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ETD.N - Q4 2022 Ethan Allen Interiors Inc Earnings Call

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## CORPORATE PARTICIPANTS

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

**Matthew J. McNulty** *Ethan Allen Interiors Inc. - CFO, Senior VP & Treasurer*

## CONFERENCE CALL PARTICIPANTS

**Cristina Fernández** *Telsey Advisory Group LLC - MD & Senior Research Analyst*

**Zachary Donnelly** *KeyBanc Capital Markets - Analyst*

## PRESENTATION

### Operator

Good afternoon, and welcome to the Ethan Allen Fiscal 2022 Fourth Quarter Analyst Conference Call. (Operator Instructions) Please note, this conference is being recorded.

It is now my pleasure to introduce your host, Matt McNulty, Senior Vice President, CFO and Treasurer. Thank you. You may begin.

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**Matthew J. McNulty** - *Ethan Allen Interiors Inc. - CFO, Senior VP & Treasurer*

Thank you, Hector. Good afternoon, everyone, and welcome to Ethan Allen's analyst conference call for our fiscal 2022 fourth quarter and full year results. Joining me today is Farooq Kathwari, our Chairman, President and CEO. Mr. Kathwari will open and close our prepared remarks, while I will speak to the financials midway through. After our prepared remarks, we will then open the call for your questions.

Before we begin, I'd like to remind the audience that this call is being recorded and webcast live under the News & Events tab on the Investor Relations page of our ethanallen.com website. There, you will also find a copy of our press release, which contains reconciliations of non-GAAP financial measures referred to in this release and on this call. A replay of today's call will also be made available via phone and on our website.

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.

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

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

Thank you, Matt, and good to have you all participate in our conference call. We are pleased and gratified to report very strong financial results for the quarter and the year ended June 30, 2022. For the quarter, our sales of \$229.7 million increased 28.8%. And for the fiscal year, sales of \$817.8 million increased 19.4%. Our operating margin for the quarter increased to 18.3% and for the fiscal year increased to 16.9%. Our diluted EPS for the quarter was \$1.23, an increase of 73.2%. And for the fiscal year, it was \$4.05, an increase of 70.9%, all reflecting strength of our vertically integrated structure and a strong team.

Now back to Matt to provide more details on our financials. And after that, I will provide a brief overview of our areas of focus to continue our progress. Matt?

**Matthew J. McNulty** - *Ethan Allen Interiors Inc. - CFO, Senior VP & Treasurer*

Thank you, Mr. Kathwari. As a reminder, we present our results both on a GAAP and non-GAAP basis. Non-GAAP results include restructuring initiatives, asset impairments and other corporate actions and are further detailed in our press release.

For the quarter, consolidated net sales increased 28.8% as a result of strong backlog, increased levels of manufacturing production that led to higher deliveries and increasing receipt of offshore products. For the full fiscal 2022 year, sales rose 19.4% to \$817.8 million. Wholesale segment written orders were down 10.7% to last year's fourth quarter but were up 14.2% compared to the fourth quarter of 2019. For the full year, wholesale written orders were lower by 0.5% but up 7.6% compared with the full 2019 year. Our retail written orders were down 19.5% for the quarter and 4.6% lower for the full fiscal year, primarily due to a very strong prior year comparable. However, when compared to 2019, retail orders were up 12.9% in the quarter and up 14.9% for the full year.

The higher level of manufacturing productivity and related shipments of products helped reduce our backlog and improve delivery times during the year. Our wholesale backlog as of June 30, 2022, was \$102 million, down 14.7% from a year ago but still up \$56 million or 120.8% from June 30, 2019. In the near term, our teams are effectively managing the business to work through the higher order backlog and to service our customers.

Consolidated gross margin was 58.2% in the just completed fourth quarter and 59.3% for the full 2022 year, primarily due to strong retail segment sales, previous product pricing actions that are now working their way through our delivered sales and higher manufacturing productivity, partially offset by higher input and freight costs. Increased wholesale contract business shipments lowered our retail sales mix from 84.5% of consolidated sales last year to 82.1% in this year's fourth quarter, reducing our quarterly consolidated gross margin while helping increase our operating margin.

Our consolidated operating margin increased from 13.5% in the year ago fourth quarter to 18.3% in the current year fourth quarter. For the 2022 full year, consolidated operating margin improved to 16.9%. Operating margin expansion over last year was primarily due to fixed cost leverage on the higher sales volume, wholesale and retail gross margin improvements and cost containment measures, including lower marketing costs and reduced G&A compensation expense as we operate more efficiently.

Our SG&A expenses, when expressed as a percentage of sales, decreased from 44.7% last year to 39.8% in this year's fourth quarter, reflecting our strong operating leverage. For the full year, SG&A expenses decreased from 45.7% to 42.9% in 2022. This operating margin expansion, combined with double-digit delivered sales growth, helped generate record profits as diluted EPS for the fourth quarter was \$1.23, up 73.2% to last year. On a full year basis, diluted EPS rose 70.9% to \$4.05 in 2022.

Now turning to our liquidity and capital resources. We ended the fourth quarter with a strong balance sheet, including cash and investments of \$121.1 million as of June 30 and no debt. We generated \$29.4 million of cash from operating activities in the quarter due to strong net income and the conversion of inventory into delivered sales by increasing our manufacturing productivity. Capital expenditures were \$4.4 million for the quarter and \$13.4 million for the full year. We continue to invest capital in manufacturing plant upgrades, including additional machinery and equipment to further increase capacity, safety and efficiency, construction of new retail design centers, updating the projection of many existing design centers and in technology and infrastructure.

We have continued to pay and increase our cash dividend. In April, our Board of Directors increased the regular quarterly cash dividend by 10% to \$0.32 per share, which is subsequently paid in May, and brought our full year 2022 total to \$48.3 million. Also, as just announced yesterday, our Board declared a special cash dividend of \$0.50 per share in addition to our regular quarterly dividend of \$0.32, both of which will be paid on August 30. All in, these are great financial results in a volatile environment.

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

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

All right. Thank you, Matt. Our strong financial results of fiscal '22 benefited from many internal initiatives and external factors: strengthening our team at various levels in our vertically integrated structure, including strengthening our Board of Directors, continued strengthening of our product offerings under the umbrella of Classics with a modern perspective.

Focus on quality. We maintain our high level of quality standards across our product offerings as about 75% are made in our North American workshops. This is a great advantage with many disruptions, cost increases and challenges associated with offshore manufacturing.

Focus on interior design services through our over 1,500 in-house interior designers. Combining technology to this service is a game changer in efficiency and service.

Continued expansion of our design centers and investments in existing design centers. During fiscal 2022, we opened new state-of-the-art design centers in Westport, Connecticut and Walnut Creek, California in the U.S. and 2 new locations in South Korea. Some of them were delayed because of availability of air conditioning and all kinds of stuff. But the good news is we are going to have -- we plan to open many more in this fiscal 2023. And at this very stage, we are in the process of opening 6 new design centers. One is a replacement in Manhattan. One is in Skokie, Illinois, which is near Chicago; The Villages, which is Northern Florida; Syracuse, New York; San Jose, California; and Plaistow, New Hampshire. These are -- all of these are under our control, and most are scheduled to open by the end -- certainly before the end of this calendar year and perhaps some early in 2023, again, depending upon availability of some materials like for construction.

Now continued investments in North American manufacturing has been critical. Our upholstery products are made in our operations in North Carolina and Mexico, and our wood products are made in our operations in Vermont and Honduras. We have continued to make them more efficient, more productive. And we have a very strong, talented workforce, both in the United States and south of the border.

Now continued investments in our North American logistics. We continue to invest in our major national distribution operations, which are located in Virginia and North Carolina and over 30 retail service centers all over North America. We have continued to deliver our products to our retail network at one delivered cost despite major increases in transportation and other costs.

Continued strong growth in our contract business, especially with the U.S. government. This is what helped us increase our wholesale business and our margins, as Matt just mentioned.

Now strengthening our marketing initiatives has been key and has involved both internal and external marketing. Utilizing technology and digital mediums in getting our message across has helped us to increase our exposure while reducing overall marketing costs, and importantly, providing technology tools and advertising to our 1,500 interior designers has helped us in our communications to clients at the local level.

With this very brief overview, I'm now pleased to open for any questions or comments.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Your first question comes from the line of Cristina Fernandez with Telsey Advisory Group.

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**Cristina Fernández** - *Telsey Advisory Group LLC - MD & Senior Research Analyst*

I want to start with the demand environment. Can you talk about how the quarter progressed into July? Any change from your customers, what you're seeing there in behavior and your thoughts about the ability to maintain demand above pre-pandemic levels as we look forward over the next couple of quarters?

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

Yes, Cristina, it's a very important subject. Pleased to say that in July, although we have not -- of course, I'm making this information available. Normally, we do not do this. But in July, this is last month, we were able to do a little bit more than what we did in the previous year, which was good news. It is part of -- it was a result of a number of factors. One is some of our marketing initiatives went from June to July, which helped us. So that also has an impact of -- in fact, to give you a perspective, we normally end our promotions at the end of June -- end of the month. That was June 30. But this year, we decided to extend them right after the Independence Day, I think, July 7. So we took some business away from June, took it into July, ending having the July end strongly.

**Cristina Fernández** - *Telsey Advisory Group LLC - MD & Senior Research Analyst*

So I guess as a follow-up on the topic of promotions, do you expect to be more promotional year-over-year going forward just given that the industry, at least more towards the middle, low end of the price point, seems to be getting more promotional?

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

Cristina, we have maintained very strong offers to our clients throughout this period. Even with very strong demand in this last year, we did not change much of our offerings in terms of the savings to our clients in the last 2 or 3 years. And our objective is to continue. It's already very strong, and we will continue to do that. Obviously, as you mentioned, we keep in mind, we take a look at what's happening in terms of consumer interest, traffic. But at this stage, we are going to continue with our very strong programs, which we have maintained in the last few years.

**Cristina Fernández** - *Telsey Advisory Group LLC - MD & Senior Research Analyst*

And then one other question. On the gross margin, I wanted to understand better the higher input costs that you are seeing that led to the gross margin decline year-over-year even with the volumes being that much higher than what we saw -- than we've seen in the past couple of quarters?

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

Yes. A number of factors Matt mentioned. First is the fact that the costs have increased. Last quarter, we did see them stabilize, even start coming down. But for the 3 quarters before that, the year before that, costs of materials, of transportation, taking -- bringing our lumber to our mills, bringing fabrics to our mills and all of that has increased. It has somewhat slowly started coming down because of the fact of demand and all the pressures. So I think from a perspective of raw materials, perspective of our labor, I think it has somewhat stabilized right now for us.

**Operator**

Your next question comes from [Zach Donnelly] with KeyBanc Capital Markets.

**Zachary Donnelly** - *KeyBanc Capital Markets - Analyst*

Congrats on the really strong quarter. I had a question kind of regarding international performance. I know last quarter, you had touched on kind of weaker written wholesale trends from China kind of with the rolling sort of COVID lockdowns over there. I was wondering if you can kind of touch on any trends you might be seeing over there, whether or not that's been improving or not.

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

No, I think that there have been and continues to be lots of challenges, especially China. We have maintained actually interestingly decent business in Korea since we just opened up 2 new design centers in South Korea. We have continued to do reasonably good business. It was slower but has made some improvement in other international markets. The biggest international market we have is the fact that we supply and we are involved with furnishing all the American homes, diplomats' homes all over the world. That's our biggest international business, and that has been very strong. And that also, as Matt had mentioned, that when we have a very strong wholesale business, it tends to reduce the percentage of gross margins, but it increases our operating margin, which is good news for us.

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**Zachary Donnelly** - *KeyBanc Capital Markets - Analyst*

Got it. Understood. And then kind of as a follow-up to that. So regarding any of the imports or import costs you guys are seeing, I know you kind of touched on that last quarter, too, with freight logistics costs kind of increasing. Are you still sort of seeing that? Or in terms of goods being imported, are you seeing any sort of benefit from a stronger dollar at this point?

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

Yes. Actually, I would say that for us, the worst is over. In the last few months, if anything, costs are coming down. Keep in mind, 75% of the products we make are in North America, where we had major increase in transportation costs. Transportation costs take going from our central warehouses in Virginia and North Carolina to California to Maine to Florida. They all increased, but not to the same level as, for instance, a container cost going from \$2,000, \$3,000 to \$28,000 from East Asia. Those costs are coming down. Still very high, but they are coming down. And the good news is, as we said, we have a relatively smaller exposure because of imports. And we look forward to even reducing these costs that have taken place in North America of transportation costs.

All right. Any other questions or comments?

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**Operator**

(Operator Instructions) Ladies and gentlemen, there are no further questions at this time. And I would like to turn the call to Mr. Kathwari for closing remarks.

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

Well, thank you, and I'd like to again thank all our associates for this great performance. This is extremely great. We know that going forward, there will be some challenges, but the good news is that we have a strong base manufacturing. Our interior designers are doing an amazing job, and I believe that we will have an opportunity to continue to make progress as we move forward. So thanks to all for joining, and thanks to all our teams.

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**Operator**

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

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