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ETH.N - Q2 2021 Ethan Allen Interiors Inc Earnings Call

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## CORPORATE PARTICIPANTS

**Corey Whitely** *Ethan Allen Interiors Inc. - Executive VP of Administration and CFO*

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

**Matthew McNulty** *Vice President-Finance*

## CONFERENCE CALL PARTICIPANTS

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

**Joseph Isaac Feldman** *Telsey Advisory Group LLC - Senior MD, Assistant Director of Research & Senior Research Analyst*

## PRESENTATION

### Operator

Greetings, and welcome to the Ethan Allen Fiscal 2021 Second Quarter Analyst Conference Call. (Operator Instructions) Please note, this conference is being recorded.

I will now turn the conference over to our host, Matt McNulty, Vice President of Finance. Thank you. You may begin.

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### Matthew McNulty - Vice President-Finance

Thank you, Diego. Good afternoon, and welcome to Ethan Allen's conference call for fiscal second quarter ended December 31, 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 am pleased to now turn the call over to Farooq Kathwari.

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

Thank you, Matt, and thank you all for participating in our quarterly call. As we all know, the last 12 months have been dramatic, challenging and also rewarding in many important changes to strengthen our enterprise and also achieving strong results. This has been an amazing journey. Nine months back, I had to furlough about 4,000 associates, closed all our manufacturing and most of retail, our stock price, like most enterprises, bottomed to close about \$8.

As you know, the good news is written sales have continued to grow. Quarter ending December 31, 2020, increased 45% from previous year quarter. Our adjusted earnings per share of \$0.69 increased 155.6%. Our backlog for retail division increased 146%. And after Corey provides a brief overview, I will review our initiatives. Corey?

**Corey Whitely** - *Ethan Allen Interiors Inc. - Executive VP of Administration and CFO*

Thank you, Farooq. During the second quarter of fiscal 2021, our teams remained focused on serving our clients and keeping our workplaces safe. Our retail segment written orders continue to accelerate, achieving 44.9% growth compared to the prior year. Our e-commerce orders reflected 194% growth for the quarter. We are pleased that our January retail written orders are continuing the upward trend.

Consolidated net sales for the quarter were \$178.8 million, a 2.4% increase to the prior year quarter. Wholesale net sales increased 10.5% as production levels throughout our manufacturing steadily improved, and our peak production weeks during the quarter matched the pre-COVID-19 production levels. Wholesale segment written orders increased 28.1%. Excluding GSA and other government orders, wholesale segment orders grew 39.7%. We continue to see COVID-19 pandemic-related disruptions that are delaying issuance of new GSA and other government orders.

Our retail net sales increased 4.1% for the quarter. At the end of the quarter, both retail and wholesale had high order backlogs that we expect to get caught up over the March and June quarters.

Our adjusted gross margin increased 80 basis points to 56.9%. 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 81% compared with 79.7% a year ago, which positively impacted consolidated gross margin.

Adjusted operating margin, which excludes the impact of pretax charges from restructuring initiatives, asset impairments and other corporate actions, increased to 13.1% compared to 5.4% a year ago, primarily due to a 3.9% increase in gross profit and an 11.4% reduction in adjusted operating expenses. Adjusted operating expenses for the quarter were lower due to reductions in selling expenses, including advertising costs and reduced compensation expense as we are operating more efficiently with 19% less head count than in the prior year period.

Our GAAP EPS was \$0.67 compared to \$0.27 in the prior year quarter. Our adjusted diluted EPS increased 155.6% to \$0.69 compared to \$0.27 in the prior year second quarter.

As of December 31, our balance sheet remains strong with cash on hand of \$80 million, inventory of \$126.7 million and no outstanding borrowings. During our fiscal first half, we generated \$65.9 million of cash from operating activities, a 181.8% increase from the prior year period. We paid regular dividends of \$5.3 million during the quarter. In November, the regular dividend was increased by 19%, and we just paid \$6.3 million in regular dividends on January '21, reflecting the increased \$0.25 per share dividend.

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

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

All right. Thank you, Corey. I am also pleased to provide a brief overview of our initiatives, which as we have discussed previously focuses on 5 important areas. The first is talent. Talent development is key and a continuing process. Crisis does create an opportunity to review talent, and I'm pleased we have greatly strengthened our leadership in our retail network, in our merchandising, in our marketing, manufacturing, finance, technology and other areas of our vertically integrated enterprise.

The second area is marketing. We continue to refine and invest in various mediums, most importantly, in the digital mediums. Digital mediums have enabled us to increase our reach to more potential clients while reducing our marketing costs.

The third area is service. We continue to make progress despite many challenges due to COVID-19, the issues -- the transportation issues in getting products from East Asia, shortages of raw material. However, our advantage of making about 75% of our products in our North American workshops is an advantage. And as reported, we expect to catch up in the next few months. And we are also investing in our North American manufacturing. Our logistics network of delivering products in white glove service across North America is a strong advantage, and we continue to refine.

The fourth area is technology, combining technology with personal service of about 1,000 talented in-house professional interior designers has been a key to increasing written business at retail. We also -- as Corey said, we also have had major increase on our e-commerce. We are investing in technology in various areas, including retail network, manufacturing and operations.

And the fifth area is social responsibility. We've always been in forefront in this area, not because of external pressures, but because it's the right thing to do for the welfare of our associates and our clients.

Now as we indicated in the press release, we see that our January written orders continue the upward trend. Also, the government orders that were postponed have started to come in, in January.

And with this brief overview, I'm pleased to open up for any questions and comments.

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## QUESTIONS AND ANSWERS

### Operator

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

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

Farooq, I was hoping to ask about this important topic of converting these orders into revenues, particularly because the order trends that you've been seeing are just so extraordinary. I mean this is the best that I can recall in over a decade of covering the company.

I know that this is an unusual world that we're in. There are logistical challenges. It sounds like you'll be able to make some progress here in your fiscal third quarter. But could you talk a little bit about what a reasonable revenue growth rate might be given the strong backlog that you have to work through?

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

Yes. Brad, it's a very important issue. It's been a challenge. I would say that -- overall, I don't have to mention all the issues that every -- that I'm sure you've all heard about the issues of transportation of raw materials and all of that. Our advantage is the fact that 75% is made in our North American workshops, and we have increased our capacities.

We have worked very hard to get some raw materials, which have created issues like, for instance, we don't make the fabrics. We make 100% of our upholstered products which is the largest category of -- in our business, in our own workshops. So it's improving. I would say that we would see increases in this coming quarter and maybe more might follow -- flow into the fourth quarter, but we'll see how it goes, Brad.

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

Okay. Is there a -- any sort of way you could help frame up what's a reasonable revenue range -- reasonable revenue growth rate might be for this March quarter? Because in a normalized year, if your supply chain and your factories were 100%, one would think that we would be seeing double-digit revenue growth this quarter. Can you help give us any perspective on what reasonable growth might be for this quarter?

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

Yes. No, Brad, I mean, obviously, we have 146% increase in our backlog in our retail division. We have a measure in the wholesale. I would say that I'm just thinking loud right now because again, there's so many factors beyond our control. I would say that we should increase our revenue -- our delivered sales that we are talking about, right, this quarter, I would say that at least anywhere between 10%, 15%, 20% in that range is what I would like us to increase our delivered sales.

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

That's very helpful, Farooq. And lastly for me, I was curious if you could just give us some sense of how you're managing some of the inflation that we're starting to see bubble up. Obviously, some of the raw material prices are increasing transportation costs, et cetera. How do you feel like Ethan Allen is positioned to deal with some of those in the quarters ahead here?

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

Yes. They are increasing. And in fact, I'm sure that you're also aware of the fact that, obviously, our exposure to external sourcing is less than 25%. But even there, we see a major increase in transportation costs, especially -- I think the short-term thing that we are -- everybody is being asked to pay somewhat of a premium to even book a container. If our business are all import related, it would be a big, big issue.

I would say that we have, fortunately, most of our lumber. We do it -- we have our own saw mill, we go to the forest. We are okay over there. Where we do see some -- we do see increases is really more on the 25% of the imported products and of course, the fabrics. So I would say that, Brad, that there is an increase. And what we are considering is in the next few months a small price increase at retail.

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**Operator**

Our next question comes from Joe Feldman with Telsey Advisory Group.

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**Joseph Isaac Feldman** - *Telsey Advisory Group LLC - Senior MD, Assistant Director of Research & Senior Research Analyst*

So I wanted to ask, with the January backlog up so much, did stimulus help that at all? Or is it just that the demand is so strong? Like what's driving that? Was it the marketing that helped? Or it sounds -- are you seeing new customers come in? What do you think that's behind it all?

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

Joe, we've got a great company. We've got great products. We've got great people. That's the #1. But also, I would say that the result is -- certainly, the result is people have been interested in home, there's a lot of interest in home. And then people are looking at our brands where we have quality, we can deliver the products. And it also goes back to that Brad had asked, we have also given more discounts or savings than we normally would do. And there's a reason for it.

Even though our margins have held up, our sales have increased, we have given savings up to 25%. And the reason is that we want to -- and I wanted to make sure that all the new people that are interested in home come to us and become our clients. And that's what also taking place. So I would say the benefit of our client base, plus increasing clients through, of course, our marketing, through our name and also the savings is -- which has all helped us increase the business.

**Joseph Isaac Feldman** - Telsey Advisory Group LLC - Senior MD, Assistant Director of Research & Senior Research Analyst

Got it. And that was another topic we wanted to ask you about was on the promotional side. I mean have you had to -- have you scaled back the promotions this period, just given the demand is so high? And how do you envision the environment in the coming 6 months to round out the fiscal year?

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

But, Joe, take a look at this. When you take a look at what we have done, we have given more discounts. We have had somewhat less production. We have been faced with all issues, but our margins at our wholesale increased and our margins at retail increase with all of this. So a lot of reasons behind it, but efficiency in terms of operating our business, at our manufacturing level -- at the retail level has given us, at this stage, greater margins with all the challenges I've talked about without an increase in sales.

Now I'm talking about gross margins. Our operating margins have also increased with a lot of reasons. And of course, as Corey just mentioned, we have reduced our expenses. We have even reduced our marketing expenses from spending close to 5% to spending less than 3%, not because it's been less -- we have -- it's less effective. But today, digital marketing and all the tools that we are using is giving -- helping us to reach more people and less costly.

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**Joseph Isaac Feldman** - Telsey Advisory Group LLC - Senior MD, Assistant Director of Research & Senior Research Analyst

Understood. Understood. If I could just sneak one more in. I guess if I were to walk in today and buy a new sofa, how -- what are you telling people these days? Is it 8 weeks, 12 weeks, I assume, 14 weeks? Like what's the time frame you're giving them these days?

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

The good news is that it's being reduced and approximately 8, 9 weeks is the time we are giving. And keep in mind it's all custom. And we also have an element, which we call Quick Ship, which is still made custom, but there, we are now shipping in less than 6 weeks.

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**Operator**

Thank you. There are no further questions at this time. I'll turn it back to management for closing remarks.

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

Thank you. Well, thank you very much. And I know, of course, we have given a lot of information out, and I understand the reason we don't have questions is because we've given a lot of information and of course, the results are good. The objective really is to continue to operate the business. As I said earlier, the first important thing is do it safely. The welfare of our people is tremendously important at all levels, and we are very, very pleased that our people have really done an amazing job in terms of managing this health crisis.

So we're going to continue to be very proactive. We have a major, major focus in increasing our offerings to reach a consumer base that we believe is very much relevant to us. We are going to increase our technology. We are going to increase our manufacturing, for instance, we are doubling our production in some of our wood products in North America.

We had already, in the last few years, invested greatly to double our capacities in terms of capacities of our facilities in our upholstery manufacturing. And so we are ready to grow the business, and we are ready to service it.

So again, thanks to everybody being part of Ethan Allen and to all our stockholders and also to all our associates who are listening.

**Operator**

Thank you.

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

Thank you very much.

**Operator**

This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.

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