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ETH.N - Q3 2021 Ethan Allen Interiors Inc Earnings Call

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CORPORATE PARTICIPANTS

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M. Farooq Kathwari *Ethan Allen Interiors Inc. - Chairman of the Board, President & CEO*

CONFERENCE CALL PARTICIPANTS

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Cristina Fernández *Telsey Advisory Group LLC - MD & Senior Research Analyst*

PRESENTATION

Operator

Greetings, and welcome to the Ethan Allen Fiscal Third Quarter Earnings Call. (Operator Instructions) As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Corey Whitely, Executive Vice President, Administration and Chief Financial Officer. Thank you, sir. You may begin.

Corey Whitely - *Ethan Allen Interiors Inc. - Executive VP of Administration, CFO & Treasurer*

Thank you, Victor. Good afternoon, and welcome to Ethan Allen's conference call for Fiscal Third Quarter ended March 31, 2021. This conference call is being recorded and webcast live on ethanallen.com, where you'll find a copy of our press release, which contains reconciliations of non-GAAP financial information referred to in the release and on this call. A replay of today's call will also be made available via phone and on our website. After our prepared remarks, we'll open the call to questions.

As a reminder, our comments today will include forward-looking statements that are subject to risks and uncertainties that could cause actual results to differ materially. Please refer to our SEC filings for a complete review of those risks. The company assumes no obligation to update or revise any forward-looking matters discussed during this call. I will provide a brief recap of our financial results and then turn the call over to our Chairman and CEO, Farooq Kathwari.

During the third quarter of fiscal 2021, our teams remain focused on serving our clients and keeping our workplaces safe. Our retail segment written orders continue to accelerate, achieving 58.1% growth compared to the prior year third quarter, with our March written order setting a new March record. This order growth also reflected 21.9% growth over the fiscal 2019 third quarter, and it was also a 23.9% sequential growth compared to our strong second quarter written orders. Our e-commerce orders reflected 100% growth for the quarter compared to the prior year quarter. We are pleased that our April retail written orders are continuing an upward trend.

Wholesale segment written orders increased 39%. Excluding GSA and other government orders, wholesale segment orders grew 48.3%. Our consolidated net sales for the quarter were \$177 million, an 18.2% increase to the prior year quarter. Our retail net sales increased 22.2%, and wholesale net sales increased 15.8%. At the end of the quarter, both retail and wholesale had high order backlogs that we expect to get caught up over the June and September quarters.

Our adjusted gross margin increased 130 basis points to 57.3%. The increase in consolidated gross margin was due to higher productivity in our manufacturing and a change in the sales mix. Retail sales as a percentage of total consolidated sales were 79.9% compared with 77.2% a year ago, which positively impacted the consolidated gross margin.

Our adjusted operating margin, which excludes the impact of pretax charges from restructuring initiatives, asset impairments and other corporate actions, increased to 11.1%, primarily due to the improvement in gross margin and a 2.1% reduction in our adjusted operating expenses. Adjusted operating expenses for the quarter were lower despite the strong sales growth due to reductions in selling expenses, including advertising costs and reduced compensation expense.

Our GAAP earnings per share for the quarter was \$0.61 per share compared to a \$0.01 loss per share in the prior year quarter. Our adjusted diluted EPS increased to \$0.58 compared with \$0.02 in the prior year quarter. As of March 31, our balance sheet remains strong with cash on hand of \$109 million and no outstanding borrowings. Inventory of \$135.7 million increased 7% from the second quarter, reflecting an increase in production and import receipts.

During the third quarter, we generated \$36.2 million of cash from operating activities. We paid regular dividends of \$6.3 million during the quarter, and we were pleased to announce on April 27 that our Board of Directors declared a \$0.75 special cash dividend, along with a \$0.25 regular cash dividend, and these will both be payable on May 25 to shareholders of record on May 11.

With that, I'll turn the call over to Farooq.

M. Farooq Kathwari - *Ethan Allen Interiors Inc. - Chairman of the Board, President & CEO*

Thank you, Corey, and I'm very pleased to have all of you join us today. As we mentioned in our earnings release, crisis creates an opportunity to make positive changes. In March and April 2020, we furloughed approximately 70% of our global workforce, closed about 250 manufacturing, logistics and retail design center facilities in North America and closing over 100 retail locations internationally, borrowed \$100 million as a precautionary measures and to maximize financial flexibility. A year later, our teams have performed very well. We have brought back most of our associates in our corporate, logistics and retail network.

Our workforce in our manufacturing has surpassed pre-pandemic levels. We have paid back all the borrowings, ended the quarter with over \$100 million of cash and as Corey just said earlier this week, declared a special dividend of \$0.75 per share in addition to the regular quarterly dividend of \$0.25. We are positioned well to continue our growth. We continue to strengthen our manufacturing in North America, which produces about 75% of our products. About 70% of this production are made when orders are received. Customization provides greater choices to our clients and also important in managing our inventory. The combination of skilled crafts persons, increasing use of technology has helped reduce time to make our custom products.

We, along with others in our industry have been impacted by delays in raw materials, especially the issue of foam used in our upholstery products. We do see improvements and believe that we should be able to increase production this quarter and the next quarter. Our long-term focus on maintaining and growing manufacturing in North America is a major advantage. During the last few years, we have expanded our facilities and invested in machinery and technology and in good position to service our growing sales.

We continue to strengthen our product offerings under the 3 attitudes of classic, country, coastal and modern. In particular, utilizing our North American manufacturing, we have expanded our 100% customer upholstery program and have introduced important programs in case goods such as our custom dining program and custom bedroom program. We are in process of introducing 2 other important case good programs in this and following quarter, a custom home office program and custom bedroom program, again, offering many custom choices made in our North American workshops.

Our focus on interior design services continue to differentiate us and help strong sales. Our investments in technology during the last few years, enabling our interior designers to virtually assist clients has been a game changer. We also continue to reposition our design centers. In the last 1 year, we opened new design centers in Alpharetta, Georgia, that's Atlanta; San Mateo, California; Oxnard, California; Towson, Maryland; Portland, Oregon; Green Bay, Wisconsin and Lancaster, Pennsylvania.

We continue to strengthen our marketing. This includes utilizing traditional mediums, such as direct mail and television. We are increasingly using digital mediums, including our website, e-mails and the recent introduction of our 2021 style book. Most importantly, we are forwarding digital magazines to our clients and millions of prospects. And finally, in these challenging times, we continue to focus on safety and treating our associates and customers with dignity and compassion.

With this, I'm very pleased to open up for any questions or comments.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Brad Thomas with KeyBanc Capital Markets.

Bradley Bingham Thomas - *KeyBanc Capital Markets Inc., Research Division - Director & Equity Research Analyst*

Congratulations on the momentum in the business.

M. Farooq Kathwari - *Ethan Allen Interiors Inc. - Chairman of the Board, President & CEO*

Yes. Thanks, Brad. A lot of good work by our teams really have done a great job.

Bradley Bingham Thomas - *KeyBanc Capital Markets Inc., Research Division - Director & Equity Research Analyst*

Absolutely, no question. I wanted to just try to help connect the dots to our model and try to think about what's possible from a financial perspective, given the strong order trends, given that you have a very healthy backlog. The last few quarters, you've done sort of just shy of \$180 million in revenue each of the last 2 quarters. Can you help us get a sense for what's possible from an output standpoint on a quarterly basis? Because clearly, it would seem like the demand trends and the backlog are strong enough that you could be doing north of those kinds of numbers. How should we think about that?

M. Farooq Kathwari - *Ethan Allen Interiors Inc. - Chairman of the Board, President & CEO*

Well, as we -- certainly, we do have the backlog. We -- as I mentioned, the challenges have been more on the issue of getting raw materials. We are -- 25% of our products are -- do come from outside our facilities, and that is where we have had even a greater issues because some of that 25% is offshore. Having said this, we have been -- we had a few hundred containers tied up, but they have now released. So those products will be coming in. Our manufacturing is starting to receive more, especially I'm talking about upholstery, where foam has been an issue. So I would say that we are going to have increases in production in this quarter. And I think that how much more we will be able to do this quarter will really still depend upon receiving the products and time from overseas and the raw materials. But certainly, Brad, we're going to -- look, we should do better than what we did this quarter.

Bradley Bingham Thomas - *KeyBanc Capital Markets Inc., Research Division - Director & Equity Research Analyst*

That's very helpful, Farooq. And then just one other question for me as a follow-up on how to think about costs going forward? How should we think about SG&A and the need for investments in the business and things like advertising as we think about growing SG&A going forward?

M. Farooq Kathwari - *Ethan Allen Interiors Inc. - Chairman of the Board, President & CEO*

Yes. I mean, we have -- I would also say this that which perhaps the question would come up, we did have some slower business coming in for the state department in the last 4 months. But in April, it looks like those folks are back to work. So we have had a good April, and that's important because when Corey mentioned the difference between our total wholesale this year and last year, part of that was due to effect a somewhat lower state department. But Brad, the good news is they're starting to send us orders. And now the question about ...

Corey Whitely - *Ethan Allen Interiors Inc. - Executive VP of Administration, CFO & Treasurer*

The SG&A.

M. Farooq Kathwari - *Ethan Allen Interiors Inc. - Chairman of the Board, President & CEO*

The SG&A. Brad, I think that our advertising is about, what, 3.5%, \$6.2 million we spent this quarter as against last year, the same quarter, we spent \$8.3 million. Interesting, with the mediums that we are using in advertising are different today than last year. Digital has changed our lives, even in advertising. We used to send a tremendous amount of direct mail, printed direct mail. Now we have been able to purchase over 3.5 million names, and we are selling about the same size of a digital magazine through digital mediums. Think of this, we just printed a 260-page-or-so style book. I don't know if you've gotten it. If you're not, Corey, make sure they get it. That is that today, you can see 260 pages style book on an iPhone. So what I'm getting at is this, all these digital mediums has made it possible for us to reach more people with less expense. So that is going to be what we're going to continue to do.

Bradley Bingham Thomas - *KeyBanc Capital Markets Inc., Research Division - Director & Equity Research Analyst*

All right. Very helpful. And congrats on the momentum and good look going forward.

Operator

(Operator Instructions) Our next question comes from Cristina Fernández with Telsey Advisory Group.

M. Farooq Kathwari - *Ethan Allen Interiors Inc. - Chairman of the Board, President & CEO*

Cristina, good to have you back.

Cristina Fernández - *Telsey Advisory Group LLC - MD & Senior Research Analyst*

I wanted to ask about the raw material shortages in specific the foam shortages that it seems like they're pretty broad-based across the industry. Can you expand on what you're seeing and what kind of delays you are experiencing and being able to deliver those products to customers?

M. Farooq Kathwari - *Ethan Allen Interiors Inc. - Chairman of the Board, President & CEO*

Yes. Our -- we have major upholstery operations in North Carolina. And every week for the last few weeks, they have either worked 3 days or in sometimes 2 days. But now good news is they're working from 3 to 4 days. You can see the -- all in the last 2 or 3 weeks, so we have added more days. We have an upholstery operations in our operations in Mexico. Fortunately, that has not been impacted by the foam shortage because it is available there. So I would say this, Cristina, that it is improving. People are getting more, and I would think that the projection is that by end of May, they will come pretty close to meeting the requirements.

Cristina Fernández - *Telsey Advisory Group LLC - MD & Senior Research Analyst*

Okay. That's good to hear. And I have 2 other questions. One, on the press release, you noted that you already had brought back most of the retail workforce and also I think the manufacturing workforce was above pre-pandemic level. So if that's the case, I mean, should we expect SG&A expenses to trend back up? Or can you have as to workforce would and still keep SG&A in like the \$80 million range a quarter?

M. Farooq Kathwari - *Ethan Allen Interiors Inc. - Chairman of the Board, President & CEO*

We have reduced to some degree our headcount at the corporate and the retail level. The manufacturing, as I mentioned, we've increased it because our production has increased. I think that where our expenses are going to be proportionate to the business coming in. As the business increases, our expenses, for instance, I say, our selling expenses relating to our design network increases. So I think you can take it as the proportionate to increase in business is that, how are we expect our expenses to increase.

Cristina Fernández - *Telsey Advisory Group LLC - MD & Senior Research Analyst*

Okay. And then one last one. So April, I guess, the comment was the business was -- has been good. Any more details you can share? Is it pretty similar to what you saw in the second quarter and in March? Or is it better even? Any more color there would be helpful.

M. Farooq Kathwari - *Ethan Allen Interiors Inc. - Chairman of the Board, President & CEO*

Cristina, I would say this that we had a strong quarter. Certainly, March was very, very strong for a lot of factors because the first and most important is that we've got good programs. We've got really the talent of our interior designers and today using technology, as I said, is a game changer. I do not expect that our designers will be able to do what they did. But then also, we had a price increase on April 1 that took some business in March. So we were expecting that perhaps April is going to be somewhat weaker. But as Corey mentioned, it is strong. Again, still consumer interesting in their home. Our programs are strong. So those are the factors that had a positive impact on April, despite the fact we had a very strong March because, as you know, when you increase prices, people try to take advantage of it before they become effective. So we are pleased with the fact that our business in April is showing strength. And now we'll -- as we go forward, we'll see what we need to do. We still have a fairly strong backlog that we have to deliver. And we are somewhat better positioned than other than in our industry because of our own manufacturing. And -- but still, we are also impacted by some raw material shortages.

Cristina Fernández - *Telsey Advisory Group LLC - MD & Senior Research Analyst*

And best of luck this quarter.

M. Farooq Kathwari - *Ethan Allen Interiors Inc. - Chairman of the Board, President & CEO*

All right, Christina, thank you very much, and keep -- look forward to seeing you soon one of these days.

Operator

There are no further questions at this time. I'd like to turn the floor back over to management for any closing remarks.

M. Farooq Kathwari - *Ethan Allen Interiors Inc. - Chairman of the Board, President & CEO*

Well, thank you, and thanks, everybody, for being on the call. And as usual, I think that we were fortunate that we have a strong network of people. We have a strong network of our -- in our vertically integrated company. So we've got a lot of opportunity to continue the progress. So thanks very much.

Operator

Ladies and gentlemen, this concludes today's conference. You may now disconnect your lines at this time. Thank you for your participation, and have a great day.

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