Delta Apparel, Inc.
First Quarter 2013 Earnings Conference Call
October 25, 2012

Operator:
Please stand by, we're about to begin. Good afternoon to everyone participating in Delta Apparel, Incorporated's First Quarter 2013 Earnings Conference Call. Joining us from management are Mr. Bob Humphreys, Chairman and Chief Executive Officer; and Ms. 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 prediction, 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 than 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 if it becomes apparent that any projected results will not be realized.

I'll now turn the call over to Delta's Vice President and Chief Financial Officer, Ms. Deb Merrill, who will provide the details of the Company's fiscal first quarter.

Deborah Merrill:
Thank you and good afternoon. Delta Apparel had a good first quarter. Net sales for Q1 of fiscal 2013, which ended on September 29th, were 130.1 million. That represented a 5.3% increase over the prior year's 123.5 million, setting a new first quarter record for the Company. We believe that puts us right on track to meet our guidance for fiscal 2013, and to set yet another record for full year revenue, which would be our tenth in a row.

Net income for our 2013 first quarter came in at 3.6 million, or $0.41 per diluted share, compared with 4.4 million, or $0.50 per diluted share, for the prior year's quarter. It's important to note that this year's first quarter included a one-time charge of 1.2 million, which shaved $0.10 off our earnings per share. That charge covered legal and professional fees related to the previously disclosed Audit Committee internal investigation in our Activewear Division. Had this one-time charge not been incurred, we would've achieved net income of 4.4 million, or $0.51 per diluted share, which would have been a first quarter record for net income. Even with the charge, we met our goal for the quarter, and remain comfortable with our guidance for full year net income in revenue.
Delta's first quarter performance was primarily driven by strong growth and improved margins in the basics segment, as well as in the branded segment Art Gun business. The higher revenues were offset somewhat by lower average selling prices that resulted by cotton price declines and product mix changes. Fiscal 2013 first

quarter net sales for our Basics segment rose 26.6% to 66.5 million, compared to 52.6 million in the prior year period. The increase was led by the Company's FunTees business, which enjoyed a 48% rise in unit volume, and 41.5% net sales growth during the quarter.

Delta Catalog experienced a 35% increase in unit volume and 20% net sales growth. The higher unit volumes leveraged against fixed manufacturing costs, coupled with lower cotton cost in inventory enabled Delta to reduce pricing while maintaining acceptable margins in the Basics segment.

The market for undecorated tees was stable during the first quarter, with overall market demand keeping pace with channel inventories.

Branded segment sales for fiscal 2013 first quarter were 63.5 million, versus 70.9 million for the comparable 2012 quarter. The 10% shortfall primarily resulted from lower net sales in Soffe, Junk Food, and The Game, which were only slightly offset by sales growth at Art Gun. Soffe's revenue was down due to weak department store business with low replenishment orders, but Soffe did experience solid growth in the military and sporting goods channels.

While the decline in Junk Food sales was primarily driven by mix changes and early shipping of fall merchandize, the business achieved growth with its core Junk Food brand in boutiques, specialty chains and high end department stores, and maintained strong margins during the quarter. Slower sales in Collegiate products lowered The Game sales during the quarter, but solid growth is anticipated from the Salt Life and Motorsports lines for the remainder of the year.

Art Gun continued the strength it has shown over the past several quarters, with a net sales increase of nearly 230% over last year's first quarter.

SG&A expenses as a percentage of sales continued to improve in our 2013 first quarter. When we look at the normalized SG&A expenses, which would exclude the previously mentioned one-time charge, it would've come in at 18.9%, compared to 19.9% of sales for the comparable 2012 period. We also improved our days sales outstanding and inventory turns compared to June.

Capital spending during the quarter was 1.7 million, and we believe that will continue to at about that quarterly rate for the entire year.

Depreciation and amortization, including non-cash compensation, was 2.3 million in the quarter.

Taking advantage of our strong cash flow and lower working capital requirements, we reduced our total debt at September 29th to approximately 102.6 million, which is a decrease of nearly 12 million from our fiscal 2012 year-end. We will continue our efforts towards lowering our capital requirements and reducing debt throughout fiscal 2013.

Concurrent with reducing our debt during the quarter, we also repurchased 72,854 shares of Delta stock at an average price of $14.07 per share, for a total of about $1 million. Since the price we paid was significantly less than Delta's book value of $16.90, we believe that was a logical use of funds. We expect to continue such repurchases while our shares are trading below what we believe its intrinsic value. As of the end of the first quarter, we had 4.7 million remaining authorized by the Board for share repurchases.

We believe our fiscal 2013 first quarter is an indication of things to come. We managed our business through a very difficult cotton price spike of last year, and have emerged with an increase in overall market share, improved manufacturing operations, lower inventories, and solid margins to build upon as the year progresses.

I'll now turn the call over to our Chairman and CEO, Bob Humphreys, for his thoughts on the quarter and for the rest of the year.

Robert Humphreys:
Thanks, Deb, and thank all of you for joining us on our conference call this afternoon. I'm pleased to tell you that the strategies we initiated last year in the face of the spiking cotton prices and higher energy costs drove the success of our fiscal 2013 first quarter. While our Basics segment certainly led the way, we saw improvements across the board in many of our businesses, although in different ways.

In our Branded segment, all of our businesses had strengthening margins with the exception of Soffe. In the department store channel, we are still suffering from cautious retailers who are judiciously managing their inventories, and in some cases, favoring private label alternatives. We were seeing some improvement in Soffe's Military and Sporting Goods lines, but have lost shelf space with national mid-tier department stores for spring on Basic merchandise.

We are currently evaluating a number of strategies to better leverage our Soffe brand assets to accelerate growth, and have recently added a strong business-to-business platform aimed at gaining market position in the Sporting Goods channel. We continue to focus on information technology initiatives that will streamline our business operations and enhance our service levels to our customers.

Our Salt Life store in Jacksonville, Florida had a good quarter, with sales meeting our expectations. Looking ahead, we see the Salt Life store as a model that retailers can successfully emulate in their own locations for the marketing and promotion of Salt Life products. We believe we can drive Salt Life's geographic growth with solid grassroots marketing campaigns, and we now have a marketing manager fully on board to expand the Salt Life brand to the West Coast.

As I mentioned, our Basics segment did very well in the quarter, with lower selling prices being more than offset by higher volumes and lower cost. Our goal obviously is to have all of our businesses contributing to sales and gross profit at a high level by the end of the year. In that regard, we're making excellent progress in leveraging our creative talent in retail relationships across all of our operating units.

We are encouraged by the fact that inventories are running below what we had expected; therefore, we stepped up our manufacturing levels in the first quarter, and are evaluating an even stronger running schedule for the second half of the year. While we do have some down time scheduled in our internal forecast to manage inventories, we were seeing some indications that we may be able to run a fuller schedule than we had anticipated.

As Deb mentioned, we had about $1.7 million in capital expenditures in the first quarter, and anticipate approximately that amount per quarter to continue for the remainder of the fiscal year. Our focus for most—much of this investment, excuse me, will be on the modernization and expansion of our screen and digital printing capabilities, as well as branding and point of sale displays for branded products.

Overall, the first quarter gave us every reason to be optimistic about the remainder of the year. We are remaining short on cotton commitments as cotton prices continued to moderate, and we are carefully managing inventories. Barring any unforeseen event, unit volumes should continue to grow, and leveraged against fixed costs, should keep margins strong and improving.

In addition, we are continuing to focus on reducing debt and further strengthening our balance sheet. Given our good first quarter, I remain confident that the guidance previously provided for fiscal 2013 can be achieved. Based on anticipated net sales growth, we believe that 2013 will be another year of record revenue for Delta Apparel, in the range of 500 million to $510 million, or about a 3% increase over fiscal 2012.

With higher unit volume and leveraging fixed costs, we believe net income should be in the range of $1.65 to $1.80 per diluted share, even with the inclusion of the previously mentioned $0.10 per share charge in the first quarter.

Now Deb and I would like to answer any questions you may have.

Operator:
Thank you. If you would like to ask a question on today's call, please signal by pressing the star key, followed by the digit one on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Also, if you pressed star, one earlier during today's call, please press star, one again to ensure our equipment has captured your signal. And we'll pause for just a moment to allow everyone an opportunity to signal into the queue.

And we'll take our first question from Jamie Wilen with Wilen Management.

James Wilen:
Hey, fellas; nice quarter. First, I just want to head straight to the guidance that you gave, $1.65 to $1.80, which was the same guidance you gave at the end of the year without knowing that you had a $0.10 charge. So are you—I mean effectively you've raised it to $1.75 to $1.90 because you had no idea at that point in time that you would have any charge coming; is that true?

Deborah Merrill:
Yes, Jamie, I would say that that—based off of our first quarter that that is correct. We had a strong first quarter that then, you know, is giving us the ability to still meet our original guidance even with that additional $0.10 hit.

James Wilen:
Fantastic, okay. And that—everything from there is fully behind? You had one, let's say, disgruntled employee who said something and you had to spend $1.2 million to prove that what he was saying was not correct, and it's now done?

Deborah Merrill:
Yes, we believe that's all behind us and the expense has been taken in the first quarter.

James Wilen:
Okay. And no recourse to get any of that back I assume in this world?

Deborah Merrill:
That would be correct.

James Wilen:
Okay. In the Basics business, why is FunTees so strong? What's happening—what happened to their business then, and what is the outlook for FunTees?

Robert Humphreys:
Well, I think it's FunTees and our, you know, Undecorated product as well, Jamie. We had a really strong quarter with strong growth. I think a culmination of a number of things. Our service level are good, our inventory levels are good in our Undecorated. And by that, it's more than just having, you know, how many units you have, it's having the right units of the right SKUs on hand so you can really service business good, so that certainly helped us in the first quarter.

On the FunTees side, I'd say it's driven primarily by the new businesses that we have been adding really over the last two years. It's been one of our initiatives in that business. We've hired some people to just work on that. You know, it takes awhile to, you know, get programs, work through sampling, et cetera, et cetera, and then, you know, finally later you're actually shipping more product. So that was certainly a help, and built the revenue. Our plants in that business are running well; probably better than they ever have, although we see them improving further. We just had some good initiatives there. We're installing some new screen printing equipment. You know, we've had good partnerships with some key customers there. So certainly a good quarter, and, you know, things that we think we can continue to build on.

James Wilen:
Would you expect that business to have strong double digit growth moving forward, or is that just a one shot deal in this quarter?

Robert Humphreys:
You know, it can't continue at the same pace that it did.

James Wilen:
Right.

Robert Humphreys:
But, yes, we see growth going further in that business.

James Wilen:
Okay. In the world of cotton and in retailing, have retailers, as they raise the price of cotton goods because you raised their prices, it seems like things are selling at a little bit higher level. Do you think retailers will be able to maintain that higher level, and is there a new era for what cotton is really worth, and, you know, a little bit more room in there for everybody?

Robert Humphreys:
Yes, you know, perhaps. We'll see. You know, I don't think the retailers ever really raised retail prices to fully reflect how high cotton got, which was probably good in the overall scheme of things, and so probably where retail prices are right now and where cotton prices are right now, you know, in general is probably pretty well balanced. So, you know, I think we're probably okay there through the springtime.

James Wilen:
Okay. On the Junk Food side, business was down in this quarter, but you said you're looking for growth throughout the rest of the year. Why is that?

Robert Humphreys:
Well, a couple of things. Really, one reason it was down is we shipped several programs right at the end of last fiscal year that, you know, we had ready and customers wanted to go ahead and take it. And you may recall us talking about that got us to an all-time record revenue that at Junk Food, but it did take some business out of the first quarter.

We've got good momentum in a lot of the Junk Food initiatives that we've had, and we've got some new programs, some of which we'll start shipping them in the second quarter. So, you know, we think we have enough visibility there. We've had good sell-through really across the board on Junk Food. We've had some good increases in the whole e-commerce side of the business. So, you know, we have enough visibility there that we think, you know, we have some opportunities to continue to grow that business.

James Wilen:
Okay. And lastly, just wanted to congratulate you on the buyback of stock; if you can buy back a million dollars every quarter, I think it's easily doable within how much money you make and you can pay down debt, but it does create great long-term value for shareholders as you really start to turn in numbers in the years ahead. Nice job. Thanks, (inaudible).

Robert Humphreys:
Thank you very much.

Operator:
And once again, if you would like to ask a question on today's call, please press star, followed by the digit one on your telephone keypad.

And we'll take our next question from James Fronda with Sidoti.

James Fronda:
Hey, guys. How are you?

Deborah Merrill:
Good.

Robert Humphreys:
Good, thanks.

James Fronda:
I'm just curious to know for the gross margin, do you think this 24% is a decent level to use going forward depending on where cotton prices go obviously; if they stay, you know, where they are?

Deborah Merrill:
Yes, James. And in fact, usually, you know, our second—there is some seasonality in our gross margins quarter-by-quarter, but then overall we would expect that gross margins could continue to improve as the year goes on as we get back in the back-half of the year.

James Fronda:
Okay. All right, that's all I had. Thanks, guys.

Operator:
And we'll take our next question from Liz Pierce with ROTH Capital.

Elizabeth Pierce:
Hi. Good afternoon, guys.

Deborah Merrill:
Hey, Liz.

Elizabeth Pierce:
So, unfortunately I have dropped off four times, so I don't know if you've already—I presume you might have already addressed it in some detail, but I'm just trying to really get my arms around what's going on with Soffe. I mean I understand what's happening at the mid-tier department store, but how much do you think this is just product? Do you—I mean has the product had its day in the sun and it's time to revisit the product, or what?

Robert Humphreys:
Yes, I think, Liz, we're, you know, where we're having problem at mid-tier is where people were just buying items from us; mostly the, you know, that entry price point Soffe short. It still sells very well in a lot of channels of distribution. And, you know, if you look at the national sporting good chains and regional sporting goods chains, they continue to buy more Soffe product, but it's more of a collection versus just an item. So, you know, we never like losing shelf space or position, but there's also, you know, a reaction to everything. And so for some of our other customers, they'll be delighted that this product is not in some of those locations, and we think, you know, we'll be marketing it more aggressively, and we'll continue to try to, you know, have really compelling product and rebuild some of that business in that mid-tier department store, but we'd prefer to do it in more of a collection, you know, concept, versus just having an item in there.

Elizabeth Pierce:
Hello?

Robert Humphreys:
Liz?

Operator:
And it appears that she has disconnected at this time.

And we'll take our next question from Jamie Wilen.

James Wilen:
Let me continue in the Soffe line. I mean you have a Basic product that's been there for awhile. I mean how are you—what are the things you're doing to update the product to make it just more appealing to the whole world? I mean obviously when you have a little stutter step like this you go back and you retrench, and you rethink how you're going to bring the product to market, and you come up with a whole slew of new ideas. What would those new ideas be for Soffe?

Robert Humphreys:
Yes, and, you know, that's kind of a two-edged question. Obviously on Soffe shorts we have a lot of new products, and we've actually been working for years to try to obsolete the basic Soffe short ourselves, and have made some progress in doing that. And really the sale of that entry level short, I'll call it, has held up better than we were expecting over the years. So then we, you know, we did go back, and it's branding and

packaging, obviously keeping up with the new colors. You know, we have a couple of different fits that we're offering, but, you know, still have that basic short for people, you know, who are looking for it, and that is still a very popular item.

James Wilen:
Okay. And lastly on Salt Life, and I am wearing a Salt Life shirt for you guys today. As you're expanding to the West Coast, I mean what is the game plan? You've hired people. Obviously you're going to be, I assume, set for the spring season, but what's your objective for how many doors you think you could be in on the West Coast, and how much that's going to add to the whole opportunity for Salt Life as it expands?

Robert Humphreys:
Yes. Well, you know, the Surf Show was in Orlando just a few weeks ago, and so, you know, we talked to a lot of West Coast-based retailers that we think fit our definition of a true grassroots, you know, Salt Life retailer. They've been very interested in the product and we got orders to ship them. We have, you know, some products specifically designed for the West Coast customer, and so we will be introducing those out there and also on the East Coast. So I think probably the next 12 months will give us a better indication of how well the product is perceived on the West Coast. So far it's been very good. It's been in West Marine on the West Coast for over a year now, and they've had good sell-through out there, and, you know, plan to expand their footprint. So, you know, I think if we're reasonably successful there, it should at least be as big as the East Coast business that we have.

James Wilen:
Okay, so you're still looking for the brand to have super strong double-digit growth as you move forward for this year?

Robert Humphreys:
Absolutely. And, you know, we've got a lot of that in backlog, you know, currently as we speak, so we'll start shipping that in January. And we also have, you know, a real good reaction to our footwear line that we're introducing, and we'll be shipping that in January as well.

James Wilen:
Fantastic. Great job. Thanks, fellas. Appreciate it.

Robert Humphreys:
Thanks.

Operator:
And once again, that is star, one if you'd like to ask a question on today's call. And there are no more questions at this time.

Robert Humphreys:
Okay, well thank you very much for joining us this afternoon, and we'll look forward to updating you on our second quarter results in January. Thank you.

Operator:
Ladies and gentlemen, that concludes today's conference. We thank you for your participation.