

REFINITIV STREETEVENTS

# EDITED TRANSCRIPT

ETH.N - Q1 2021 Ethan Allen Interiors Inc Earnings Call

EVENT DATE/TIME: OCTOBER 29, 2020 / 9:00PM GMT

## CORPORATE PARTICIPANTS

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

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

**Matthew McNulty** *Ethan Allen Interiors Inc. - Vice President, Finance*

## CONFERENCE CALL PARTICIPANTS

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

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

**Robert Kenneth Griffin** *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

## PRESENTATION

### Operator

Greetings and welcome to the Ethan Allen Fiscal 2021 First Quarter Analyst Conference Call. (Operator Instructions) As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Matt McNulty, VP of Finance. Thank you, Mr. McNulty, you may begin.

---

### Matthew McNulty

Thank you, Victor. Good afternoon, and welcome to Ethan Allen's conference call for our fiscal first quarter ended September 30, 2020. 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 will 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. Joining me today on the call is our Chairman and CEO, Farooq Kathwari; and our Chief Financial Officer, Corey Whitely.

I'm pleased to now turn the call over to Farooq Kathwari.

---

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

Yes. Thank you, Matt. And thank you all for participating in our call. As we advised in our press release, we are making very good progress in growing our sales, profits and strengthening our balance sheet.

A few important highlights. And I believe in this new world, we have to compare our results to last year and also the COVID impact in the last 6 months. Sales of \$151 million for the quarter ended September 30 increased 65% from our delivered sales in the fourth quarter ended June 30, 2020. Sales were lower by 13.1% from September 30, 2019.

Our written business at retail division increased 79% from fourth quarter ended June 30, 2020, and also increased 10.8% from September 30, 2019. We are pleased that we are positioning well after major challenges faced due to COVID-19 in the quarters ended March 31, 2020, and June 30, 2020.

We have strong backlogs as follows. For our retail division, backlog at September 30, 2020, increased 43% from June 30, 2020, and increased 39% from 9/30/2019. We also improved our gross margins. At September 30, gross margins of 56.8% increased from 56.3% from September 30, 2019,

and 53.3% from June 30, 2020. The gross margin of 56.8% was achieved despite our manufacturing operating at below optimum levels during the quarter.

Our adjusted operating income margin of 81% at 9/30/2020 compares to a negative gross margin of 5.4% at June 30, 2020, and 7% in previous year quarter ended 9/30/2019 and also impacted by the lower production in our manufacturing. We have continued to focus on strengthening our balance sheet with paying down \$50 million of debt and at 9/30/2020 ended with cash of \$62 million and debt-free.

Now after Corey provides a brief overview of our financials, I will provide some information on our initiatives to grow our sales and profits. Corey?

---

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

Thank you, Farooq. During the first quarter of fiscal 2021, our teams remained focused on serving our clients and keeping our workplaces safe. Our fundamentals continue to be strong with retail written orders and backlogs reporting double-digit growth compared to the prior year, both within our design centers and from e-commerce. Production levels throughout our manufacturing increased steadily during the quarter and are getting back to pre-COVID-19 pandemic levels, which we expect will reduce the high undelivered order backlogs and reduce delivery lead times in the near term.

Consolidated net sales for the quarter were \$151.1 million compared with \$173.9 million in the prior year quarter. While net sales decreased, written orders accelerated during the quarter. Retail segment written orders were up 10.8% over the prior year, including 26.5% growth in August and 11.8% growth in September. Our e-commerce orders reflected 112% growth for the quarter compared to the prior year quarter as we have continued to focus on refining our digital experience for our clients.

As Farooq mentioned, we continue to see very strong retail written order trends for October with month-to-date orders up over 50% to prior year. Wholesale segment orders, while benefiting from the strong retail growth, were negatively impacted for the quarter by the timing of GSA and other government orders due to COVID-19 pandemic-related disruptions that are delaying issuance of new orders. The delayed orders are expected to be issued in the coming months. Excluding GSA and other government orders, wholesale segment orders increased 9.2% for the quarter.

Our adjusted gross margin increased 50 basis points to 56.8%, primarily due to expansion within the wholesale gross margin, partially offset by a decrease in the sales mix and lower manufacturing production from COVID-19-related disruptions. Adjusted operating margin, which excludes the impact of pretax charges from restructuring initiatives, asset impairments and other corporate actions, increased to 8.1% compared to 7% a year ago, primarily due to strong gross margins and cost containment, resulting in a 14.3% reduction in adjusted operating expenses. Adjusted operating expenses for the quarter were lower due to reductions in selling expenses and reduced compensation expense as we are operating more efficiently with 23% less headcount as compared to September 2019.

Adjusted diluted EPS was \$0.36 compared with \$0.35 in the prior year first quarter. Our GAAP EPS was \$0.37 compared to \$0.53 in the prior year quarter. As you may recall, last year, our GAAP EPS results for Q1 included a onetime net pretax gain of \$4.9 million or \$0.18 per share from the sale of our Passaic, New Jersey property, net of restructuring activities. As of September 30, 2020, our balance sheet remains strong with cash and cash equivalents of \$62 million and inventory of \$127 million. During the first 3 months of fiscal 2021, we generated \$42.2 million of cash from operating activities and as Farooq mentioned, we paid the remaining \$50 million in outstanding debt using available cash on hand.

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

---

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

Yes. Thank you, Corey. Our focus remains on the following important initiatives to grow our sales and profits and to have a strong balance sheet. Number one is to continue focus on strengthening our talent. We have a strong team managing our vertically integrated enterprise. During the last year, we have strengthened our retail, marketing and product development teams.

Second is focus on service. It's critical. Our advantage of making about 75% of our furniture in our North American facilities provides a competitive advantage, especially during these challenging times. We are adding to plant capacity and investing in technology. As we indicated, we expect to catch up on most of our backlog by end of this quarter and some early next quarter. We have maintained strong marketing initiatives, including television, direct mail, digital, and print. We have also introduced digital magazines in categories such as mattresses, outdoor, lighting and rugs and have seen an increase in business in these categories. We plan to continue our strong marketing in the next 3 quarters of this fiscal year.

Fourth is combining personal service with technology is a strong competitive advantage. Our investments are providing tools such as augmented reality, 3D floor planner, web AR is making it possible to have our interior designers interact with clients even during the pandemic periods.

Number fifth, operating our business with high standards of safety protocols following CDC guidelines for safe store, manufacturing and logistics operations for -- and for our customers and our staff is important and an important focus. And finally, as advised in our press release, we are very pleased to have continued strong business increasing by 50% month-to-date in October written orders compared to October 2019. This is a result of strong product programs, personal services and technology. Also, to some degree, it was helped that last year, written was impacted by the introduction of the Member Program. We look forward to continue our progress and remain cautiously optimistic.

With this -- and now, we're happy to open for any comments. Operator?

---

## 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 and Equity Research Analyst*

I wanted to talk a little bit more about working through the strong backlog and strong written orders that you've generated. Could you help us think about your ability to convert these orders into GAAP reported revenues in this upcoming quarter and how we should try to triangulate these strong written trends to revenues going forward here?

---

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

Yes, Brad. Of course, that is critically important. Our manufacturing is almost close to operating at the pre-COVID levels. Now having said this, we still have issues relating to some raw materials from fabrics, but we are catching up. And I believe that, as I said, if I today just had to give an estimate, I would say that the backlog, perhaps 60%, 70% of that, we would be able to produce or even more of that this quarter and some of it in the next quarter.

Now another issue that we have is that we also have to see customers' ability to take products. We have products. Our -- we are getting them into our service centers all across the country. And now we are working to see that the customers take them in because, as you know, there are issues on that side, too. But I would say this, that most of it by December and some by January and February.

---

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

That's helpful, Farooq. And could you talk a little bit about the competitive and promotional landscape? I think broadly, what we're seeing out of the industry is, is because of the strong demand and because of some inventory in availability that many in the industry, many of your competitors are dialing back on the promotion. Can you talk about your ability to get stronger margins in this quarter ahead of us here?

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

Yes. So Brad, the -- that's an important question. Now our -- almost, I would say, close to 80% of what we sell is custom. That's a big difference. So we don't have a lot of excess inventory. Now in this period, people are in a hurry. They've been sitting in their homes. They want products and they want it tomorrow. Now we can do some of that, but we cannot compete with folks who got lots of inventories on hand and they sell it right from their warehouses. So that has been an impact. And we've seen many people who are more of a commodity business or people who have an ability to have had inventories, they have sold but now what I hear is that they're also running out of it, and now they're waiting for containers coming from overseas.

In our case, we have the ability, as I said, 70% plus is made in our own workshops. We have had to gear it back up because we had the COVID in the March quarter. We had to close all our plants. We were asked to close all our plants. And unlike a typical retailer, they don't have the overhead of plants. We have a positive because when it's all operating, we get the benefit of margins. We get the benefit of service. But on the other hand, when there are times where we are not able to produce at a level of that will maintain the right kind of margins, it has an impact on our margin. And that you can see right now, that our margins -- when our plants are operating at full capacity, our retail is operating at higher volumes, our logistics is operating, we have a great opportunity, as we've done in the past years of operating at margins. So our focus right now, good news is that we are -- our manufacturing is operating. We do have the opportunity of fulfilling this backlog, so that we'll have an opportunity. That has a good opportunity of continuing to increase our cash and margins.

---

**Operator**

Our next question comes from Bobby Griffin with Raymond James.

---

**Robert Kenneth Griffin** - *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

So I guess the first question I want to ask was maybe on October trends. Understanding that the prior year comparison is a little different with the membership model. But can you just talk about October and reference to maybe September which would help us think about the strength of the business? Did you see the business and orders get stronger in September -- I mean in October versus September sequentially? That way, it takes the weird comparison out of the equation.

---

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

Yes. Bobby, I mean, I actually had this included this October only yesterday talking to Corey. And what I said, we've got to let people know that this question is going to come up. How are we doing in October? And initially, we were going to say, we are doing well, but that's not enough. This 50% increase is a big increase. And it is reflective of 2 factors, which is the impact of the COVID impact -- I mean not COVID, but the membership impact last year and the increased business this year. I mean if I had to say, and again, this is just sort of -- just to give you a little -- I would say most likely, 30% of this so -- and these are my estimates, not Corey's and Matt's, I would say that about 30% of the 50% is due to the current and 20% or so due to the fact that last year, we were impacted by membership.

---

**Robert Kenneth Griffin** - *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

Okay. That's very helpful. I appreciate that, Farooq. Did you change the marketing message at all? Or anything interesting in October versus September, August? Or is just the customer coming back with more strength?

---

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

We did know, actually, a number of factors, which is that right from June onwards, keep in mind that in March quarter up to June, we were -- we had closed almost all our design centers. So it was actually in September and even in October, we're bringing people back in. We still haven't

brought in all the people that we need to bring in. So it is a factor of not only marketing. Yes, we maintain strong marketing. We have maintained very strong direct mail. We have maintained digital advertising. But from time to time, we do television. But what also is a factor is that we are now bringing more people in operating in our design centers.

Keep in mind, for instance, our -- we have a different business model than a typical retail where people come in and see and buy it. Our designers operated from homes. In fact, in many design centers still in many cities like, for instance, Seattle and Chicago, in bigger cities where the COVID situation was greater, we were not operating 7 days a week. But now starting in October and then -- and finally, in November, I think almost all our design centers will be operating 7 days a week. We still have not been.

So in October, we increased more people. We can maintain our marketing, and we added more days of sales. All of those things happened in October.

---

**Robert Kenneth Griffin** - *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

Okay. And then Farooq, I mean, I understand it's still early kind of this buildup in recovery. But clearly, you guys are operating the business with less headcount and less SG&A dollars, pretty big delta versus last year. I mean, how much of that do you think you're going to be able to maintain going forward? Do you still have to bring some more SG&A costs back on? How do we think about that for next year, next fiscal year?

---

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

We are going to -- our manufacturing, most of the folks are back in our manufacturing. It is really in the retail, at this stage, we are still operating with less people. And I would say that, as we move forward, that if you take a look at, for instance, as of now, our total headcount is down approximately -- if you take a look at prior year, I'm talking about at the end of September compared to last year, we're down 23% in total headcount. And a lot of it is still at retail. Our manufacturing is more or less caught up back to where we were. And in fact, we're going to increase it because with all this new business coming in, we are looking to see how we can -- we're adding more people in Vermont. And you know what, there's a little bit of shortage of people there. We are adding more people in North Carolina. We're adding more people in Mexico and Honduras. So at this stage, it's 23%. If I were to say that at the end of the day, it also depends on business.

The business continues to increase. We will operate with what we had last year, but we'll have more business. But right now, it's 23% and I would say that by the end of this quarter, most likely, it might be down 15% or so or 10% -- I mean, between 10% and 15% based on business by the end of this quarter compared to the previous year.

---

**Operator**

Next question comes from Cristina Fernández with Telsey.

---

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

I wanted to follow up on Brad's question about converting the backlog to sales. So if you can convert 60% to 70% of the backlog to sales, does that imply that you can -- that sales can be up in the December quarter year-over-year? Or should we still think about being limited by capacity and still having a year-over-year decline?

---

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

Yes. I think that, as I mentioned, the factors are the question about consumers also taking in the products because our product is somewhat different than all the other products that they are buying and going into a large furniture store. That is how they take it and they buy it. In our case, they've ordered it. It's all custom. And it's interesting that again, across the board, there are people who want it for yesterday. There are folks who want to

wait. But I would say this that -- and perhaps, Corey, you may also chime in, in here. My perspective is this, that for the next -- for this quarter coming up, the chances are we'll be -- we should be pretty close to what we did last year. But it would be somewhat of a struggle to make sure that all this product is delivered. But that is our objective. Corey, what do you say?

---

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

Yes. No, I agree, Farooq. And looking at it, obviously, there's some unknowns out there, but our manufacturing is getting back ramped up. And with where we were last year for this quarter, we do likely will meet or just somewhat exceed that a little bit.

---

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

Okay. Yes, that's really helpful. And then going back to the October trend, which was very strong, can you remind us what the October order number was last year? I don't think I have that. And then the trends you're seeing in October, are you seeing better traffic to the design centers? Or is it still conversion or e-commerce? How are you -- I guess, what is different? Or how are you getting to that accelerated number? Like what business trends are you seeing that are different?

---

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

Cristina, I don't know. I don't think we give any monthly order numbers. So let's hold that up for a minute, Matt and Corey will look at that. But as far as trends, it's an interesting -- that people that are coming in, there's less traffic. Our traffic is lower than last year for us, but it's more qualified. And when they come in, they are -- they've already done their homework, which is very good. There are -- our designers are very productive working with them. And as I mentioned also, with all the technology tools that we have, designers are making appointments. They are able to virtually show them all their designs and plans. And it's amazing how much of work they're doing today by combining personal service and technology. So yes, our traffic is still lower, but more qualified.

---

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

Well, has it picked up from like August and September? Or is it trending year-over-year is still a pretty similar decline?

---

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

You compared to last year?

---

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

Well, just over the past couple of months.

---

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

No, no, it is picking up every month. Compared to last year, it is lower.

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

Got it. Okay. And then one last one question. Are you -- over the past couple of months, are you seeing any meaningful differences between performance by market or for example, between some of your suburban stores or design centers and urban centers like we continue to hear? New York is very weak. Other markets, broadly speaking across retail, any trends you can share there would be helpful.

---

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

Yes. It's really -- it's an interesting thing because, I mean, of course, I watch it very, very carefully. Like, for instance -- and it has sort of, to some degree, varied month-to-month. A few months back or even after last month, we saw that, that order was doing extremely well. There's a little bit of a challenge now. I guess, in Florida with -- again, it also reflects the question of COVID, how far and where it is and what stage it is at. We have issues, for instance, when you go to the West Coast. Seattle had been impacted the more by this COVID. San Francisco and all that area have been affected by wildfires, so there's a lot of other factors other than the COVID.

And I would say like this is our business in New Jersey is very good. Long Island is very strong. And Connecticut is very strong. A lot of -- Manhattan is somewhat weaker from last year. I mean, still holding up, but is weaker. And of course, we know the factors. A lot of people are moving to suburbs. And so our business in Connecticut, our business in New Jersey, Long Island is very good, and that also reflects what's taking place because our business in Washington area is very good. So I would say that in most areas, we're doing well. In fact, we've done extremely well in Ohio, well in -- I would say that in North Carolina, in South Carolina, great results. And it also reflects -- so I would say that -- I would not say that some areas are doing better than others. It's interesting. In some areas, like, you've got to be specific. Like Manhattan is a tough situation. San Francisco has been more difficult. Seattle has been difficult, but other areas have been doing well.

---

**Operator**

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

---

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

Thank you for all of you who are participating and listening. And we are really gratified with the work that our associates have done under very, very trying circumstances. It's great to see the increase in our business, the increase and the focus of people in terms of strengthening our balance sheet, watching every expense and building all these backlogs. And as I said, we are a vertically integrated company. Good news is when everything is working, it helps every element of our business, and we're looking forward to that. Thanks very much for participating in this call.

---

**Operator**

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

---



**DISCLAIMER**

Refinitiv reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES REFINITIV OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2020, Refinitiv. All Rights Reserved.