of volume, where would be the ideal inventory level for you to end fiscal 2013?

Bob Humphreys:
No, I don't think we're really prepared to talk about that right now, Jamie, and we—you know, really it varies so much by business and we'd want to maybe go through that a little bit more carefully.

Jamie Wilen:
Okay. Within the Soffe business, the volumes declined because you—the prices had been raised and have you lowered the prices on Soffe? What are the dynamics within that market right now that are changing so much?

Bob Humphreys:
Yes. Well, you know, I think we're still analyzing that and, you know, challenging ourselves about why our volume did decrease the way it did. Clearly, you know, prices were higher to the end consumer through retailers, you know, this spring. Other major brands have told us that they saw demand for their products deteriorate when those higher products actually got, you know, to the retail floor. But, you know, I don't think—we're just taking that as the gospel and, you know, we're looking internally at what we can do better from a, you know, a merchandising or product development or what have you to make sure we've got our best foot forward there. You know, we are changing some pricing around on products that we feel like can help accelerate their volume.

Jamie Wilen:
Has your sell through been consistent through various market segments or have others fared worse or better than...

Bob Humphreys:
No, it's been the weakest in national department stores.

Jamie Wilen:
Okay. Are there other areas where the replenishment cycle has been strong?

Bob Humphreys:
Well, I wouldn't say strong but stronger and, you know, on par with the prior year.

Jamie Wilen:
Okay.

Bob Humphreys:
And on different segments used replenishment to different levels, so I don't know that that's, you know, a complete apples-to-apples comparison.

Jamie Wilen:
Is your store (inaudible)—I mean, your still in the same number of doors in stores in Soffe, it's just more the reordering has not been as strong?

Bob Humphreys:
Yes, that's true and probably, you know, net-net in more doors, you know, where we've had some pickups. You know, you're continually adding product in different departments and sometimes a department goes away so again it's a little bit hard to quantify in exact numbers.

Jamie Wilen:
Okay. On the Salt Life side, can you talk about the—what percentage increases you had during the fiscal year, what you expect in the current one and the number of doors you're in to start 2012 to end 2012 and where you think you'll be in 2013?

Bob Humphreys:
Yes, I don't think we have that exact data on, you know, on—right at hand, Jamie. We are in a big increase in doors. We've got a large regional department store that we're in over 200 doors now, we've got several regional—major regional sporting good stores that we're in, you know, 50 to over a hundred doors in one case, so that roll-out has been, you know, very good. We recently hired someone for our West Coast to start seeding (ph) the brand out there and, you know, expect to start gaining traction on the West Coast some time during fiscal '13.

Jamie Wilen:
Okay. Who was that large regional with 200 doors or can you not tell us that?

Bob Humphreys:
Yes, I don't really want to speak for them.

Jamie Wilen:
Okay. Okay. And then, lastly, back to Soffe. You mentioned that you're going to go after some very—some business channels that previously were underserved or not served at all by the Company, what are those channels that you're going to go after now?

Bob Humphreys:
Well it's a specialty market. You know, the regional units that are going after the teen customer and probably more West Coast based and we've had some preliminary discussions with them, there were some products we had that they were interested in and we recently brought someone on board to focus on that and develop that business for us. We think we have some good relationships primarily through our Junkfood business so, you know, we hope (inaudible) could be some upside business for us.

Jamie Wilen:
Okay, I'll hop back in the queue.

Deb Merrill:
Jamie, Jamie.

Jamie Wilen:
Yes.

Deb Merrill:
I will speak just briefly on your inventory question. I mean, we do expect inventory levels to decline over the next—you know, over—during fiscal '13. You know, I would say, you know, in the range of about 10%, you know, upper single-digit declines in that inventory balance both from some expected lower cost in that inventory and some lower units in certain business units.

Jamie Wilen:
Okay. So a 15 to $20 million decrease in inventory would be your target for the current fiscal year?

Deb Merrill:
I would say that'd be in the range of it, yes.

Jamie Wilen:
Okay, great. Thanks.

Operator:
And once again, it is star, one if you have a question at this time. Star, one if you have a question.

And again, star, one. And we'll take a follow-up from Jamie Wilen with Wilen Management.

Jamie Wilen:
Okay. Yes, I'm—your gross margins for 2012 you previously said were 18.4%—or, no, that was your SG&A. What were your gross margins for 2012?

Deb Merrill:
Seventeen point one percent.

Jamie Wilen:
Seven—and, you know, obviously you're targeting to be a lot higher over time, but where would your target be for 2013? Are you capable of, with the volatility of cotton prices, to be able to shoot towards something this year?

Deb Merrill:
I would just say that we're shooting to be more in line with where we were in fiscal '11 which was 24.5%. We might—you know, in that range, but certainly closer to that coming from the 17% in 2012.

Jamie Wilen:
Okay. And the—more of the increase is going to come from the basic tees or the branded tees?

Deb Merrill:
I'm sorry, say your question again, Jamie?

Jamie Wilen:
Is more of that increase in gross margin going to be coming from the branded tees or the basic tees in 2013?

Deb Merrill:
Basically coming in our Basic segment because fiscal '12 is where the majority of the cotton cost impact hurt our margins in 2012, so that increase is primarily going to come from the Basics segment.

Jamie Wilen:
Yes. And where has pricing been in the last month or two on the Basic side? Where have the industry leaders pointed the direction?

Bob Humphreys:
Yes, you know, they're down about 15% from, you know, this time last year and, you know, have been steady to maybe even inching up a little bit, you know, over the last eight to 10 weeks. And I'd say overall it seems that supply and demand are in pretty good balance and, you know, people have the cotton situation behind them and are working through, you know, in an orderly manner.

Jamie Wilen:
And the industry dynamics with AnabelB (ph) and BOD (ph) by Gildan (ph) and the new plants that Alstyle (ph) have, I mean, how would you assess the state of the industry within that consolidation and the change in manufacturing locations?

Bob Humphreys:
Yes. Yes, I think there's been other changes maybe in overall participation by different players, but again I'd say as we sit here it's probably as orderly as we've seen over the last several years where, you know, it appears that overall demand and overall capacity is in pretty good balance. Now, obviously that can change if people, you know, (inaudible) plants, change running schedules and what have you.

Jamie Wilen:
Okay. And lastly, you've been able to successfully build on to your business with some acquisitions at advantageous times and prices and product lines, what's the outlook out there currently especially given the, you know, the relative turmoil with cotton prices over the last year? And are there things out there for you to take advantage of and how is the pricing on those guys?

Bob Humphreys:
You know, there are things out there. So far, you know, the things we've seen we'd probably disagree on their valuation of it which has occurred on just about every acquisition we've done. You know, sometimes you just have to wait around and see. So, you know, we'll see, and obviously take a look at that. At the same time we do feel good about some of our organic, you know, opportunities that we have. We feel good about some internal brands that we already own that we want to make sure we're investing in them as we would, you know, acquiring a brand as well.

Jamie Wilen:
Okay. So the bottom line is strong start to the year but you're just cautious about the industry outlook given the economy and cotton prices as you look forward beyond the first quarter.

Bob Humphreys:
That's correct.

Jamie Wilen:
Okay. All right. Thanks, fellows. Appreciate it.

Bob Humphreys:
Okay. Thank you.

Deb Merrill:
Thank you.

Operator:
And that does conclude our question-and-answer session. And now I would like to turn the call back over to Bob Humphreys and Deb Merrill for any additional or closing remarks.

Bob Humphreys:
Okay. We appreciate everyone joining our call and we'll look forward to speaking to you in a couple of months about our first quarter results. So, thanks so much.

Operator:
And once again, that does conclude today's call. We do appreciate everyone's participation.