Crown Crafts, Inc.

Third Quarter FY23

February 15, 2023 at 11:00 a.m. Eastern

CORPORATE PARTICIPANTS

Craig Demarest - *Chief Financial Officer*

Olivia Elliott - *President and Chief Executive Officer*

PRESENTATION

Operator
Good day, and welcome to the Crown Crafts, Incorporated Third Quarter Fiscal Year 2023 Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. Please note, this event is being recorded.

I'd now like to turn the conference over to Craig Demarest, Chief Financial Officer. Please go ahead.

Craig Demarest
Thank you, Jason. Welcome to the Crown Crafts investor conference call for the third quarter of fiscal year 2023. With me today is Olivia Elliott, the company's President and Chief Executive Officer. A telephone replay of this call will be available one hour after the end of the call through 4:00 p.m. Central Time on May 15. Also, a web replay of this call will be available for 90-days and can be accessed by visiting our website at www.crowncrafts.com.

Before we begin, I would like to remind listeners of the cautionary language regarding forward-looking statements contained in the press release. That same language applies to comments made in today's conference call.

I will now turn the call over to Olivia.

Olivia Elliott
Thank you, Craig. Good morning, everyone, and thank you for joining us for our third quarter fiscal year 2023 conference call. As we noted in our press release that went out this morning, the ongoing macroeconomic challenges related to inflation continued to impact our consumer demand, which was, in general, worse than expected during our third quarter.

We also continue to experience lower replenishment orders for some items for which retailers still have excess inventory. In spite of these challenges, our balance sheet remains strong, and we believe we're well positioned to withstand the current headwinds and take advantage of future growth opportunities when the markets return to more normal conditions.

I'm going to look at the third quarter results at a high level, and then I'm going to turn over the call to Craig, and he'll go into a little more detail. Third quarter net sales were $19 million, down from $22.7 million last year. Year-to-date net sales were $53.4 million, down from $61.7 million last year.

Multiple forces in the marketplace have contributed to the sales decline. After experiencing empty shelves during the 2021 holiday season due to port issues, retailers responded by building up their inventory levels during the first calendar quarter of 2022, resulting in over-inventory situation by late spring. This situation has been exacerbated by a change in consumer buying patterns, whereby many consumers are now trading down to lower-priced items, buying fewer items or foregoing some items altogether due to inflationary concerns.

In response, many retailers have lowered their in-stock levels. At retailers where we can see data on sell-through to consumers, in many cases replenishment orders aren't keeping up with sell-through. It is important to note that our retail partnerships remain strong, and we continue to place new items.

Third quarter net income was $1.3 million or $0.13 per diluted share, compared with $2.4 million or $0.24

per diluted share last year. Year-to-date net income was $4.8 million or $0.48 per diluted share, compared with $7.5 million last year or $0.74 per diluted share. Prior year-to-date net income included an almost $2 million gain of forgiveness of our Paycheck Protection Program loan and a $797,000 loss related to Carousel Designs. Excluding the impact of the loan forgiveness and Carousel Designs, prior year-to-date net income would have been $6.3 million or $0.63 per diluted share.

We finished the quarter with $3.1 million in cash and no borrowings on our revolving line of credit. Although our inventory remains a little high at $25.8 million at the end of the quarter compared with $24.5 million at the end of December 2021, we were able to reduce our inventory levels during the third quarter, a period in which we typically see an increase in inventory as we approach Chinese New Year.

We continue to be diligent in managing inventory, the majority of which is current in-line products. In order to move some inventory to make room for new programs, we have provided higher than normal discounts to retailers in some cases, and we've also taken some reserves on inventory that we intend to sell to closeout customers.

We believe that our inventory will return to close to normal levels over the next couple of quarters. We also announced that our Board of Directors declared an $0.08 per share cash dividend on the company's common stock that will be paid on April 7, 2023, to shareholders of record at the close of business on March 17, 2023. This represents an annualized yield of 5.4% based on yesterday's closing price. We're very pleased that our balance sheet remains strong, and we can continue our commitment to return long-term value to our stockholders.

We remain excited about our long-term opportunities as we move forward with our strategic plan, which includes expanding in the toy category, growing our product offering both organically and through acquisition, increasing our direct-to-consumer sales, reducing operating costs, and making further investments to enhance our technology and improve our organizational structure. At the same time, we're managing our business to maximize profitability in the face of current challenges.

And now I'll turn the call over to Craig.

Craig Demarest
Thanks, Olivia. I'll only give financial highlights. For a more detailed analysis, I'll refer you to the company's Form 10-Q filed with the SEC this morning. As Olivia mentioned, net sales were $19 million for the third quarter of fiscal ’23, compared with $22.7 million for the third quarter of the prior year, a decrease of $3.7 million or 16.4%.

Sales of bedding, blankets and accessories decreased by $2.8 million, while sales of bibs, toys and disposable products decreased by $963,000. Sales declined in part due to sales to a struggling retail customer that were approximately $600,000 lower in the current year quarter. We're also seeing the effect of current macroeconomic conditions, more so in the current quarter than in prior quarters, as consumers diverted their discretionary spending to holiday purchases.

Net sales decreased to $53.4 million for the first nine months of fiscal '23 compared with $61.7 million for the same period in the prior year, a decrease of $8.2 million or 13.4%. Sales of bedding, blankets and accessories decreased by $6.8 million and sales of bibs, toys and disposable products decreased by $1.4 million. The decreases in sales are primarily due to lower replenishment orders at retailers as the company's customers continue to reduce purchases because their inventories increased, which we believe resulted from customers' excess inventory purchases during the first quarter of calendar '22 and consumers' response to macroeconomic conditions.

Gross profit decreased by $1.7 million and decreased from 27.1% of net sales for the prior year quarter to 23.7% of net sales for the current year quarter. Gross profit decreased by $1.8 million, but increased from 27.4% of net sales for the prior year nine-month period to 28.3% of net sales for the same period in the current year.

The decrease in the gross profit amount is associated with the decline in sales during the period and is net of the positive impact of the closure of Carousel, which in the prior year nine-month period recognized a gross loss of $689,000 as a result of the closure of the business in the first quarter of fiscal '22. Although the gross profit in the prior year nine-month period was impacted by increases in costs across the entire supply chain, the company in the current year has realized some stabilization in its input costs.

Finally, the company has benefited from recent increases in the selling prices of our products. Marketing and administrative expenses decreased by $352,000, but increased from 13.6% of net sales for the prior year quarter to 14.4% of net sales for the current year quarter. Marketing and administrative expenses decreased by $733,000, but increased from 15.6% of net sales for the prior year nine-month period to 16.6% of net sales for the same period in the current year.

The prior year nine-month period included $496,000 of charges incurred by Carousel. Other items in the prior year nine-month period include a just under $2 million gain recognized from the forgiveness of the PPP loan. The current year-to-date provision for income taxes is based upon an estimated annual effective tax rate from continuing operations of 23.3% as compared with an estimated annual effective tax rate from continuing operations of 20% for the prior year. The gain on extinguishment of debt associated with the forgiveness of the PPP loan was permitted to be excluded from taxable income, the effect of which lowered the effective tax rate for the prior year period by approximately 4 percentage points.

During both the current and prior year quarters, the company recorded discrete reserves for unrecognized tax liabilities as well as adjustments to income tax expense associated with excess tax benefits or shortfalls arising from the vesting of non-vested stock and the exercise of stock options.

The effective tax rate from continuing operations, combined with the effect of the discrete income tax items, resulted in an overall provision for income taxes of 24.4% for the current year 9-month period and 19.4% for the comparable prior year period.

Net income for the third quarter of fiscal '23 was $1.3 million or $0.13 per diluted share compared to net income of $2.4 million or $0.24 per diluted share for the third quarter of fiscal '22. Net income for the first 9 months of fiscal '23 was $4.8 million or $0.48 per diluted share compared to net income of $7.5 million or $0.74 per diluted share for the same period in fiscal '22.

And with that, I will turn the call back to Olivia.

Olivia Elliott
Thank you, Craig. Jason, we'll now open up the line for questions.

QUESTIONS AND ANSWERS

Operator
Thank you. We will now begin the question-and-answer session. To ask a question you may press star then one on your touchtone phone. If you're using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star then two. At this time, we will pause momentarily to assemble our roster. Again, if you have a question, please press star then one.

Our first question comes from Michael Bernstein from Laurelcrest Capital. Please go ahead.

Michael Bernstein
Olivia, good morning.

Olivia Elliott
Good morning. How are you?

Michael Bernstein
Good. How are you? I noticed you said the sales were down $600,000 with one customer and that's probably Buy Buy Baby, are you getting credit coverage with that customer now?

Olivia Elliott
We are not.

Olivia Elliott
We are no longer shipping to them.

Michael Bernstein
You're not shipping to them. Do you have any exposure?

Olivia Elliott
We do have a little bit of exposure. It's not very much, but we have some.

Michael Bernstein
And how much business did you do with them the prior year?

Olivia Elliott
They were about 2% of our business.

Michael Bernstein
Two?

Olivia Elliott
Two.

Michael Bernstein
I'm sorry. Did you say 2% or 3%? I'm sorry, I couldn't hear you.

Olivia Elliott
Somewhere about 2% to 3%, yes.

Michael Bernstein
Okay. Thank you very much.

Olivia Elliott
You’re welcome.

Operator
Our next question comes from John Deysher from Pinnacle. Please go ahead.

John Deysher
Good morning. Just a quick question in terms of shelf space here. It sounds like you're making a lot of accommodations to your customers. And I just want to confirm that you feel those accommodations are allowing you to maintain your shelf space?

Olivia Elliott
We do. I mean, as anything goes, you lose a peg, you gain a peg. But overall, our shelf space remains very strong. I think the biggest problem is that the customers aren't reordering to the same levels as the consumers are buying.

John Deysher
Okay. So it's more of a macro headwind than you losing shelf space as the reason for the sales decline?

Olivia Elliott
Correct.

John Deysher
Okay. Okay. Regarding the Buy Buy Baby exposure, can you give us an idea of what the dollar amount is?

Olivia Elliott
It's less than $0.25 million.

John Deysher
Less than $0.25 million. Okay. All right. Very good. Are any of your other customers in any kind of distressed situation like that?

Olivia Elliott
Not that we're aware of. I mean, everybody else, we continue to ship and continue to give the credit coverage.

John Deysher
Okay. And no difficulty collecting receivables?

Olivia Elliott
No.

John Deysher
Okay. Great, thank you very much.

Olivia Elliott
Thank you.

CONCLUSION

Operator
Again, if you have a question please press star then one. There are no more questions in the queue. This concludes our question-and-answer session. I would like to turn the conference back over to Olivia Elliott for any closing remarks.

Olivia Elliott
Thank you. And thank you, everyone, for your continued support and interest in the company. And a special thanks to all of our employees, suppliers and customers. We look forward to talking to you again in June when we release our fourth quarter and fiscal year 2023 results. Thank you.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.