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PRESENTATION

Operator

Good afternoon, and welcome to the Ethan Allen Fiscal 2023 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, Chief Financial Officer and Treasurer. Thank you. You may begin.

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

Thank you, Darryl. Good afternoon, and thank you for joining us today to discuss Ethan Allen's Fiscal 2023 and Fourth 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 we begin, I'd like to remind the audience that this call is being recorded and webcast live under the News and Events tab on the Investor Relations page of our ethanallen.com website. There you will 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.

Our comments today may 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'm pleased to now turn the call over to Mr. Kathwari.

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

Thanks, Matt. Thank you for participating in our fiscal 2023 and fourth quarter financial and operating results. As we reported, we had strong financial results for our fiscal year and fourth quarter ended June 30, 2023. For the year, sales of $791.4 million, gross margin of 60.7%, adjusted operating income of $133.5 million, which is 16.9% of sales, and adjusted earnings per share of $4.03 compared to $3.93 in the previous year.

Our fiscal fourth quarter was also strong with adjusted operating income of $30.6 million for an operating margin of 16.3%. We have continued to generate strong cash, and as of June 30, 2023, had cash and investments of $172.7 million and no debt.

We are also pleased that yesterday, our Board approved a regular quarterly cash dividend of $0.36 per share and a special cash dividend of $0.50 per share, both payable August 31. As expected, the focus and very high demand of consumers on the home during the COVID-19 pandemic has moderated. We are well positioned to continue our progress.

After Matt provides a brief overview of our financial results, I will provide an overview of our focus to continue our strong operating and financial results. Matt?

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

Thank you, Mr. Kathwari. As a reminder, we present our financial results on both a GAAP and non-GAAP basis. Non-GAAP results include restructuring initiatives, impairments and other corporate actions and are further detailed in our press release. We believe the non-GAAP presentation better reflects underlying operating trends and performance of the business.

Our financial results for the fiscal 2023 full year and fourth quarter ended June 30 are highlighted by strong gross and operating margins, improving lead times from decreasing backlog, disciplined cost and expense controls, strong operating cash flow and a robust balance sheet. As we operate in a post-COVID-19 era, our operations produced strong financial results, which I will now discuss.

Our fiscal 2023 consolidated net sales of $791.4 million were lower than last year by 3.2%. Our fourth quarter consolidated net sales totaled $187.4 million, a decrease of 18.4% due to lower delivered unit volume from softening order demand and reduced manufacturing production from lower backlog.

Sales in the fourth quarter a year ago set a near record pace leading to a difficult comparison. Compared to the fourth quarter of fiscal 2019, which is pre-pandemic and more reflective of historical norms, our consolidated net sales were up 1.9%. Wholesale segment written orders during fiscal '23 were 9% lower compared to last year, but only 2.1% lower than fiscal 2019. For the quarter, our wholesale orders were down 14.7% to last year and were 2.5% lower than our pre-pandemic fourth quarter of 2019.

Retail segment orders were 12.3% lower in fiscal 2023 when compared to last year, and down 12.5% for the quarter, primarily due to a strong prior year comparable and a reduction of consumer focus on the home. When compared to 2019, retail orders for the full year were up 0.8%, while our quarterly orders were down 1.2%.

We ended the fiscal 2023 year with wholesale backlog of $74 million, down 27.7% from a year ago as we were able to reduce the number of weeks of backlog. However, our wholesale backlog still remains higher than pre-pandemic levels, and our teams are effectively managing the business to work through this order backlog and to service our customers.

For the full fiscal 2023 year, our consolidated gross margin was 60.7%, a 140-basis point improvement over last year. In the just completed fourth quarter, consolidated gross margin was 61.5%, our ninth consecutive quarter that consolidated gross margin exceeded 58%. When compared to last year, our quarterly consolidated gross margin was up 330 basis points due to favorable sales mix, disciplined promotional activity and lower input costs including reduced inbound freight and raw material costs, partially offset by lower delivered unit volume. Retail sales, which carries a higher gross margin increased to 83.4% of fourth quarter consolidated sales, up from 82.1% last year.

For the 2023 fiscal year, our adjusted operating margin was 16.9%, a 50-basis point improvement over last year as we carefully managed expenses in the declining net sales environment. Fourth quarter adjusted operating income and margin was 16.3%, down from 18.5% last year due to lower consolidated net sales, higher retail delivery and health insurance costs and new product display, merchandising and sample costs, partially offset by gross margin expansion and our ability to maintain a disciplined approach to cost savings and expense control.

Our SG&A expenses decreased 7.6% and equaled 45.1% of net sales, which is an increase from 39.8% last year due to fixed cost deleveraging on lower sales. On a full year basis, adjusted diluted EPS rose 2.5% to $4.03. For the fourth quarter, our adjusted diluted EPS was $0.96 compared to $1.25 last year. Our effective tax rate was 25% for the full year and 23.6% for the fourth quarter, which varies from the 21% federal statutory rate primarily due to state taxes.

Now turning to our liquidity and capital resources. We ended our fiscal year with a strong balance sheet, including cash and investments of $172.7 million as of June 30 and no outstanding debt. We generated $26.3 million of cash from operating activities during the quarter, bringing our total fiscal year amount up to $100.7 million, a 45.1% increase over last year. This growth was driven by strong profit performance and a reduction in inventory carrying levels and accounts receivable, partially offset by a decline in customer deposits.

Our inventory levels decreased $27.3 million since the start of the fiscal year as we restore our operating inventory levels to more historical norms as backlog decreases while also ensuring appropriate amounts of inventory are on hand to service our customers.

Capital expenditures were $13.9 million for the year, including $3.2 million during the fourth quarter as we continue to invest capital in manufacturing, retail, technology and infrastructure. We also continued our practice of returning capital to shareholders in the form of cash dividends. In April, our Board increased the regular quarterly cash dividend by 12.5% to $0.36 per share, which was subsequently paid in May and brought our fiscal 2023 dividends paid total to $46.4 million.

Also, as just announced in our earnings release, our Board declared a special cash dividend of $0.50 per share in addition to our regular quarterly cash dividend of $0.36 per share, both of which will be paid on August 31. We have paid a special cash dividend each of the past 3 years and have paid an annual cash dividend every year since 1996.

In summary, our vertically integrated business delivered strong fiscal 2023 operating results during a period marked by industry-wide softer demand and challenging headwinds. We achieved these positive results and generated strong cash flows while protecting our margin gains through disciplined investments and solid execution. As we move into fiscal 2024, we must continue to carefully manage our expense structure while investing in growth initiatives that we believe will further our business.

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*

Thank you, Matt. As I mentioned, we and our industry greatly benefited from the consumer focus on the home during the COVID-19 pandemic and as expected, consumer focus is now on many other areas as well. As we noted in our press release, we are very well positioned.

During the last 3 years, we have greatly strengthened our enterprise in several important areas, including the following: strengthening talent. We have strong talent in our various areas from product development, marketing, manufacturing, logistics, retail, technology and operations. Our product offerings and marketing have been enhanced. Our product programs under the umbrella of classics with a modern perspective are being introduced to our network. Our marketing has been greatly expanded, especially utilizing digital mediums.

The repositioning of our retail network. We are in the process of launching our refreshed projections under the umbrella of interior design destination. Our plan is to complete the launch in our 175 North American design centers during the next 6 months. This provides us great opportunity to reach our clients and is also a strong motivation for our interior design team. As you know, we have the largest interior design network. We are pleased and honored that last week in a study by Newsweek, we were named 1 of America's top 10 retailers, including recognition as #1 retailer in the premium furniture category.

Continued strengthening of our manufacturing and logistics. We have continued to invest in our 10 North American manufacturing operations, which produced about 75% of our products with 75% of them custom. Our national and retail logistics continue to be enhanced. We provide excellent and consistent service at 1 delivered price to our customers throughout North America.

Technology, our focus and continued investments in technology have been a game changer both in providing excellent interior design service, combined with technology and in the efficiency of our manufacturing and logistics operations.

And finally, we remain focused on being socially responsible as it is an important part of our business, our culture and to the communities in which we serve and operate in. As we mentioned in our press release, we remain cautiously optimistic.

Operator, we are now pleased to open the call for any questions and comments.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first questions come from the line of Brad Thomas with KeyBanc Capital Markets.

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

Brad, is it you?

Bradley Bingham Thomas - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

It is me here. Yes.

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

Good to hear you, Brad, after some time. And you are doing well?

Bradley Bingham Thomas - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

I'm doing well, I'm thrilled to not have another earnings conflict here during this call today. So good to hear you live, Farooq.

Well, thanks for all the prepared commentary. I was wondering if you could talk a little bit about the cadence of the business from a written perspective, with a little bit of a slowdown from what you posted in the March quarter. I was wondering if you could talk about some of the dynamics behind that? Did you change at all? How promotional were you? Is it getting more competitive? Did the consumers seem to just pause and how you're thinking about the cadence of orders as we look forward here?

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

Yes. As we mentioned that we were operating in the last 3 years at very, very high levels of orders coming in. Consumers interest was tremendously great. And now it has come back to somewhat, you might say, normal, which is, as Matt also mentioned, we look at our fiscal 2019 as the base year prior to the COVID. And based on that, we are still holding up pretty good.

Our backlogs are still higher than what we had in 2019. And where the positive thing has been that we have been able also to become more efficient at all levels. And for instance, that the role of technology has just been amazing of the efficiency it has brought in and the productivity it has brought in both at our manufacturing and at our retail levels.

Today, we have most likely -- when you go back to 2019, we have many -- much less -- many less interior designers doing more business because of the fact of technology. Similarly, our manufacturing, 25, 30 years back with 30 manufacturing plants. Today, we have 10 and they're operating extremely efficiently and effectively because of the combination of obviously good talent, but also technology.

So I would say that our business is obviously moderated. But as you can see, despite the fact we had lower sales than last fiscal year, our gross margins improved, and our operating income also improved. So we will continue to see us operate more efficiently and effectively, both at a gross margin level and the operating income level.

Bradley Bingham Thomas - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

And that's a great segue to my follow-up question there. The gross margin, obviously, very strong. I know some of that is a function of channel mix and on where the sales come from. But how are you all thinking about the puts and takes on gross margin as we think about the next year?

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

I think that the -- obviously, the gross margin is impacted by the amount of production and sales. We run -- we are a vertically integrated company. We have manufacturing. And obviously, our manufacturing benefits with higher volumes and on the other hand, if had lower volumes, the manufacturing does have a negative impact on gross margins.

So those are issues from the perspective of gross margins. Having said all of those things, I think that more or less where we are, we are -- we expect to remain -- that's what our expectation is to remain at the level we are because of the efficiencies that we have brought in.

Bradley Bingham Thomas - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

I appreciate it.

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

All right. Thanks very much. Good to hear your voice. Now this is -- I tell you that the folks don't completely know it, but I think you were there 30 years back when we took this company public, correct?

Bradley Bingham Thomas - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

Not quite that far. Going through the great financial crisis, but not quite that far. Yes.

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

Okay, you're still young. All right.

All right, Darryl, please go ahead.

Operator

Our next questions come from the line of Cristina Fernández with Telsey Advisory Group.

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

I wanted to follow up on Brad's question around demand. Can you comment on, I guess, how volatile are these trends? Are you seeing like similar trends from week to week or month to month? Or is there a lot of volatility in the market? And I was also curious what you're seeing in ticket versus traffic, are -- is ticket outpacing traffic?

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

Yes, it's a good question. It's an interesting time we are living in, that this past -- this summer, we have seen the impact of people going on vacations, not staying in their home, quite different than a year back. So I think what we're seeing -- I think if we look at it, we have seen more of an impact this summer of people doing other things. And also the fact remains that a lot of people did buy products for their home.

So I would say that our perspective is that as this summer time ends that people will -- we expect people to go back to the normal levels of coming into our design centers, perhaps not as high as we saw in the last 3 years. But I would say that our expectation is we should do better in traffic than we did in the pre-COVID area.

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

And then I had another question on the -- also on the gross margin, how much of a benefit are you seeing from input costs, whether it's transportation, freight and raw materials year-over-year?

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

Yes. I mean, the -- our gross margins and operating margins are both -- 2 important areas, which are impacted both by the impact of freight coming in, our -- and also the delivery of our products. Keep in mind, as I mentioned, that we deliver our products at 1 price throughout the United States and also throughout Canada.

So in the last 3 years, the transportation cost of delivery in the United States was extremely high. The cost of delivery of a container, let us say, from Indonesia or East Asia to the United States had gone from $3,000 to $30,000. It's come back. Our costs in the United States were also very high at the retail level because of the domestic transportation. Our cost of sending a trailer from east to the west had tripled, it's coming back to the normal levels. To answer your question, I think that we are having a positive impact on our margins both as a retail and at the manufacturing level due to reduction of costs.

Also, our -- we are a manufacturer. Lumber costs have gone up very, very high. Then I'll come back to the pre-COVID levels. So on 1 hand, we are going to be impacted with the impact of somewhat lower deliveries. But on the other hand, we are benefiting from the lowering of the costs, whether it is of raw materials or freight. Both to our manufacturing and to our retail because as you -- part -- a lot of our freight goes into our operating expenses; some it goes to our cost of goods that portion that goes into our manufacturing side.

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

That's helpful color. And then the last question I had was on the store refreshes, how many have you done so far? I know you did the Danbury store at your headquarters. And those that have been completed, how are they performing relative to the rest of the chain and the ones that have not been touched?

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

Yes, it's a very, very important and good question. I believe you came to the Danbury design center; you saw it. We are in the process right now. We have not completed any as yet completely, but they're all in the process of getting completed. And I would say the process of getting them completed because it needed products. It needed also the work in each of the design centers, needed painting, some electrical work, and all those kinds of things. That is being done right now.

At this phase, we are in the process of updating the interiors and in some cases, the exteriors of our design centers and starting in about, I would say, 4 to 6 weeks, they will start getting products, which is being made and getting ready. So as I said, within 3 to 4 months, most of the design centers would have received the product. And the objective is, which is something that we couldn't have said that 5 years back that the interior projection that you saw in Danbury is the projection that we're going to have nationally in 175 design centers.

The other reason that we are able to do it today is that technology has played a tremendously important role. In the past, we had to have the product in the design center or the store for people to see. Today, with our digital technology and virtual reality, our designers can develop and they do develop designs for the consumer with all kinds of colors and design and products. That is a game changer.

So to answer your question, I think you'll start seeing it in the next 2 to 3 months, the process will start, and our objective is most of them will be completed in about 6 months.

All right. Thank very much. And any other questions or comments?

Operator

Thank you. I see no further questions in the queue. So I'll hand the call back over to Farooq Kathwari for any closing comments.

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

All right. Darryl, thank you, and thank you, everybody, for being on the call. We -- these are interesting times, and the good news is that we are very, very well positioned and we look forward to continuing our progress and our growth.

So thank you very much for participating in this call.

Operator

Thank you. That does conclude today's teleconference. We appreciate your participation. You may disconnect your lines at this time. Enjoy the rest of your day.
