



Delta Apparel, Incorporated
Fiscal 2012 Second Quarter Earnings
January 26, 2012

Operator: Please stand by, we are about to begin. Thank you, and good afternoon to everyone participating in Delta Apparel's Fiscal 2012 Second Quarter Earnings Conference Call. Joining us from management are Bob Humphreys, Chairman and Chief Executive Officer; and Deb Merrill, Vice President and Chief Financial Officer.

Before we begin, I'd like to remind everyone that during the course of this conference call, projections or other forward-looking statements may be made by Delta Apparel's executives. Such statements suggest predictions and involve risk 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. This document contains and identifies important factors that could cause actual results to differ materially from those contained in the projections or forward-looking statements. Please note that any forward-looking statements are made only as of today, and the Company does not commit to update or revise these statements, even it becomes apparent that any projected results will not be realized.

I'll now turn the call over to Delta's CFO Deb Merrill who will provide the details of the Company's fiscal second quarter and first six months.

Debra Merrill: Thank you and good afternoon. As you no doubt have already determined from our press release, this was no ordinary quarter for Delta Apparel. Before I go into the details of our results for the period, I want to discuss briefly what made the quarter more difficult and what we did to improve the Company's outlook for future quarters.

A big challenge faced in times of volatile raw material costs and other inflationary pressures is the markets and consumers willingness to accept apparel price increases when apparel has been in a deflationary environment for many years. This is especially true on basic undecorated t-shirts, our Delta Catalog business.

During the past 18 months, the industry has witnessed a remarkable and unprecedented increase in cotton prices from about \$0.60 per pound to highs of over \$2.00 per pound. As this was occurring, selling prices on basic undecorated tees were increasing, however prices did not go high enough to cover the tee cotton cost. Being a vertical manufacturer, there's a lag between when yarn is brought into inventory and when the manufactured products are sold and the cost recorded in cost of sales. In the fall, cotton t-shirts began declining quite dramatically off the peak and demand for tees weakened. This led to significant selling price declines on basic tees. The disparity between the lower selling prices and the high product costs impacted our Delta Catalog business by 3.2 million in the second quarter. In addition, the inventory on hand still contained high cost cotton that would impact future quarters. Rather than letting this play out over several future quarters, we made the decision to absorb the entire impact in the second quarter by marking down the value of our undecorated tee inventory by 16.2 million, bringing the total impact on our second quarter results to 19.4 million or \$1.46 per share. Taking the entire amount of the inventory markdown in the second quarter immediately puts this behind us and allows us to operate our Delta Catalog business for the remainder of the year without the negative effect of high cotton cost.

With that said, second quarter net sales were 105.5 million, up from 104.7 million in last year's second quarter. The Company had a net loss in the second quarter of 13.6 million or \$1.61 per share, compared to net income of 1.4 million or \$0.16 per diluted share in the prior year period. As a reminder, the prior year second quarter included a gain of \$0.07 related to our Art Gun acquisition.

Sales in the basic segment, which includes the Delta Catalog business as well as our private label FunTees business increased to 57.6 million, a 2.4% increase over the prior year second quarter. The sales decline in the Delta Catalog business was more than offset by increases in the FunTees business driven from private label programs with new customers, as well as higher volumes in pricing with existing customers.

In the branded segment, sales for the second quarter were 47.9 million down slightly from a year ago. Vintage tee sales were strong during the quarter continuing the double digit sales growth experienced in the first quarter. Sales of Salt Life branded products also continued to grow through geographic and sales channel expansions. This was offset by greater than expected fall off in demand for Softe products. While the increased pricing to offset higher cotton costs resulted in decreased volumes and slightly lower margins overall for the branded segment, gross margins did improve in the Art Gun and Junkfood businesses.

For the first six months of fiscal 2012, sales increased approximately 8% to 229 million versus 212.6 million for the first six months of

fiscal 2011. The Company had a net loss in the six month period of 9.2 million or \$1.09 per share resulting from the second quarter loss partially offset by the Company's record earnings in its 2012 first quarter. SG&A expenses as a percentage of sales continue to improve in the second quarter, and for the first six months are 19.5% of sales compared to 20.2% of sales in the prior year six months, reflecting the continued leveraging of our fixed, general and administrative costs.

Our effective tax rate for the quarter and first six months includes the full tax benefit expected from the inventory markdown. We expect our effective tax rate in the third and fourth quarters to be approximately 24%.

Capital spending during the quarter was 1.7 million, and depreciation and amortization, including non-cash compensation was 2.2 million. We continued our stock repurchases during the quarter using 830,000 to buy back 50,000 shares at an average of 16.60 per share. At quarter end, we had 6.1 million remaining authorized for repurchases. Total debt was 120.5 million at December. Historically, we are at our peak working capital levels during the March quarter. As such, we would expect debt levels to increase in the March quarter and then decline as we approach our fiscal year end.

Despite the week demand in the second quarter, we believe we fared better than the market overall, and continue to experience overall sales growth both in the second quarter and first six months. Although we will continue to see some margin pressure in our branded and private label businesses related to the high cost cottons, our undecorated tee business will be operating in the third and fourth quarters without the negative impact of the high cotton costs.

As we head into the spring selling season and with the burden of the high cost cotton on our undecorated tees behind us, we expect to see sales and earnings growth over the prior year in the second half of fiscal '12. For the full fiscal 2012, we expect net sales to be in the 480 to 500 million range, and earnings in the range of 50 to \$0.60 per diluted share.

I'd now like to turn the call over to our Chairman and CEO Bob Humphreys for some remarks on our future growth strategies.

Bob Humphreys: Thanks Deb. You've just heard about the challenges we faced navigating through some unprecedented times in the cotton market combined with a weak general economy, and the bold steps we took to mitigate the effect of these challenges for future quarters.

While cotton has come off its highs, it is still volatile. Most analysts are forecasting world consumptions to be below world production

for this crop year resulting in a further increase in ending stocks. While this would suggest a further weakening in cotton prices, we have seen circumstances over the past several years where fundamentals are ignored by speculative investors who often trade more on technical analysis. Therefore at current pricing, we will remain conservative in our future cotton commitments.

As Deb mentioned, demand for undecorated tees continues to be weak. The industry took substantial additional downtime during the holiday shutdown. My analysis suggests approximately 5% of the annual production was curtailed. Over the next several months, we'll know that this reduction in output, combined with lower inventories at the distributor level was enough to get overall industry inventories and demand back in balance.

We continue to feel good about our direct strategy in this market segment. We have recently gone live with a new BtoB (sp?) website to offer higher service levels to our customers. We also believe we have the right leadership team in place to continue to grow market share with enhanced product offerings on basic tees, and are further leveraging these products in the expansion of our branded businesses. In addition, we are continuing our efforts to reduce costs and manage the capital employed in our business operations.

Our manufacturing facilities are operating efficiently and improving productivity. Our six sigma initiatives are driving reduced demand, reduced production of quality and further expansion of output to the existing equipment on hand. We will continue to adjust our running schedules as necessary to appropriately manage overall inventory levels.

Although we remain cautious about the overall state of the economy in the apparel marketplace, we are very optimistic and excited about the many opportunities we have with the assets in our business to drive growth in the future. Those drivers quite simply are great people with amazing creative talents, brands with consumer appeal, great products which serves specific needs and expansion opportunities on multiple levels.

In our second quarter, our private label programs for international, athletic and lifestyle brands grew almost 40%, with more than half of this growth coming from the expansion of the customer base. We believe our private label programs offer a significant opportunity for continued growth, and we are continuously exploring additional ways to improve profitability while maintaining the extremely high service level required by these customers.

JunkFood continued its momentum from the first quarter with another quarter of double digit sales growth. Leveraging the talents of our excellent creative team and new license, we continue to broaden the category offerings. We were being requested to take on new projects such as the Monopoly game, which is currently being featured as the storefront display of

the new Kissens (sp?) in Santa Barbara. The seasonality of JunkFood drives stronger sales in our first half that we are confident that over time, we can strengthen JunkFood shipments in our second half as well.

We expect growth in our Soffe business in our second half and for our full year. We have the strongest order book for spring shipments in our history, and are well positioned to support our replenishment business. Our rollout of a new XT46 men's training gear, and further emphasis on the sporting goods channel offer important growth opportunities for the future.

Salt Life branded products continue to perform well at retail and will be an important driver of future growth. By the end of June, we will have thorough geographic coverage across the Southeast supported by regional and national retailers. These include department stores, sporting good retailers, outdoor retailers and specialty shops. While the brand got started at the grass roots level along the coast, we are finding there is excellent consumer demand inland as well. We are expanding our Salt Life product offerings and developing plans to build distribution in other parts of the country. Our e-commerce site www.saltlife.com is growing rapidly in popularity, and recently won an award for one of the best of new websites. Our Salt Life retail store will be opening this spring in Jacksonville Beach where Salt Life was born.

In summary, while we remain concerned about overall economic conditions and volatility in raw material and energy costs, we remain optimistic about our business prospects. We believe the combinations of our brands, license agreements and unique creative talents, combined with our manufacturing and service platform will allow us to further grow our business and gain market shares in the channels where we participate.

At this time, I'm going to turn the call back over to the Operator to begin questions.

Operator: And, if anyone would like to ask a question, you may do so by pressing star followed by the number one on your telephone keypad at the time. Please make sure that your mute function is turned off to allow your signal to reach our equipment. Once again, that is star followed by the number one to ask a question. We will go first to David Griffith of Roth Capital partners.

David Griffith: Yes, good afternoon.

Debra Merrill: Good afternoon.

David Griffith: Deb and Bob, can you maybe touch a little bit on the components of inventory? You know, if you basically added back the write down, it looks like we'd be at about maybe close to \$200 million. Have you brought in

more yarn at this point? And Bob, it sort of sounded like you were still fairly cautious on pricing.

Bob Humphreys: Yes, we are still cautious on pricing, and you know, future commitments, and I think Deb could probably give you a little more flavor on where that reserve resided in different categories of inventory.

Debra Merrill: Sure. David, you're correct on the inventory would be just right at about 199 million if you add back the write down that we took. And that is, you know, certainly has some higher pricing on cotton in our brand and in private label businesses in that inventory value, along with some slightly higher units based on the weaker than expected demand in the second quarter. But, we do anticipate those inventory levels declining as we head through the end of the year, and the higher cost cotton and rest of the businesses flush out as well as the units sold during the fiscal year. So, we expect to see that decline as it normally does over the course of our third and fourth quarters.

David Griffith: So, just kind of ballpark, what would you estimate is sort of the inflationary impact in inventory? It doesn't sound like units are up substantially.

Debra Merrill: Yes, I would say that there is probably still about 8 to 10% higher—of that cost is higher cost in the inventory as opposed to even.

David Griffith: Got you. And then, Softe, you mentioned a bit of a fall off, and yet it sounds like the forward look is actually really good. Kind of, what changed there? Or, is it just some new programs that really helped there?

Bob Humphreys: Yes, I think, you know, first of all, the December quarter is Softe's weakest quarter, and so, a little bit of a change there can have a big impact. Unusually for them, all four distribution channels were either down or flat, which often times we don't have one or two but we'll have growth in other places. You know, the weather certainly wasn't pro Softe, and then we, you know, had (inaudible) and, you know, open to buy dollars going away when other types of products were not selling, you know, we continue to have good sell through with our product and continue to have growth at our website there on Softe products, which we always think is a good barometer for how your brands are really performing.

And then, as far as the second half, we just have a strong forward order book, much stronger than we typically have in Softe, and a little bit different terms and conditions on that order book that gives us more confidence that our retailers are committed to take that product. So, you know, we seldom have problems. Once we give it to the retailer, Softe has a long history of their products retailing well, but you do have to get it to the retail floor before you can sell it.

David Griffith: Right. And, are there some specific programs that are really performing well or that you can call out?

Bob Humphreys: Yes, I don't know—I mean, we have some new programs rolling out. They're not going to be the ones that really move the needle. You know, we always have fresh graphics, you know, fresh tops for the junior market, but still, the Softe short is strong. We've got some retailers that are going to carry it for a longer period of time. You know, we'll have some additional doors on that product. So, you know, it's a combination of a lot of little things, and then again, particularly the forward commitments on what we consider the fashion buys, the things that we are not going to replenish.

David Griffith: Very good. And then just lastly, could you maybe tell us a little bit more about the business and business website and when that launched and kind of what you're going after there?

Bob Humphreys: Okay. Deb, you want to take that?

Debra Merrill: Sure. We launched that during the second quarter, and we have had a Delta for the Delta Catalog business, a website out there for a while, but what we did is freshen that up and put features out of there so that our customers would be able to view inventory levels, place their orders at their pricing structures, and basically have the convenience of placing their orders throughout the day, and then submitting their order for shipment. And so, we've gotten some very positive response on that website from our customers, and we think that that not only is going to provide extra service levels for them, but then also enhance our business and allow the two to work together nicely there.

David Griffith: Very good. Okay, thanks.

Operator: We will go next to John Curti of Singular Research.

John Curti: Good afternoon.

Bob Humphreys: Hey John.

John Curti: Had a question regarding the inventory write down, because you mentioned that, it kind of sounds like you took most if not all of the flow inventory write down on the private label side, and very little if any on the branded side.

Debra Merrill: John, we took the inventory write down on the inventory associated with our undecorated t-shirt business, our Delta Catalog business where we did, and that's where it has the most impact where we did not take on any inventory write downs for that reason in the private label business as

well as in the branded. So, it was just that Delta Catalogue business that the write down relates to.

John Curti: So, those other areas will be fighting the head wind of higher cotton prices over the back half of the year?

Debra Merrill: They will be experiencing some margin pressures, however those are the businesses where we really were able to get paid those higher cotton prices through increased selling prices on—you know, to a much greater extent than we would have been able to in that undecorated t-shirt business. So, there will be some margin pressure but not nearly to any great magnitude like it would have been on the undecorated even.

John Curti: Then you mentioned that private label was up 40% with about half of that expansion of the customer base. Could you talk about that expansion in the either new channels or new big customer wins there?

Bob Humphreys: Mm hmm. Yes, you know, I'm hesitant to talk about specific customers because, you know, we don't like to be the ones that announce their source and strategies and what have you, but you know, we have added more business with the major consumer lifestyle brands that, you know, you'll see at department stores and retail channels, and then I think a little bit of further support of people who have programs directly with retailers as well. So, we think we have a unique service model there. It's transaction intensive. There's a lot of support that these customers need, anything from inventory tracking and quality consistency to certification of the workforce in these locations. You know, everything they wanted to do to protect their brand or identity, whether it's a retailer or a brand owner. So, we do think we have a unique system there that will continue to grow carefully, and because of the service level required, you know, you need kind of major customers and not a lot of small programs because you just can't service them well.

John Curti: So, with that expansion of the customer base, kind of just very early in the process then, we should see volumes continue to build in the back half of the year with those new customers?

Bob Humphreys: That's correct. Several of them, we really just started shipping in the second quarter, but they'll continue on out through the rest of the fiscal year.

John Curti: And then with respect to Salt Life, you mentioned that you've now got coverage, kind of across the south. I know when you purchased the brand, it was very local. So, can you give us an indication of maybe how many outlets you're in now versus when you first took over the brand?

Bob Humphreys: Yes, I would say, without having an account right in front of me, we were probably, I would say in the 100 to 125 doors when we took this over about 12 months ago, and I'd say by June, that would be north of 500. So, it has expanded rapidly just in the last couple of months where we did small tests with some major retailers there rolling it out faster than what we would have expected.

So, right now we're all hands on deck to properly service that, and you know, help them roll out the new product. But, virtually everywhere we've put it, we've had sell through that exceeded our expectations and our retailers. So, obviously we feel good about that. As I mentioned, it seems to sell as well 300 miles from the coast as it does at the coast. So, you know, that's obviously been very encouraging for us.

John Curti: You also mentioned further possible geographic expansion. Will that be occurring in this current fiscal year? Or more likely in the following fiscal year?

Bob Humphreys: Yes, I would say in the following fiscal year. And there are some national retailers, West Marine would be an example, you know, that certainly is carrying the product in other geographic regions. But, you know, we are evaluating some different strategies to go make a bigger impact in different regions, you know, when we go there, do it in the right way, build the same grass roots support like we had in the Florida coast and in the Carolina's and what have you. So, we're working on those strategies now, and I would say it would be more next fiscal year before we actually start seeing revenue from that.

John Curti: And lastly, we had signed up some new licenses. H&B (sp?) and you were also doing headwear for Under Armor. I was wondering how those were progressing?

Bob Humphreys: They are continuing on. You know, H&B, we're really just getting product developed and approved by them and we'll be taking that to market, but we are now shipping product for Under Armor and their headwear business.

John Curti: Will the H&B product ship in the second half?

Bob Humphreys: It will start shipping but I would say it would be more of a next fiscal year, you know, initiative where we really can start seeing the sales.

John Curti: It kind of sounds like you've got a lot of initiatives that are going to carry over into the following fiscal year before they start to gain some traction or get started.

Bob Humphreys: Yes absolutely. And, you know, particularly a lot of these small license are new license for us that don't have a big retail presence now. You know, they do start small and you kind of have to nurture them and let them gain momentum. So, it's not necessarily any one that is going to make a difference, but we do have to develop—start bringing them along. And you know, over time they make a difference, and then when you're really fortunate, you get a Salt Life or something like that comes along that can have a pretty big impact pretty quickly.

John Curti: Thank you very much.

Bob Humphreys: Okay.

Operator: And, we will go next to Jamie Wilen of Wilen Management.

Jamie Wilen: Hi fellows. Let me just follow along on the last questions because he asked a bunch of mine already. In addition to what you singed up with H&B and Under Armor, are there any other new licenses in the pipeline for you?

Bob Humphreys: You know Jamie, we don't have anything new right this minute to talk about. We always have list ones that we're working on, and you know, negotiating for. I mentioned Monopoly. That was one again that the owner of that brand asked us to do something to kind help on the apparel side and get some new, you know, excitement and notoriety. We were flattered that they came to JunkFood. They're some really fun interesting product. Like I said, it's in the storefront of Kissens right now in Santa Barbara. So, that will be some new product rolling out. And again, it's usually no single license but the accumulative affect of that.

I will say that, you know, what we've been able to do on the Salt Life side, not only with physical product and rolling it out but the distribution we've gotten it in, you know, we delivered a website from scratch in about four months there. We had significant sell through in the second six months which were the six months ending in December. There's a lot of content on that website. It's beyond just pick a t-shirt. But anyway, that is being recognized in the marketplace, both by people who have brands and distribution and other retailers, and so, you know, we do get phone calls about, hey I could be your next Salt Life. And, we don't always agree with that obviously, but it's flattering to get the calls and more importantly to get the ideas pitched to us that

we can take advantage of as we, you know, select the right products and feel like it fits into our appetite and not overloading what we're trying to do.

Jamie Wilen: Okay. On Salt Life, not a day goes by that I don't see a sticker on the back of a car or someone actually wearing a Salt Life shirt, and I'm kind of amazed at the hold that it has on people. I was wondering, you're taking the growth in a very controlled manner, and what really is the reason for it? Do we not have the inventory to be able to service it? Or, do you want to be kind of like a Coors beer approach coming from Colorado to the East Coast if the people are really clamoring for it?

Bob Humphreys: Well, I think, if you just think back 12 months ago, you know, when we took this thing over, it was kind of run out of a warehouse with a system that basically did more in a hodgepodge of sourcing, you know, some good art, some good ideas, but there was no real regular apparel business plan. And so, we were sitting there, you know, flat footed with that and we took on the inventory they had; we started developing new products; we started sourcing new products; we had to get that moved to a distribution center that we could control and operate; we've been getting that distribution center equipped to ship and handle this kind of products, you're going to ship cased goods, you're going to do pick and pack to support the smaller retailers; we're installing the software platform that we use for our branded business which is Blue Cherry and we'll go fully live on that prior to the end of this fiscal year; we had to build a website from scratch. And so, the worst thing you can do with these brands is overrun your headlight, and give retailers a bad taste in their mouths about how you're servicing the business.

And so, you know, while it seems silly, how could we be out of a t-shirt but we have a nicer t-shirt that we've developed for Salt Life, there's some different products and we want to do it right, I guess is my point. So, we're certainly not trying to slow it down but we are trying to do it in a thoughtful way that really does build brand equity over time. You know, we've got some other announcements we think will be forthcoming on Salt Life and what we can do there in the next several weeks or months. Just stay tuned.

Jamie Wilen: Got you. On your website, could you tell us the growth in website sales at the moment?

Bob Humphreys: Deb, do you have that number?

Debra Merrill: Yes. Overall, you know, across our different branded sites, at the last kind of two years or so, we have been tracking probably 20 to 30% growth rate over the cheater period across all of those sites.

Jamie Wilen: Okay. And, a couple of cost questions. I don't know if you can tell me the answers, the difference—the percentage of costs that cotton represents in undecorated tee versus a branded tee.

Bob Humphreys: Deb.

Debra Merrill: And, I guess when you're talking about a percentage, it depends on if you're talking about the percentage when it was \$0.60 cotton or the percentage when it was \$2 cotton.

Jamie Wilen: Okay.

Bob Humphreys: Well, let's just use \$1 and I'll take that kind of Salt Life t-shirt which is a nicer t-shirt than the real commodity tees but we won't have those customers buy that, and I think it really speaks to why we have the strategy we do for more value adding. So, let's just say that t-shirt today at \$1 cotton is going to have about \$6 worth of t-shirt in it. And, if you were selling it in the screen print market, it would probably be a \$2.50 tee. Like I say, it's a nicer tee with a pocket on it.

So then, if you printed on that t-shirt, you're going probably add about \$1 of value adding to it. Maybe if you do some retail put up, you're going to add another \$0.50 to \$1, you know, depending on what type of put up that is, it's a bag, it's the hanger or whatever. So, you know, maybe you're up to \$4.50 tee. And then, if we sell that as a Salt Life tee and we've printed on it and we've done the retail put up, then it's going to be about a \$9.50 tee.

Jamie Wilen: You've got me real confused there Bob. Can you...

Bob Humphreys: Okay. Let me go back.

Jamie Wilen: I mean, if a—I thought you were saying on a 2.50 tee, it's \$1 of cotton. Is that what you're saying?

Bob Humphreys: No, well I'm sorry. On a 2.50 tee at \$1 of cotton is going to have about \$0.50 of cotton in it.

Jamie Wilen: Fifty cents of the 2.50 is cotton, okay.

Bob Humphreys: Yes. Okay? And then, you know, you probably followed my other steps. I think was talking about cotton per dozen and I was talking about a single tee there.

Jamie Wilen: All right. And let's see. Lastly, the buyback program, you have some availability. Will you be active in the market again once the quiet period ends?

Bob Humphreys: Yes, and actually, the way we do that, and new Safe Harbor rules quiet periods really don't apply because there's some mechanism out there that keeps us from influencing the market, but you know, we always are looking at that in our cash availability and other business opportunities, and I'll say the orderly trading volume of our stock. So, you know, we certainly have availability out there under what the board authorizes us to do, and if you look back over our history, I think just about every year, there might have been one or two where we weren't buying back our stock, and you know, we think it's a good buy at these levels and would continue on that path.

Jamie Wilen: Okay. And lastly, you made a comment about the second half, you expect your sales in the second half to be above year ago? Or, did you say sales and profits or just sales? I didn't quite catch that?

Bob Humphreys: Where we sit today, we would expect growth in sales in our EPS.

Jamie Wilen: Okay, perfect.

Bob Humphreys: Remember, that will be after the cotton adjustment, obviously.

Jamie Wilen: Absolutely, absolutely. Okay, thanks fellows.

Operator: And, we will go next to James Fronda of Sidoti & Company.

James Fronda: Hey guys. Most of my questions have already been answered. Basically, one question I had though going forward, I mean, what type of growth are you looking for? Are you going to strictly organic with what you have now? Or, are you looking to make more acquisitions? Do you have any thoughts?

Bob Humphreys: Well, you know, we've always been, I would say somewhat of an opportunistic acquirer. When we think a business, a, works for us and b, is priced reasonably for what the business's size and market share and brand, equity and what have you, and we often find that we disagree with sellers about what that should be.

James Fronda: Yes.

Bob Humphreys: So, we don't have a certain hey, we've got to go acquire x amount of revenue. What we do believe is that we can meet our, I'll call it intermediate business goals 12 to 24 months out with the opportunities we have at hand, organic growth, improving our operations, what have you. And, you know, sometimes further license or license brands which are—can do the same thing for us as an acquisition but without some of the heartache in capital associated with an acquisition. You know, as soon as I say we're not interested in acquisitions, then a great one comes by and it makes a liar out of me. But, we'll keep our eyes open but have a strategy in place to grow our business with what we have.

James Fronda: All right. Makes sense. Thanks guys.

Operator: We will go next to John Boone of Scopia.

John Boone: Hey guys. I just have a couple of quick questions about the basic apparel market. You had mentioned that kind of you've done some work and I think you threw out a high percent number a little earlier in the presentation, but I think it would be helpful if you can just give a little bit of a timeline on kind of, when really the market turned and to what extent you think it turned in terms of, like you said, the 5% before. And, how you really think that broke out between distributor de-stocking and then the other part maybe being end use demand substitution to something besides t-shirts, and then maybe some other category.

Bob Humphreys: Yes. Well, that's a big complicated question. I don't know if I have answers for all of that, but you know, I'll just say that if you look back retrospectively, which obviously is a lot easier, but probably starting in July of last year, you know, up until that point, the whole industry I would say was chasing demand and price increases were going through in an orderly manner. And again, about end of June and end of July, when the season starts slowing down as well, and so we stall that and I'd say pricing kind of remained steady, and really remained, you know, pretty steady through September and into October, but by late October early November, from where we were seeing, and obviously we have not as a broad a view as maybe some bigger players in that marketplace is really when we started seeing, you know, some weakness in demand, and then a pretty quick really fall off in pricing, and competitors started getting very aggressive on trying to move more volume through pricing.

So, you know, we saw that, and then you had most people take either two or one additional week out of manufacturing before the Christmas shutdown. So, that's typically about two weeks in Central America. And so, for most people, that went to four weeks, and some three weeks. In our case, we shut down Central America for one extra week, but we kept our U.S. textile and Mexican sewing going to support these private label programs that were not affected by this.

So, and obviously, if you start shutting down manufacturing for four weeks, then you know, your time coming down, your time coming up, you know, takes out some of the production just through the inefficiencies of starting up and shutting down, getting people back to work, back productive and what have you. So, you know, it's not a perfect science but my analysis of that from seeing what was going on was if you took the annual output of I'll call it undecorated tee, so you go into the market, forget how they went there, it was about a 5% production of—reduction of annual production which I consider, you know, a substantial amount. If you look at ending inventories for the distributor market, I think they were slightly below where they were a year ago. Their shipments were slightly below where they were a year ago, but you know, the good news is if you went back several periods, the distributors were over-inventoried. So, I think that part has been flushed out.

And, you know it is too soon to tell, but in the next four to eight weeks, we'll know if the industry, you know, all of the manufacturers took out just the right amount or too much or not enough.

John Boone: Mm hmm. And, when you said 5% reduction, you mean kind of all of 2011 compared to 2010? Or, just the month that it was struck?

Bob Humphreys: Yes. I just say, if you looked at the in-place capacity on an annual basis and what it would normally be run, let's call a normal year say it's going to run for 49 weeks, whatever that total capacity is, I'd say was reduced by about 5%.

John Boone: So, then those last few months of the year really came down?

Bob Humphreys: Yes, principally in December; December and early January.

John Boone: Okay.

Bob Humphreys: Obviously, I don't have exact information by everybody, so some of us (inaudible), and you know, knowing the industry and the outputs and that sort of thing.

John Boone: Mm hmm. What's your view on whether or not end use demand and substitution happened, people kind of switched from shirts to some other sort of product? I mean, do you think that happened?

Bob Humphreys: Yes. I'm sure it probably happened some. You know, we don't really sell to the distributor market, so if you look at where we sell,

people generally specifically are looking for t-shirts. I don't know that are pulse is on that maybe as good as some other peoples. But, my sense right now is the end demand for tees is at least steady, you know? It's solid. We're going into a national election year which is generally always good for t-shirts and promotional type items there. So, my sense is that the demand is going to be okay, and then you know, the question is are we over-inventoried or not, and if so, how long does that take to correct itself? But, I would say, you know, you take any big market and you take 4 or 5% of its capacity away suddenly, it has a big impact. You know, it's not just like people slowed it up a little bit.

John Boone: Yes, that makes sense. And, just one last quick question. When you talk about the example as just a second ago, on the previous question, it kind of went from the \$0.50 cotton to the \$2.50 blank t-shirt, and then kind of said what it would be, it would be 9.50 if you sold it as kind of the branded tee.

Bob Humphreys: Right.

John Boone: How should we think about the incremental margin on that retail side? I mean certainly, I'm assuming you know costs go up to some to have to put...

Bob Humphreys: Yes.

John Boone: I mean, that's an incredible jump.

Bob Humphreys: So, you know, you go from basically a mid teen gross margin to a 50, 55% gross margin. Now, you've got some offsets to that. You've got more SG&A costs. In the Salt Life example I was using, you know, we would have royalties to pay. You'd have some other examples like maybe a JunkFood shirt. There would be similar numbers if it's JunkFood proprietary art, you know, we wouldn't have royalties to pay. But, clearly the opportunity for, you know—and we try to look at things at the operating margin opportunity more so than the gross margins.

John Boone: Right.

Bob Humphreys: But you know, you've got—for us, where we are in the marketplace, a better chance. If you can be a dominant force in the commodity business, that may be different. But for us, we think more value adding more are ways to differentiate ourselves as a way to improve our operating margins.

John Boone: Mm hmm. And, do you think operating margins for basic versus retail is that much more compressed than the mid teens to the 55 jump?

Bob Humphreys: I was saying gross margins, not operating margins.

John Boone: Right. Right. But, when you go down to operating, like how much does a (inaudible) go down?

Bob Humphreys: Well, I think, and again, you know, now you're down to kind of specific brands and channels. You have all these other things that maybe don't perform that way, but I think if you just looked at it from an opportunity, not to say that we're performing at that level, or you know, you're ever right there, but in our business model, we probably think there's an opportunity for about a 50% increase in operating margins in our branded business than there is in our basics business.

John Boone: Well great.

Bob Humphreys: If you have a 7% in basics, you don't have an 11 or 12 in branded.

John Boone: Yes, okay. Well great, thanks.

Bob Humphreys: Okay.

Operator: And, we have one question remaining in queue at this time. Once again, if anyone else would like to ask a question, that is star followed by the number one on your telephone keypad. We'll go now to John Curti of Singular Research.

John Curti: A couple of follow ups on a couple of the different operations. First off, with respect to Art Gun, if I recall correctly, in an earlier release, you had talked about the expectation that Art Gun would be running pretty much full out in December, kind of during the holiday timeframe. I was wondering if that did in fact come to pass. Or, because of the pricing issues and the fall off in demand, you did indicate that you did see improved margins there anyway.

Bob Humphreys: I'm actually glad you asked that. It did run full in December, you know, really most of November. Maybe a slightly slower build up than what our customers had forecast to us. But, Art Gun was profitable for the quarter. Our first time, we've made a profit in that business, other than the gain we had last year from the goodwill change. So, we were, you know, happy to see that, happy to see that improvement. The revenue was up over 100% from the prior year, and you know, it did kind of prove up our business model at that level. It is a profitable business and has good opportunities for the future. Now, so, our next step is we got to get at least that level of volume in each quarter to remain profitable, but we are adding customers there that are less seasonal than some, and encouraged about some of the opportunities there. So, we would like

for it to be growing faster and like for it to be making money for us every quarter. We are encouraged that it's worth continuing to work on and are interested in the technology and capabilities for the future.

John Curti: Given the seasonality of the business, what quarter would be the next quarter where you could move to profitability on better volumes? What would be the closest to being able to do that?

Bob Humphreys: It's a little bit hard to say because they are all going pretty rapidly. And so, you know, we think we are going to see some real improved volume, maybe not to the level to be profitable in our third quarter, and I don't know if that's left over seasonality or just the growth we are getting at. So, I think it's a little bit hard to determine what the second strongest quarter is at this stage.

John Curti: Okay. And then, with respect to the cotton exchange, if you can give kind of an update there. Have you gotten that totally now fully integrated, the redundant cost out, the improved sourcing et cetera? And is that about ready to begin?

Bob Humphreys: Yes, I would say we are about 75 or 80% through that process. So, we went live in January on the again Blues Cherry system model, which we operate our branded businesses on, and are going live on the warehousing piece for that as well, which is going to provide some significant productivity gains in their warehousing operations and screen printing. So, let's say our work is not fully done now but we're really on the cusp of having the platforms in place to get there.

John Curti: Will we see an improvement in earnings back half of the year versus back half last year, simply because some of these start up costs, redundant costs are kind of out of the way?

Bob Humphreys: You know, I don't I think that those were so significant last year that you're going to be able to, you know, just look at our results and say, man, that was from cotton exchange or what have you. But, I think, you know, you will see an environment in the future where we can grow the business and become more efficient, which should drive better operating margins in that whole Softe business.

John Curti: Okay. Thank you very much.

Bob Humphreys: Okay.

Operator: And, at this time, there are no further questions. I will turn the call back to our moderators for any additional or closing remarks.

Bob Humphreys: Well, thanks for your interest and joining us today, and we'll look forward to updating you in just a few months on our third quarter results.

Operator: Thank you. This does conclude today's conference call. We would like to thank you for your participation and have a wonderful day.