Delta Apparel, Inc.
Fiscal Third Quarter FY18 Results Earnings Conference Call

Operator:

Thank you for holding, ladies and gentlemen, and good afternoon everyone, participating in Delta Apparel's Fiscal 2018 Third Quarter Earnings Conference Call. Joining us from Management are Bob Humphreys, Chairman and Chief Executive Officer, and Deb Merrill, Chief Financial Officer and President, Delta Group.

Before we begin, I would 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 projections and statements that suggest prediction and involve risks 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. These documents 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, except as required by law, the Company does not commit to update or revise any forward-looking statements, even if it becomes apparent that any projected results will not be realized.

Today's call is being recorded. I would now turn the call over to Delta's Chairman and Chief Executive Officer, Mr. Bob Humphreys. Please go ahead, sir.

Robert Humphreys:

Thank you. The fiscal 2018 third quarter was another productive period for Delta Apparel with year-over-year growth in both sales and earnings, combined with important accomplishments that should drive further improvement into the future. Our Basics segment which saw solid sales growth across all of its businesses primarily grow the gains for the quarter, while new customer wins, product introductions in our branded segment set the stage for further growth in upcoming quarters.

Our team continues to do a good job of focusing on strategies with the most potential to impact our business, and the success of those efforts is evident in our quarterly and year-to-date results. We continue to see incremental growth from a host of initiatives, including the introduction of new products and category extensions, the broadening of our customer base and investments into digital print space and expanded direct-to-consumer activities.

Our Activewear business had a great third quarter with strong sales growth at both Delta Catalog and FunTees, our private label business. Catalog saw increased demand in all of our major sales channels and sales of its high margin fashion basics products once again made significant strides with double-digit growth over the year. The market's enthusiastic response to this merchandise continues, especially the higher-end Delta Platinum line. During the quarter, we brought Delta Platinum and fleece production unto our internal manufacturing platform, which provides a number of benefits, including shorter lead times, enhanced customer service levels, and further leverage off our fixed manufacturing cost.

The private label market fundamentals remained strong, and strategic brands and retailers continue to focus on improving their supply chain and are seeing the benefits of Western Hemisphere manufacturing as a way to diversify their sourcing footprint and get their products to retail quicker. As these procurement trends continue, FunTees is evolving its customer base and anticipates several new brand partner launches in the upcoming quarters.

The quarter was an exciting period of progress for DTG2Go, which as a reminder, is our direct-to-garment digital print business formerly named Art Gun. The third quarter was DTG2Go's first full quarter of operation since the recent acquisition of the business. The integration process has gone extremely well, and the combined Company was able to expand business with some large existing customers and also bring on several new customers. During the quarter, DTG2Go also opened its fourth digital print and fulfillment facility located in Fayetteville, North Carolina on our Soffe campus. This new facility increases DTG2Go's capacity and expanded their reach into the Northeastern United States. DTG2Go can now reach nearly 80% of the U.S. population with one to two-day shipping. We're excited to see DTG2Go further strengthen its leading position in the digital print space, and we anticipate strong sales momentum through the fourth quarter and into its seasonally strongest first quarter.

Soffe sales declined for the third quarter, but were up through the first nine months of fiscal 2018. The quarterly decline resulted mainly from lower sales in the always fluctuating military channel, which offset growth with big box sporting goods retailers and the independent channel. Soffe also expanded its direct-to-consumer footprint yet again this quarter with the opening of a fifth branded retail store. The new store's located in Greenville, North Carolina, a key consumer market near the brand's headquarters.

The new DTG2Go digital print and fulfillment location on the Soffe campus is another exciting development for Soffe and creates a unique opportunity for both Soffe and DTG2Go to offer customers blended digital print and traditional print solutions from a single location.

The third quarter started with weak sales for our Salt Life business, driven by a cold wet April in the Southeast. We quickly rebounded with strong growth in May and June to end the quarter about flat with the prior year. The brand continues to perform well at new national retail accounts and e-commerce sales were once again, up double digits year-over-year. We continue to see many examples of the Salt Life brands growing popularity as a lifestyle brand and opportunities for geographic and product extensions over time. Salt Life's strong performance across the United States with new national retail accounts is particularly encouraging. The brand has performed so well with these accounts, they are now expanding into additional merchandising categories and adding doors in California and other regional markets outside of the Southeast.

Salt Life's growth in direct-to-consumer sales is another indicator that the brand is resonating with customers and gaining new fans. Sales at Salt Life's brick-and-mortar retail stores increased 51% during the quarter, and the brand's newest store in Daytona Beach, Florida continues to perform extremely well. Our two California retail stores were up 36% for the quarter and up 48% year-to-date. An additional store in the Florida market is planned for this fall in the Tampa Bay area.

Another promising trend we are seeing in Salt Life is the growing number of independent retailers who are dedicating entire retail locations exclusively to the brand. These third-party owned and operated retail stores, mainly located in coastal areas of Florida, devote all of their floor space, fixturing and exterior signage to Salt Life's merchandising and branding. The sales are growing at these locations, and they represent unique brand building opportunities that carry no incremental cost to Salt Life.

Salt Life also continues to create growth opportunities through new products and brand categories. Higher price point performance and woven products continue to become a larger piece of the apparel line, and in response to repeated customer requests over the years, Salt Life recently introduced a ladies' swimwear line through a license agreement with SWIM USA. This product line was introduced at the Miami Swimwear Show and will be in key retail locations this fall. An expanded selection of bags was also recently added to the Salt Life accessories line, and Salt Life eyewear, which was previously sold through a licensee, was brought in house during the quarter.

Last but not least, Salt Life Lager, the brand's new craft beer, was launched during the quarter, ahead of schedule and sales have been phenomenal to date. This category expansion not only targets a large new market with substantial sales potential, but also creates opportunities for brand visibility in many new retail outlets such as restaurants and grocery stores. Salt Life Lager was initially introduced in the Jacksonville, Miami and Tampa markets, but is quickly becoming available throughout all of Florida. Although we believe broader distribution will eventually be available, we are currently limiting beer sales to the key Florida market.

I'll now turn the discussion over to Deb Merrill to provide the financial details of our third quarter results.

Deborah Merrill:

Thanks, Bob. We're very pleased with our overall performance in the third quarter. Net sales increased 8% to $112.2 million from $104.3 million in the prior year period, while net income was $4.6 million or $0.62 per diluted share, a nearly 9% improvement over the prior year $0.57 per diluted share last year. Third quarter gross profit increased 9% to $24.3 million, improving 20 basis points to 21.6% compared to 21.4% in the prior year quarter.

Before I discuss our segments and individual businesses, I wanted to highlight our strong e-commerce performance, both in the third quarter and year-to-date. For the quarter, overall e-commerce sales were up 20% year-over-year, bringing year-to-date sales up 18%, including 14% growth on our consumer sites and 19% growth on our B2B site. We're excited about our continued double-digit growth on e-commerce, and especially because, unlike many e-commerce businesses, our sites are highly profitable after being fully burdened with all the costs associated with operating the sites and distributing the product.

In our basics segment, net sales grew 14% to $89.7 million, with strong sales growth coming from both Activewear and DTG2Go. Activewear sales were up 7% during the quarter on the strength of higher sales in both Catalog and FunTees. Sales grew from increased volumes being further enhanced with higher selling prices. DTG2Go's third quarter sales increased 167% from the prior year. As Bob mentioned, we've integrated the recent acquisition and are operating a seamless platform.

Seeing the power of DTG2Go and the benefits of our expanded digital print and fulfillment platform, our customers expanded business with us. In addition, we launched several new customers during the quarter and are in the process of launching others before fiscal year-end. We're excited about reaching new sales channels outside of only e-retailers, with new business coming in promotional products as well as traditional brick-and-mortar retailers that want to integrate an on-demand solution to their revenue stream.

Net sales in the branded segment were $22.5 million compared to $25.3 million in the fiscal 2017 third quarter. As Bob mentioned, Soffe's third quarter sales were down about $1 million from the prior year quarter, but are up 2% year-to-date. Salt Life's third quarter sales declined 2% year-over-year, largely due to the temporary factors Bob referenced. The new Salt Life craft beer, which debuted a few days before the end of the quarter, had only a minor contribution to the third quarter—to the June quarter sales, but we expect it will be much more meaningful sales driver going forward.

For the first nine months of fiscal 2018, Delta Apparel's consolidated net sales increased 3% to $302.5 million compared to $293.8 million in the prior year period. Excluding the $16 million of prior year sales from our Junkfood business, which we sold in March of 2017, our year-to-date sales increased 9% over the prior year period. As a reminder, in our first quarter, we recorded a discrete provisional tax expense of $10.6 million in connection with the recent tax reform legislation. This drove a $0.25 loss per diluted share for the fiscal 2018 first nine months. Excluding the impact of the new tax law, nine months earnings were up 10% to $1.18 per diluted share and up 23% year-over-year after excluding the onetime gain of $0.11 per share we realized on the sale of our Junkfood business last year.

Total capital spending for the third quarter was $3 million, bringing the year-to-date total to approximately $9.5 million, and we expect capital spending for the full year fiscal 2018 to be approximately $13 million. Depreciation and amortization, including non-cash comp, was $3.4 million in the third quarter and approximately $9.3 million year-to-date. During the quarter, we repurchased 63,300 shares of our common stock at an average price of $19.07 per share for a total cost of $1.2 million, bringing our year-to-date purchases to approximately 283,000 shares at an average price of $20 per share and a total cost of $5.7 million. At the end of the third quarter, we had $5.6 million of our Board authorization for share repurchases remaining. We continue to believe that the current price range for our shares does not accurately reflect Delta Apparel's true enterprise value and plan to continue share repurchases under our program.

Our balance sheet was in great shape at the end of the third quarter, with inventory down $6.3 million year-over-year as a result of ongoing efforts in our supply chain to lower inventory levels while still maintaining our strong service levels to our customers. Total debt, including capital lease financing, at quarter-end was $116 million, up about $11 million from a year earlier, driven from the $11.4 million initial cash investment and the recent DTG2Go acquisition.

Now, here's Bob again for our final comments.

Robert Humphreys:

Thanks, Deb. Our overall performance through the first three quarters of the year has been solid, and we like where we are in our business despite the continuing shake-up at retail and the inflationary cost pressures we're seeing in the marketplace. Looking to our fourth quarter and beyond, we remain very optimistic about our Company's prospects given the traction we're seeing from a number of various initiatives across our businesses. Our investments in the digital print space, direct-to-consumer channels and our vertical manufacturing platform should continue to generate higher returns, and we believe that we will see more incremental growth from the new product development efforts going on throughout our business.

In addition, the Salt Life brand offers tremendous growth opportunities as it continues to expand both geographically and into additional lifestyle categories. All told, we believe Delta Apparel's positioned for a strong finish to fiscal 2018 and good momentum heading into the New Year.

Now Deb and I will be glad to try to answer any questions you might have.

Operator:

Ladies and gentlemen, if you would like to ask a question, you may do so by pressing the star key, followed the digit one on your touchtone telephone. Star, one for questions. Please make sure the mute function on your phone is turned off so the signal can be read by our equipment. We'll pause a moment to assemble our queue.

We'll take our first question from Dave King with ROTH Capital Partners.

David King:

Thanks. Good afternoon, Bob and Deb.

Robert Humphreys:

Hey, Dave.

David King:

On the FunTees growth, nice growth there. To what extent is that already customers looking to source from the Americas? Has that benefit that you alluded to, has that started to contribute? Then I guess, both near term and longer term, how do you see this China tariff situation playing out in terms of impacting your business, if at all? Thanks.

Robert Humphreys:

So, I think what we've seen so far, particularly with FunTees is all pretrade war talk. There's a fairly long on-boarding cycle with most of these brands as they go through their due diligence process and we develop their specific products for them. So, I think all that was kind of—predated any talk about tariffs. Generally speaking, for most categories, there's reasonably high tariffs on apparel coming from Asia already. It obviously varies greatly by country and by category. So, we'll just have to see if there's more impact on that, but so far, the categories that we make, there haven't been large proposed tariff increases, generally speaking.

David King:

Okay. That helps. Then sort of higher level, on the basics business, you had several quarters of—you have general growth there. Some of it feels like it's been a fair amount of share gain on your part, but it does feel like the economy as well. I guess just how do you think about that in terms of how much of it do you think is share gains versus improvement in the overall market.

Robert Humphreys:

I would say, to-date, or maybe certainly up to this prior quarter is primarily share gains, I think driven as much as anything by our service levels and consistent quality over time. That's been both in our undecorated and our decorated areas. We are able to offer people a vertical printed package in offshore retail put up for people, which is a bit unique in our marketplace. So, I think good, steady work over a number of years is paying off there. We think we've got more to come to offer a broader service level and expand our base there. Then no doubt, the internal product development that we've done on higher performing and higher fashion product lines has driven a lot of growth, and I think, changed our perception in the marketplace from being a primarily basic tees to more fashion-forward products and offering a broader assortment to our customers.

David King:

Okay, and then it sounds like your—the economy itself is also starting to have an effect as well more recently, and do you see that kind of continuing? Am I interpreting your comments correctly?

Robert Humphreys:

Yes. Again, I'll note that we've yet seen so much of that. I mean, if you go back historically and look, T-shirts generally sell well in a weaker economy, and sometimes they actually get outrun by more expensive products in an improving economy. They still—even decorated are fairly low price point product at retail, but so far, so good, that whole supply/demand equation that we work in.

David King:

Okay. That's good color. Then Salt Life, it sounds like you're expecting that—the growth there to reaccelerate in coming quarters. Do you have how that business has performed in July and early August, thus far, relative to the June?

Robert Humphreys:

We don't have that yet. We're just really finishing up our July period. But again, after the really slow April, we saw a big spike in demand in comp over last year. Our retail stores were performing well. Generally, our national retailers have been performing and growing well, and in fact, grew well over the quarter. That's been offset some by independents, particularly in Florida. I think going into the year, we probably underestimated the effect of some of these hurricanes. When you go down to South Florida and the Keys, stores were completely wiped out and really just now getting rebuilt and opened and kind of missed the whole selling season there. So, while we knew we had an effect immediately, there's been a little bit more overhang there than what we anticipated.

Then I would say with some retailers, big retailers who went through private equity buyouts over the last couple of years, we see headwinds there in general, not how our products are performing at retail for them, but just in general very tight open to buy dollars that have been hurting our turns in those businesses to some degree.

We're also experiencing several new major regional sporting goods stores that we'll be putting Salt Life in way outside of our traditional geographic marketplaces for spring for trial.

David King:

That's great to hear. Last one for me. So Soffe, the revenue went down a little bit, and it sounds like it was mainly the military side of it. How is the profitability there now? Are you still targeting mid-single digit operating margins for that? How close are we to that level? Thanks.

Robert Humphreys:

Yes, so we're still basically operating at slightly above breakeven, plus or minus different months. So, we've got plenty of work to do there. Our decline was military, which is up and down, and we were going through some product changeover from a Navy training product that just ran through its life cycle. We're seeing a pickup in the military demand as we sit here today, so we'll see. But, I think we're making steady progress there, but certainly have plenty of work left to do.

David King:

Okay. Thanks for all the color and taking my questions and good luck finishing out the year.

Robert Humphreys:

Thank you, sir.

Operator:

We'll take our next question from Joe Furst with Furst Associates.

Joe Furst:

Thank you and congratulations on a good quarter. Could you explain a little bit about what your ideas are for this beer? How big a part of your business it could become, and what sort of plans do you have for that?

Robert Humphreys:

Well, thanks, Joe. So, it's obviously a new initiative for us, one that had been pitched to us a number of times about alcohol license for the Salt Life brand. We ultimately did a joint venture in Florida with some people that we thought had expertise in that market. We got something delivered into market pretty quickly. We own 60% of that joint venture, so we'll account for that in the proper manner over time. It has gotten off to an extremely strong start. We're going to be in over 2,000 doors in Florida by the time Labor Day gets here. About 400 of those doors are restaurants. So, we're seeing a broad audience there.

The demand so far has been very strong, and we'll just have to see if people are buying it as a novelty purchase or continue to buy it over time. So, we believe that this can be an important step of really kind of certifying Salt Life as a truly lifestyle brand that transcends any one product, whether it's apparel or footwear or headwear, or in this case, beer. So, we'll be monitoring that closely. At least for the foreseeable future, we'll restrict that to Florida. Based on what we're seeing so far, we would expect beer revenue to be in the high single-digits percentage of Salt Life's total revenue next year. So, that would be an extremely strong start in the first year out of the box.

Joe Furst:

It would. Another question, I noticed in buying back your own stock, your average cost, I think, last quarter it was around $19, and I noticed the stock recently has been in the $16, $17 area. Are you continuing to buy down there?

Robert Humphreys:

We are. We like that better than the $20 as a buyer. We don't understand it from a seller standpoint, but as a buyer, we like it fine.

Joe Furst:

Yes, I'm amazed that your stock price is that low. It just surprises me, it's a tremendous opportunity, I think. Thank you very much.

Deborah Merrill:

Thank you.

Operator:

We'll take our next question from Jamie Wilen with Wilen Management.

James Wilen:

Hi, fellas, nice numbers. I wanted to start with DTG2Go. You mentioned that it was up 167% from last year. Was DTG2Go larger than Art Gun? What was the organic growth for both those businesses in the quarter?

Deborah Merrill:

Yes, so Jamie, no, the DTG2Go was actually slightly smaller than Art Gun, and we really can't break the two of them apart because we're on one integrated platform. But, you can inherently see that it's up 167% and the acquisition size was smaller than our existing, how much organic growth overall is embedded in there.

James Wilen:

Okay, and the seasonality now in that business is becoming a major part of the overall—its strongest quarter should be which fiscal quarter for you?

Deborah Merrill:

It's our first fiscal quarter, the December quarter is, by far, on a revenue standpoint, its strongest quarter. But then it continues to gain in the other quarters as well, as we're onboarding new customers. But, with the holiday season in that December quarter, that's the one that spikes it up.

James Wilen:

Okay. We should be profitable in all four quarters, but most in our first fiscal, is that correct?

Deborah Merrill:

Correct, and we have been profitable in all four quarters in that business for a couple of years now.

James Wilen:

Okay, and so that's a little bit of an offset to our basic T-shirt business, which is, I assume, third and fourth is our most profitable quarters there?

Deborah Merrill:

That is correct. So, it is definitely a nice offset to that seasonality.

James Wilen:

Okay, and operating margin wise, now that you have the two together, should the operating margin of both of them be—with some synergies be more than each enjoyed separately?

Deborah Merrill:

Yes. Yes, and we are seeing that already.

James Wilen:

Okay, and any targets for what the operating margin can be in that business, obviously different from the T-shirt business?

Deborah Merrill:

Yes, we're seeing those kind of in that mid-teen type of operating margin, and certainly as that business continues to grow, that's got opportunity for expansion in that.

James Wilen:

Okay. Going back to last year's quarter, and last year's September quarter, as I'm looking forward, can you talk about how your business, with the hurricanes, Texas, Florida, how you migrated through the quarter July, August, September last year and kind of what we're comparing against this year, when we get there?

Robert Humphreys:

Yes, so in our fourth quarter, there were a couple of three hurricanes that went through first, Texas and then Florida, starting earlier in Texas, and then the weekend after Labor Day in Florida where we had them kind of back to back there for a couple of weeks. So, that was obviously later in the quarter there, but it had an impact on us, and we'll see more as we go through this year how that relates.

James Wilen:

Okay. Did that affect you uniformly throughout all your brands or Salt Life more than Basics?

Robert Humphreys:

Yes, I think—yes, Salt Life, more than anything, because a large part of that business is people visiting the coast. When they don't go because the hurricane is there or they're just going to get there, and then the aftermath of that is when these stores are damaged. A lot of the independents obviously are one to five or 10 store chains and it's devastating to those owners to rebuild those stores. But, to their credit, over time, they seem to be resilient in getting back open.

James Wilen:

Okay, and then, overall, in the state of retail, when Haines announced that Target's no longer going to be carrying one of their Champion brands or product lines, do you see anything in the state of retail that suggests a major shift from branded to private labels? How does that factor in with delta where we do both branded and private label?

Robert Humphreys:

So, I would say there is definitely a shift going on to more private label, and I'll say maybe a more sophisticated private label than what retailers have done in the past. Now having said that, having done this for many decades now, you see those trends come and go. Oftentimes then retailers, when they make merchandising mistakes or they buy too much or they have a quality problem, then they realize, man, these brands taking all of those risk is not such a bad deal. Then you often see a return to more brands. So, we see that strategy coming and going, and we've both benefited and have been hurt from it over the years.

I think there's been a lot of noise in the media with retailers getting disappointed with brands that they felt like they helped built, that then turned and sold to different channels of distribution and they get the sense of why do I want to build another brand for someone else to control. I'll do it myself. I'd say, in general, the best creative people and product development people probably would like to work in a more boutique environment and—where they can kind of have their creative juices going, and I think that's where you see brands come up with better trends, maybe better color, better silhouettes and when you start getting too big in a retail-driven private label business.

James Wilen:

Got you, and then lastly, over to Salt Life, it looks like a number of your new endeavors are products, beer, swimsuits, sunglasses that obviously you don't make but are putting the Salt Life brand on others' products. Is that going to be a major focus? What else is in your sight lines for what you will do with that brand?

Robert Humphreys:

Well, I think the real key is, we want to be true to the brand and build something that has long legs and is not an overnight flash and sensation. So, when we took over this brand, we got out a lot of categories that we didn't feel like were supportive of a long-term lifestyle strategy, floor mats, steering wheel covers, dog mats, that sort of thing. So, we kind of pulled back and really focused on apparel and getting that footprint built. There was an eyewear licensee that we thought did a good job and had quality product, and that was seen in the marketplace. They also had a lot of other product outside of the eyewear market and we were able to bring that in-house and get some experienced eyewear people coming on board. So, we felt like we could build that better out ourselves.

The same thing with the beer, that I spoke to, a joint venture with people that are deeply experienced in that business and the right distributor, which is critical there. Then, for example, in lady's swimwear, which is a product we've been asked about time and time and time again over the years, that wasn't a product that we felt like we had the expertise to develop and sell and all that. So, we did that with a licensed partner.

More of our performance products in Salt Life are sourced. So, other people make those for us, and the headwear is sourced. Although we are developing new performance products in-house on our manufacturing platform, and with those, have introduced trademark, either characteristics of the garment or marketing points about our moisture management and UV protection.

James Wilen:

Great, keep churning the numbers, keep buying back stock. Job well done.

Robert Humphreys:

Thanks sir.

Deborah Merrill:

Thank you.

Operator:

As a reminder to the audience, star, one for questions or comments please, star, one. We'll go next to Louis Moser with Mafax Investors. Please go ahead.

Louis Moser:

Yes. Good job. I just don't know whether I missed anything. Did you project any earnings or sales?

Robert Humphreys:

No, Lewis, we do not put out sales and earnings forecast.

Louis Moser:

Yes, I didn't think so. I just missed a little bit of what you said, so I wasn't sure, but everything else sounds good. Thanks very much.

Robert Humphreys:

Okay. Thank you.

Operator:

Star, one for questions. We will pause a moment. It appears we have no further questions at this time.

Robert Humphreys:

Okay. Well, thank you all very much for joining our call, and we look forward to updating you on our full year results in just a few months. Thank you.

Operator:

Ladies and gentlemen, this concludes today's conference. We appreciate your participation.