Delta Apparel, Inc.

First Quarter Fiscal 2015 Results Conference Call

February 5, 2015

CORPORATE PARTICIPANTS

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

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

PRESENTATION

Operator:

Thank you, and good afternoon to everyone participating in Delta Apparel Incorporated's First Quarter Fiscal 2015 Results 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 this call is being recorded, and 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 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 and 10-Q. These documents contain and identify important factors that could cause actual results to differ materially from those contained in the projections of 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 CFO, Deb Merrill, who will provide the details of the Company's first quarter fiscal 2015 results.

Deborah H. Merrill:

Thank you and good afternoon. While our fiscal first quarter was not what we would have liked it to be, it was about what we expected given the persistent softness in the retail environment and pricing pressures on the commodity products. Net sales for 2015 first quarter were 93.4 million, versus a 100 million for the comparable 2014 period. Although higher gross margins in the Branded business and lower selling and general and administrative costs helped offset some of the revenue weakness, we still experienced a net loss for the 2015 first quarter of 4.2 million or $0.53 per diluted share compared to the net loss in the prior year's quarter of 1.6 million or $0.20 per share.

Net sales for our Basic segment were 57.7 million in the first quarter, a decrease of approximately 8% from 62.5 million in the prior year period. The declines stemmed from lower prices on reduced unit sales in the undecorated tee business, which has been impacted by continued price discounting resulting from the weak demand in the marketplace. New programs were won in the private label business, which should drive strong sales growth as the year unfolds.

Art Gun having successfully installed state-of-the-art digital printing equipment in the prior quarter, achieved 4% unit growth during the current quarter, but revenue was hindered as customers transitioned to different price point garments. Our Branded segment had net sales of 35.7 million for the first quarter compared to 37.5 million in the prior year period, a 5% decline. Salt Life continued its excellent performance with 15% growth in what is typically its weakest quarter. Salt Life currently has a substantial spring order backlog indicating that it will experience even stronger growth rate in upcoming quarters. Our other branded products experienced lower unit sales, as the apparel retail market continues to struggle with the unsettled economy and changing consumer buying trends.

While Soffe still faces challenges from the soft retail market, we believe that its new spring merchandise, along with its upcoming marketing initiatives will result in sales growth for the year. Junkfood experienced strong growth in its specialty sales channel, but this was over shadowed by continued weakness with one of Junkfood's large retail customer groups.

SG&A for the fiscal 2015 first quarter was 18.5 million, a 6.6% decrease from 19.8 million in the prior year quarter. The decrease is the result of the strategic cost restructuring completed in the fourth quarter of fiscal 2014 and tighter spending control, offset to some degree by higher marketing expense for Soffe and Salt Life brands. Despite the lower sales in the 2015 first quarter, SG&A expenses were 19.9% of revenue, consistent with the prior year first quarter, providing further evidence of the lower fixed cost structure the Company has implemented.

Capital spending during the quarter was 2 million and depreciation and amortization, including non-cash comp was 2.4 million in the quarter. Total debt at December was a 130 million, flat with September and down 2.4 million from a year ago. Our stable debt level is due to lower capital spending and tight inventory control. In that regard, we did not have any dramatic increase in our inventory level, as it was up only about 1.4 million from the prior year. Having managed our inventory levels well allows us to start selling lower cost inventory sooner, which should benefit our gross margins in the second half of the fiscal year. During the quarter, we did not repurchase any additional Delta stock, however we will continue to evaluate that strategy against current circumstances going forward.

Given the unsettled conditions that currently exist in the apparel industry and the soft economy we're not ready to resume our practice of providing guidance, except to say that we believe the steps we have taken should ultimately result in sales expansions as well as improvement in our profitability. We are continuing to unfold the implementation of our strategic initiatives that we outlined last year and anticipate further progress in subsequent quarters.

Our Chairman and CEO, Bob Humphreys will now provide more detail about the state of our business and initiatives. So, I will now turn the discussion over to him.

Robert W. Humphreys:

Thanks Deb and thank you all for joining us on our conference call. We have been hard at work across Delta Apparel working on key initiatives that should prove positive for our results as the year unfolds. I want to walk you through some of these key points and why we believe we are positioned for growth and profitability.

Recently, Delta Apparel took decisive action to reduce our fixed cost structure within the organization and you can see the positive impact of that in this first quarter. Our administrative headcount reduction is now complete. During the December quarter, we saw a $1.5 million reduction in salary and benefit costs from this initiative, and on an annualized basis this is well over $7 million in savings.

We have recently implemented additional initiatives within our selling cost and our benefit structure that should reduce cost by another $1 million annually beginning in our second quarter. While we have always tried to keep a focus on our spending controls, we have increased that diligence to ensure we are spending in the right areas and to grow the business profitably and eliminate spending on non-critical areas. After a number of years of operating with increasing input cost; energy, transportation and raw materials, we are now seeing declines based on the drop in oil cost and weaker global demand. While these lower costs are expected to be passed along, at least to a certain extent in commodity products, we should benefit from these areas in the specialty and branded products as the year progresses.

Over the past year we've made investments in our manufacturing platform to provide us with the capacity to meet current and future requirements. We've increased the output in our Honduras textile and sewing facilities and decreased our US textile production and Mexico sew output on basic products to leverage our lower cost plants. Our Honduran facilities are poised for further expansion as demand dictates, which would significantly lower cost on incremental units.

Our El Salvador and Mexican sew and print facilities that primarily service our private label products ran well ahead of planned output and at record levels during the December quarter. We are further leveraging our manufacturing facilities as an ever-increasing percentage of our branded products are now being produced on our own manufacturing platform. Each of our brands are using our internal production to varying degrees to meet their business requirements, allowing us to leverage our manufacturing overhead and take further advantage of lower energy and raw material cost. Efficiencies in cost in our manufacturing plants improved during the quarter being partially aided by lower energy cost. These lower product cost should positively impact our gross margins in the second half of the fiscal year.

In our Basic segment, demand for undecorated tees started the first quarter better than expected, but tapered as the quarter progressed. Demand was particularly weak in December due to pricing uncertainty. Pricing seems to have stabilized a bit but time will tell how pricing holds through this important spring selling season. We have developed and introduced a number of new products in the undecorated tee market that are shipping this spring. Our customers are excited about these offerings and has placed strong pre-books for shipping in the coming months.

Our French terry and fleece product line that we introduced last season did well and we chased inventory throughout the season. We are now positioning ourselves with a stronger inventory position to service this line of business and anticipate strong growth as this year progresses. Our private label customer base continues to expand and we win new business based on service levels, our quality and speed-to-market. We ended December with a large increase in work-in-process on private label goods, which will drive increased shipments in our second quarter. Based on our order backlog, we anticipate strong running schedules for the next several quarters on our private label products.

At Art Gun, we had another successful quarter. Over the last several quarters, we have continued to not only grow with existing customers but also to expand our customer base. In the last several months, we have upgraded the Art Gun facility with the newest technology in digital equipment, which allows us faster printing speeds and much higher print quality. Art Gun is uniquely positioned to offer its customers a broad base of garment options at the best price points available. We expect further transition to Delta products as the business evolves.

Now, moving onto our Branded segment; we have our key Management team fully in place at Soffe with leaders who are well experienced in the markets where we participate. In December, we completed our transition to a new ERP system, which affords Soffe greater efficiency and improved customer service, while also reducing its staffing and technology cost. Soffe is now operating with a much lower fixed cost structure.

The new military short is shipping well and we expect solid growth in the military business during the remainder of the fiscal year. There has been positive feedback from retail partners on Soffe's spring merchandise. This product should be on the retail floor in the coming weeks. We are regaining some of the lost floor space at mid-tier retailers and expect this progress to continue in the coming quarters. In addition, Soffe is gaining additional retail space at several key strategic sporting goods accounts. Soffe is launching a new marketing campaign to support a refined brand message. The campaign includes targeted consumer outreach efforts and to drive digital engagement and loyalty with Soffe's core consumers. Sales on the Soffe website are growing nicely and we will continue to focus on expanding this sales channel. The e-commerce site also gives us a nice vehicle to engage directly with the Soffe consumer.

Junkfood continues to be sought after for its creativity by customers and license owners. Junkfood has been selected as one of the NFL partners to participate in special marketing activations and product capsules associated with the upcoming 50th Super Bowl in February of 2016. Business within one of Junkfood's large retail customer remained soft in the December quarter, but we have indications pointing to modest improvement within this channel for the upcoming quarters. Junkfood continues to see strong growth within its other sales channels, particularly within vertical, specialty and mass market retailers.

Our flagship Junkfood stores are meeting our expectations from a marketing and brand building standpoint and revenues continue to grow each month. Consumers are also seeking out Junkfood on our website, which reached record sales levels in the December quarter followed by record sales in January.

The sales momentum on the Salt Life brand continues to expand. We started our second quarter with a strong backlog of orders for spring merchandise, which has now began shipping. We expanded our consumer marketing during the quarter. As part of this, Salt Life has partnered with Made in Network to launch the Salt Life YouTube channel. This will showcase both original and aggregated content that embodies living the Salt Life. The first two original features have just been released and focus on Salt Life's involvement with the Baja 1000. We expect this channel to go live in April.

We continue to add more professional athletes and musicians to the Salt Life roster. We just added innovative surfer and musician Timmy Curran as a Salt Life team ambassador. In additional, Salt Life is sponsoring the stage at this year's Hangout Fest in Gulf Shores, Alabama. This music festival attracts over a hundred thousand people and is covered by several music networks. Of course, we also have our successful Salt Life retail store and licensed Salt Life restaurant that continue to bring the Salt Life brand to the daily lives of consumers. We are excited about our new launch of our Salt Life website in March. The new site will leverage the digital media campaigns and offer an improved consumer experience.

We recently completed a consumer survey and we are overwhelmed about the responses we received. First and foremost, they love the products and want more of them. The survey also confirmed that consumers have a strong lifestyle affiliation with the Salt Life brand.

Consumer demand is driving retail door expansion for the Salt Life business. More independent retailers desire to carry the Salt Life brand and our national and regional retailers are expanding the in store shops and fixtures with Salt Life and we are getting additional interest from new national retailers to carry the line. Retail partners continue to buy into expanded product categories, including kids, ladies and performance products further expanding the Salt Life presence in the retail doors.

So, just to summarize for a minute, we have made good progress on a number of fronts over the last couple of quarters. We have lowered our fixed cost structure, we streamlined our decision making, we have improved our manufacturing performance, we have increased output at our low cost manufacturing facilities and expanded branded businesses utilizing our own manufacturing platform. We have new consumer marketing initiatives in place promoting the Soffe, Junkfood and Salt Life brands. We have a good start on our rationalization analysis of our products and sales channels, and as the year unfolds, we will be taking steps to redeploy assets to those areas that are more strategic to our long-term goals.

This plus our current backlog of orders gives us a high degree of optimism that we will see good overall sales growth and greater profitability as the year progresses. At this time Operator, we would like to open up the call to any questions.

Operator:

Thank you. If you would like to ask a question, please signal by pressing star one on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Once again that's star one if you would like to ask a question. Our first question is from James Fronda with Sidoti & Company.

James Fronda:

Hey guys, how are you?

Deborah H. Merrill:

Good, thank you.

James Fronda:

I guess, just on the gross margin, was that all for the most part pricing that hurt you guys?

Robert W. Humphreys:

Yes, that was primarily driven by pricing and particularly on undecorated tees where pricing declined during the quarter.

James Fronda:

Okay, so the pricing…

Deborah H. Merrill:

Yes, gross margin.

(cross talk)

James Fronda:

Okay, the prices stay where it is, are gross margins are going to stay the same way?

Robert W. Humphreys:

The margins will improve sequentially each quarter as the year progresses.

James Fronda:

Okay, and that's based on more volume?

Robert W. Humphreys:

It’s a combination of things; volume, lower cost raw materials flowing through cost of sales.

James Fronda:

Okay, all right. I guess are you concerned at all in terms of the marketing spending, because I thought a big part of what you were doing was reducing SG&A, but if the marketing spending comes up that’s obviously going to hurt you guys a little bit, right?

Robert W. Humphreys:

Well, I don’t think so. We have all that built into our plan for this year. So, we have dramatically reduced our fixed SG&A cost. We had built budgets for marketing spend, particularly at Soffe and at Salt Life, and continuing at about the same pace we have been at Junkfood. So, that was built into our expectations and feel like it’s rolling out just as we expected, certainly not an additional marketing spend to what we went into this fiscal year expecting.

James Fronda:

Okay, so revenues might not improve until at least the third quarter right?

Robert W. Humphreys:

Based on where we sit today, we think revenues will improve in the quarter we are in and sequentially improve after that.

James Fronda:

Okay, all right. Thanks guys.

Operator:

Our next question comes from Chris Sansone from Sansone Advisors.

Chris Sansone:

Hi guys, how are you?

Robert W. Humphreys:

Hey Chris. How are you?

Chris Sansone:

I am doing well. I am just trying to get more familiar with the business and I am looking at the undecorated tees. So, could you give me a sense for what drives the price volatility in that business, and what is the investment and inventory required to be in that business? I mean, are you where you want to be or you think there might be an opportunity to reduce inventories or—it would sound like that business is somewhat tied to the price of commodities, I guess, somewhat tied to competitive pressures in the market, maybe what your customers are doing. But, can you give me some, just a snip on how that business works and maybe where you hope to be looking out a few quarters or so?

Robert W. Humphreys:

Yes, so just—and that's a big question. If you look at the primary competitors in the market place, you can see a lot of pricing action over the last quarter or two. Gildan being the biggest supplier in the market place, which proactively reduced price and gave a significant destocking or inventory valuation reduction back to their distributors in this quarter. So, when those actions start taking place, it does change the pricing in the market place. Cotton prices are declining, and often times when they decline market pricing declines ahead of when people start actually having cotton flowing through cost of goods.

On your inventory question, we think we are rather lean for this time of year and leaner than the other market participants in this segment, and we generally turn our inventory about 2.5 times a year, and generally what happens, the market in total sells more production than they can make from about March through August or September, and then rebuilds the inventory position in the winter months.

Chris Sansone:

So how do you guys respond when you have a big competitor like Gildan proactively reducing price? Do you necessarily have to go along, or I guess how do you…?

Robert W. Humphreys:

No doubt when the largest market participant changes prices up or down, it affects the overall market price. We have a different go-to-market strategy than most participants who sell to distributors and resale. We sell directly to the next person in the value adding chain, which is typically someone that's going to decorate the product or have it decorated for a retail account. So, we do have a little bit different go-to-market strategy, so our pricing I would say gets out of timing sync from time to time, and quite frankly we try to have products and sales strategies and service levels that separate us somewhat from street commodity play.

Chris Sansone:

Okay, still trying to learn more about it, but thank you very much for the insight. I appreciate it. Thanks Bob.

Robert W. Humphreys:

Yes.

Operator:

Once again, that is star, one if you would like to ask a question. Once again, please make sure if you are using a speaking phone that you have picked up your handset or disengaged your mute function prior to asking your question. At this time, we have no questions in the queue, so, good time to queue-up. It looks like we have no further questions. I will turn the call over.

Robert W. Humphreys:

Okay, okay, thank you all for joining us today and we look forward to updating you on our second quarter results in just a few months.

Operator:

Once again, that does conclude our call. We appreciate your participation.