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ETD.N - Q2 2025 Ethan Allen Interiors Inc Earnings Call

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CORPORATE PARTICIPANTS

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Farooq Kathwari *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

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Bradley Thomas *KeyBanc Capital Markets Inc. - Analyst*

Cristina Fernandez *Telsey Advisory Group - Analyst*

PRESENTATION

Operator

Good afternoon, and welcome to the Ethan Allen fiscal 2025 second-quarter analyst conference call. (Operator Instructions) As a reminder, this conference is being recorded.

It is now my pleasure to introduce our host, Matt McNulty, Senior Vice President, Chief Financial Officer, and Treasurer. Thank you. You may begin.

Matthew McNulty - *Ethan Allen Interiors Inc - Chief Financial Officer, Senior Vice President, Treasurer (Principal Financial and Accounting Officer)*

Thank you, operator. Good afternoon, and thank you for joining us today to discuss Ethan Allen's fiscal 2025 second-quarter results. With me today is Farooq Kathwari, our Chairman, President, and CEO. Mr. Kathwari will open and close our prepared remarks, while I will speak to our financial performance midway through. After our prepared remarks, we will then open the call for your questions.

Before I begin, I'd like to remind the audience that this call is being webcast live under the News and Events tab within our Investor Relations website. A replay of today's call will also be made available on our Investor Relations website. There, you will find a copy of our press release, which contains reconciliations of non-GAAP financial measures referred to on this call and in the press release. We believe the non-GAAP presentation better reflects underlying operating trends and performance of the business.

Our comments today may include forward-looking statements that are subject to risks and uncertainties that could cause actual results to differ materially. The most significant risk factors that could affect our future results are described in our quarterly report on Form 10-Q. 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.

With that, I am pleased to turn the call over to Mr. Kathwari.

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Thank you, Matt, and thanks for participating in our second-quarter results ended December 31, 2024. I would like to start with the devastating effects of wildfires in Southern California, which have resulted in loss of life and devastated many communities. Our team members and our clients have been impacted, and we pray for their safety. Fortunately, our design center in Pasadena closest to the fires escaped the fire and is back in operations along with all of our six design centers and a major retail service center in the area.

As we mentioned in our press release, despite the challenging political and economic environment, we had strong financial results in our second quarter, especially in our book orders. We reported consolidated net sales of \$157 million, gross margin of 60.3%, operating income of \$18.2 million, operating margin of 11.5%, and diluted EPS of \$0.59.

We had strong operating cash flow and ended with \$184.2 million, an increase of \$16.4 million from a year ago. We paid \$10 million in cash dividends and pleased that yesterday, our Board approved a regular cash dividend of \$0.39 per share payable on February 26, 2025.

After Matt presents a more detailed financial information, I will review our ongoing initiatives to continue our progress. Matt?

Matthew McNulty - *Ethan Allen Interiors Inc - Chief Financial Officer, Senior Vice President, Treasurer (Principal Financial and Accounting Officer)*

Thank you, Mr. Kathwari. Our financial results in the just completed second quarter were highlighted by strong demand, margins, and operating cash flow. Our consolidated net sales were \$157.3 million compared with \$167.3 million a year ago, and a higher average retail ticket price and lower sales returns helped to offset lower backlogs, fewer contract sales and a lower delivered unit volume. Demand levels improved sequentially throughout the quarter and concluded with a strong December aided by our special promotion.

Retail segment orders grew by 15.8%, while wholesale segment orders were up 14.3%. Written order improvement was driven by increased promotional activity, strong financing programs, and elevated interest in the home post the US elections held in early November. We ended the quarter with 172 Ethan Allen retail design centers in North America, including 141 company-operated and 31 independently owned and operated locations.

Wholesale backlog at December 31 totaled \$57.7 million, up 5% from a year ago. As expected, our wholesale backlog declined in the past three months as our state department delivered sales outpaced incoming orders. Our distribution center in North Carolina, that previously sustained flooding from Hurricane Helene in September, resumed operations, and we are thankful to those who helped us recover. Strong consolidated gross margin of 60.3% was driven by a favorable change in the sales mix, lower headcount, selective price increases, lower raw material input costs, and a higher retail average ticket price.

Our consolidated headcount totaled 3,318 associates at December 31, 2024, a decrease of 6.9% from a year ago as we continue to identify operational efficiencies and leverage the use of technology to streamline workflows throughout our vertically integrated enterprise.

Adjusted operating margin was 11.5% compared with 12.8% a year ago. Our double-digit operating margin reflects our ability to tightly manage expenses. Compared to our pre-pandemic quarter ended December 31, 2019, our adjusted operating margin has improved 610 basis points due to streamlining our vertically integrated enterprise.

Adjusted diluted EPS was \$0.59 compared with \$0.68 a year ago. For historical context, adjusted diluted EPS for the three months ended December 31, 2019, was \$0.27. Our effective tax rate was 25.4% for the quarter, which varies from the 21% federal statutory rate primarily due to state taxes.

Now, turning to our liquidity. We ended the quarter with a robust balance sheet including cash and investments of \$184.2 million and no outstanding debt. We generated \$11.6 million of cash from operating activities and kept inventory levels consistent with a year ago. Capital expenditures were \$3.8 million and included additional investments in technology, retail design center relocations and improvements, and remodeling costs associated with our hotel. New and relocated state-of-the-art design centers in Watchung, New Jersey and Peoria, Arizona were opened during fiscal 2025 that showcase our unique style while combining complementary interior design services with technology.

We also continued our practice of returning capital to shareholders in the form of cash dividends and have a current yield of 5.5%. In October, our Board declared a regular quarterly cash dividend of \$0.39 per share, which was paid on November 27. Also, as just announced in our earnings release, our Board declared a regular quarterly cash dividend of \$0.39 per share which will be paid this February.

In summary, we are pleased with our performance that saw incremental consumer interest return back to the home. Disciplined investments and solid execution throughout our vertically integrated business produced strong written demand, positive operating cash flow, and a double-digit operating margin. Our robust balance sheet has us well-positioned as we continue to move through the calendar year.

With that, I will now turn the call back over to Mr. Kathwari.

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Well, thank you, Matt. We are positioned well as a vertically integrated enterprise, which includes a very strong and dedicated team, the ability to provide interior design services with state-of-the-art technology, offering relevant, high-quality products that offer both a modern design with a classic perspective and a classic design with a modern perspective. And this is very important, these two attitudes.

75% of our furniture is made in our North American facilities. Our national and retail logistics is unique, and a great competitive advantage enabling us to deliver our products with, what we say, white glove delivery at one cost in North America to our clients.

Our retail network of 172 design centers in North America and additional design centers internationally are well-positioned. During the last two years, we have continued to strengthen our network with new and relocated design centers and especially with freshening the interiors of all with our products and attitudes. We continue to relocate to stronger locations and add new design centers.

After the pause due to COVID, we have been introducing new products to strengthen our offerings. Our marketing initiatives continue to get our message across. This includes direct mail magazines, digital magazines, our website, local, and regional advertising. During the last few years, while strengthening our offerings, our retail network, our manufacturing, our logistics marketing, and technologies, we have been able to also reduce our headcount. Technology has played a very important role in that. At December 31, 2024, was 3,318, down 7% from a year ago and 27% less than December 2019. During this period, we also repositioned our manufacturing, our national logistics, and our retail network.

In summary, we continue to strengthen the various areas of our vertically integrated enterprise and are well-positioned to meet the opportunities and challenges ahead.

With this, I would like to open it up for any questions or comments.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Brad Thomas, KeyBanc Capital Markets.

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Yeah. Hello, Brad.

Bradley Thomas - *KeyBanc Capital Markets Inc. - Analyst*

Hi. Good afternoon, Farooq. Good afternoon, Matt. And first and foremost, congratulations on the very strong end of the year -- end of the quarter, I should say, end of the calendar year on the order front.

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Yeah, thank you. It was -- it is very encouraging to see that.

Bradley Thomas - KeyBanc Capital Markets Inc. - Analyst

It really is. We've all been waiting for a turn in the industry, and I think we're hopeful that, that is what's coming to fruition here. I guess that was going to be my first question was, what's the degree of confidence that you have, Farooq, that this is the turning point here for the company and for the industry?

Farooq Kathwari - Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer

Well, I can also mention that there are factors that led to this as well. So certainly, obviously, it reflected our enterprise, our strong product programs, our network, but it also reflected the fact that we did give a special savings during this quarter, which helped. Now -- but it would not have happened without all the other factors. So I think that all of those factors helped make this quarter, especially on the written business, very, very strong.

Now, your next question about -- as we move forward, we are positioned very, very well. January did start weak, mostly because of weather. We had very tough weather in many parts of the country for the first three weeks. But when the weather improved in the last week or so, we can see more robust activity. We feel good about it.

To answer your question, we have strong programs. Our retail network has been repositioned. Our -- we have strong manufacturing logistics. And as I said, we have been able to do all of this while making it extremely efficient. So I think the opportunity of having strong product programs, the opportunity of the efficiency that we have brought in, and really a strong designer network and combined with technology.

As I mentioned, this major decrease in the headcount is mostly due to combining good talent with technology. And I think as we do that, we feel confident that we'll keep -- we'll continue with the progress.

Bradley Thomas - KeyBanc Capital Markets Inc. - Analyst

That's great. And clearly, the incremental promotions seem to be a positive for you here. Do you intend on keeping up these incremental promotions or will you be more normalized going forward?

Farooq Kathwari - Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer

We'll use both. It depends on the opportunities take place as there are certain opportunities of timing, certain special timing of holidays, events, gives us an opportunity to do that. So we'll combine both as we go forward.

Bradley Thomas - KeyBanc Capital Markets Inc. - Analyst

Great. And maybe just one more last one for me here, Farooq. It was such again, impressive acceleration from your September quarter to your December quarter in terms of orders. Any other nuances that you might highlight? Is this all new customers or incremental customers coming in or is there anything different happening in terms of the average ticket or the types of customers or the types of products? Just any other detail would be really interesting.

Farooq Kathwari - Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer

Yeah. I would say that in the last year or so, we have also been introducing new product. We will continue to do that because, again, before -- prior to that, we were cautious because we had very high backlogs and we didn't want to introduce new products because of service. Our service position is very good right now so that we are now being more aggressive introducing new products.

The other one is that we are also increasing our marketing. In fact, in this last quarter, we increased our marketing spend. And we will -- in terms of -- and a lot of that we are doing is in terms of marketing, in terms of getting more new customers in and the new forms of marketing, utilizing technology to bring people in. So we increase our marketing by about \$0.5 million?

Matthew McNulty - *Ethan Allen Interiors Inc - Chief Financial Officer, Senior Vice President, Treasurer (Principal Financial and Accounting Officer)*

Correct.

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Increased our marketing. Think of this in last quarter by \$0.5 million, which was what about 0.5%?

Matthew McNulty - *Ethan Allen Interiors Inc - Chief Financial Officer, Senior Vice President, Treasurer (Principal Financial and Accounting Officer)*

15% higher.

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Yeah, but 2.5% [of net sales?] (added by company after the call)

Matthew McNulty - *Ethan Allen Interiors Inc - Chief Financial Officer, Senior Vice President, Treasurer (Principal Financial and Accounting Officer)*

Yeah.

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

From 2% to 2.5%, 15% higher, Brad. So we will continue to do that also, but to continue to utilize more innovative ways of marketing than the old traditional ways we used to do.

Bradley Thomas - *KeyBanc Capital Markets Inc. - Analyst*

That's great. We've certainly heard some good data points out of the industry, but this really exceeded anything that we've heard out of any way else here of late. So congratulations, and I'll turn it over to others.

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Thanks very much.

Operator

Cristina Fernandez, Telsey Advisory Group.

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Yeah. Hello, Christina. How are you?

Cristina Fernandez - Telsey Advisory Group - Analyst

How are you? Good afternoon, Farooq and Matt. I wanted to follow up on Brad's questions about the demand trends. I mean, you talked about progression through the quarter. How were trends in October and November? I guess what I'm trying to get through was how much is that special promotion in December help or how you already started to see an improvement in the prior months.

Farooq Kathwari - Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer

Cristina, I think that there was improvement, but a major improvement did take place in December because of the special -- and look, it was not that a major promotion. It was a 5% more savings. And so it was the combination of all factors that made it happen.

Cristina Fernandez - Telsey Advisory Group - Analyst

And then I guess, what was the impetus for increasing the promotions? I feel like you've been pretty steady over the past couple of years, usually like 20%, 15% off with it. Is it a response to competition that you saw out there, just wanting to accelerate the order intake? Maybe walk us through, I guess, that decision that you haven't done too much of that before.

Farooq Kathwari - Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer

Well, it's a combination of a number of factors. It is the fact that we felt that because we were in a much better service position that we will be able to deliver the products. That is a very important factor. Because I didn't want to spend a lot of money, and we had delays of service because of the backlogs. So that was an important factor. We felt we are ready, and that's why that was a major factor in investing in marketing.

Cristina Fernandez - Telsey Advisory Group - Analyst

And with the higher promotions, should we expect an impact to the gross margin, which has been very high in the past couple of quarters going forward?

Farooq Kathwari - Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer

Yeah. Keep in mind that if you take a look at historically, it was not that many years back, we used to spend close to 5% of sales on our marketing.

Now, with all the technology and other elements, we took it to half of that. So keep in mind, we have reduced our total marketing by almost 50% as a percentage of sales than what we used to do. We increased this time by about 0.5%.

Cristina Fernandez - Telsey Advisory Group - Analyst

And then another topic I wanted to talk about was your exposure to Mexico, and you've always talked about 75% of manufacturing in North America. Obviously, we are all aware of potential tariffs. How much of that 75% is manufactured in Mexico? And if there were to be tariffs on input from that country, would you look to move it to the US or Honduras or I guess, how are you planning for the different outcomes?

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Now that there is an important issue. And in fact, we were having a discussion with our team on that today, that Mexico is our upholstery products that are made in Mexico. We have two major operations, one in Mexico and one in North Carolina. The Mexico operation makes and cut fabrics for our operation in North Carolina. And then it also makes products -- full products in Mexico.

So it is approximately at this stage, I would say, that close to of our total manufacturing in Mexico represents approximately 25% of our total manufacturing. So we have some flexibility as we go forward. There's a possibility we could consider raising prices. There's a possibility that more of that product could be made in North Carolina because we are manufacturing in both places.

Cristina Fernandez - *Telsey Advisory Group - Analyst*

Thank you, and best of luck here this quarter.

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Right Well, thank you very much. And we look forward. We've got our team members. They're really motivated. They're working hard. A lot of -- we are looking at all these uncertainties. But the good news is as I said, we are well-positioned based upon our manufacturing in North America, which includes United States, Mexico, Honduras, and we do have some manufacturing comes out of countries like Indonesia and Vietnam that for furniture. We do make some accessories in other products in many other places from Italy to China, but most of it is right in North America.

Operator

(Operator Instructions) And if no further questions, I have to turn the floor back to Mr. Kathwari for any closing comments.

Farooq Kathwari - *Ethan Allen Interiors Inc - Chairman of the Board, President, Chief Executive Officer*

Thank you very much. We are -- thank you for attending. We are -- our teams are working very, very hard. We are looking at all the events in the world. And the good news is we are well-positioned, and we are also positioned to take steps based upon whatever happens and whether it's a question about duties and anything else. We are all watching it very carefully. But I think at this stage, our main focus is to continue to grow our business and to continue to strengthen the various elements of our vertically integrated structure. Thanks very much for participating.

Operator

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

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