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ETD.N - Q3 2024 Ethan Allen Interiors Inc Earnings Call

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PRESENTATION

Operator

Hello, and welcome to the Ethan Allen Fiscal 2024 Third Quarter Analyst Conference Call. (Operator Instructions)

As a reminder, this conference is being recorded. It's now my pleasure to turn the conference over to Matt McNulty, Senior Vice President, Chief Financial Officer and Treasurer. Please go ahead, Matt.

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

Thank you, Kevin. Good afternoon, and thank you for joining us today to discuss Ethan Allen's fiscal 2024 third 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 website. There you will also 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. A replay of today's call will also be made available on our Investor Relations website.

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 that could affect our future results are described in our annual report on Form 10-K. 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*

Thank you, Matt, and thank you all for participating in our third quarter earnings call. As we stated in our press release, we are pleased with our financial performance and continued strengthening of our enterprise. We are also seeing incremental consumer interest for returning back to the home after being previously diverted to other areas such as travel. Again, after Matt provides a brief financial overview, I will discuss in greater detail our initiatives. 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 exclude restructuring initiatives, impairments and other corporate actions. We believe the non-GAAP presentation better reflects underlying operating trends and performance of the business.

Our financial results in the just completed third quarter were highlighted by our robust balance sheet, strong cash dividends and a double-digit operating margin. Despite currently operating in a challenging home furnishings industry, our operations produced positive financial results, which I will now discuss.

Our consolidated net sales totaled \$146.4 million, reflecting lower delivered unit volume, reduced manufacturing from lower backlog, a cautious consumer environment and a strong prior year comparable. Overall demand patterns across our industry have been sluggish. Our written order trends in the quarter were impacted by continued softening of the market, elevated interest and inflation rates, reduced design center traffic, partially due to adverse winter weather conditions and a strong prior year demand.

Wholesale segment written orders decreased 14.6% compared to last year, while retail segment orders were down 8.6%. We ended the quarter with wholesale backlog of \$57.7 million, reflective of historical norms and pre-pandemic levels. We continue to improve customer lead times and reduced the number of weeks of backlog during the quarter.

Consolidated gross margin was 61.3%, the 12th consecutive quarter that our gross margin has exceeded 58%. The 140 basis point increase in consolidated gross margin was driven by a change in sales mix, lower manufacturing input costs and reduced head count, partially offset by deleveraging from lower unit volumes and higher sales of designer floor samples.

Adjusted operating margin of 10% reflects fixed cost deleveraging from lower sales, partially offset by gross margin improvement, lower head count, less variable expenses and the ability to maintain a disciplined approach to cost savings. Our SG&A expenses decreased 9.6% and equaled 51.4% of net sales, up from 44.7% last year due to lower sales volume relative to fixed costs.

Compared to our pre-pandemic 2019 third quarter, our operating margin has improved 380 basis points due to our initiatives focused on streamlining and reducing the operating cost structure while enhancing operating efficiencies. Adjusted diluted EPS was \$0.48. Our effective tax rate for the quarter was 25.1%, consistent with a year ago.

Now turning to our liquidity. We ended the quarter with a robust balance sheet, including cash and investments of \$181.1 million and no outstanding debt. We generated \$23.7 million of cash from operating activities during the quarter, primarily due to net income and improvements in working capital.

In February 2024, we paid a regular quarterly cash dividend of \$9.2 million, or \$0.36 per share. More recently, on April 22, our Board of Directors increased our regular quarterly cash dividend by 8.3% to \$0.39 per share, which will be paid in May. This recent action marks the fifth time we have increased our regular quarterly cash dividend since January of 2021.

In summary, we remain cautiously optimistic as the strength and stability of our balance sheet has us positioned well to maximize on our vertically integrated structure in anticipation of a better macroeconomic and home furnishings environment. We are building a fundamentally stronger company, protecting our profitability and enhancing our operational efficiency.

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

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

Thanks, Matt. As we discussed in our last quarterly meeting, our results reflect post-COVID demand. COVID emergency started to end about 12 months back, and consumers' interest diverted to other areas such as travel, resulting in lower sales for us and our industry also resulted in a number

of bankruptcies in our industry and in my opinion, they do not take the precautionary measures. We did take strong measures to reduce inventories and expenses and increase our cash. We do now see the start of increased interest in the home and start of positive sales.

While Matt has given some financial information, I would like to again emphasize the fact that our operating margins of 10% for quarter ended March 31, 2024, are, of course, lower than the 15.2% for the quarter ended March 31, 2023. And however, our pre-COVID, that is March 31, 2019, our operating margin was 6.2%.

Our net income of \$12.4 million for quarter ended March 31, 2024, again, compared to \$22 million as of March 31, 2023 and \$8.2 million as of March 31, 2019. We have continued to have a strong cash position, as Matt just said, at March 31, 2024 of \$181 million; March 31, 2023 at \$156.2 million; and again, very importantly, that at March 31, 2019, that's pre-COVID, our cash of \$25.7 million.

We've also maintained strong cash dividends for quarter ended March 31, 2024, paid \$9.2 million. And as we just mentioned and Matt did in our press release, that the Board increased our regular dividend to \$0.39, an 8% increase.

Very importantly, with the combination of technology and personal skills and looking at our business from a base zero, we have been able to reduce our head count. As of March 31, 2024, it was 3,448 compared to 3,816 as of March 31, 2023, a decline of 9.6%. And very importantly, we had a head count of 5,120 as of March 31, 2019, a reduction of 32.7%. Tremendously important is the fact of reviewing all our operations, you might see from base zero, having great talent and technology that has resulted in strong efficiency in our enterprise.

Now very briefly on some of our current initiatives. During the last 12 months, we launched the interior design initiative. This initiative reflects our next reinvention in our 93 years. Most of our 175 design centers in North America have been repositioned. And the main elements are our design centers reflect consistency of product programs across North America, and we are currently working with our international partners.

Very importantly, the size of our design centers have been reduced. At this stage, our objective is to have the maximum size of 12,000 square feet from the 20,000 or so, 20,000 square feet that we have had, that most of our design centers were operating in. The extra space has been converted in the design centers the way we have the space into what we call a designer floor sample area. We've been selling the extra inventory resulting from the change.

Now the impact of this has been that is, of course, very cash positive, but it also had an impact of lower margins because we were selling a lot of floor sample products. And another impact it had was on our manufacturing, because instead of products we made for manufacturing, we were selling a lot of products from floor samples.

Now the good news is most of that is over. We still have products that will be sold because this does take some time, but we have now started to have more of the orders coming in and going to our manufacturing. As I said earlier, the combining very strong interior designers and technology is a game changer in terms of productivity and costs.

Now in our marketing and merchandising. Our marketing is constantly utilizing technology in developing and distributing our message. During each month, 2 digital magazines of about 36 pages are distributed each time to 9.5 million customers and prospects.

In April, we just introduced our new Style Book, which has been very well received by our teams and clients. They will -- this Style Book will be, again, available both in print form and digitally.

Merchandising is focused on strengthening our product programs and introducing them to our network and consumers in a planned manner. We did have all that, some of our product introductions, but now we have been very aggressive. And in fact, in the next 6 months, we'll have a fair amount of new products introduced.

We also want to make sure we stay relevant. I, along with some of our key people, had an opportunity last week to review products in the Milan fashion and furniture fair so that we understand where we are. And again, as you know, our focus has been to be -- to have products that differentiate

us. And that will be our focus. You'll see more of that coming in. Our product programs, I say we're focused on plastics but with a modern perspective. And we believe that is the right attitude for us.

Now in manufacturing and logistics. We have 75% of our products are made in our manufacturing in North America. In furniture, I mean, we do get other products like accessories and other things from different parts of the world. And we continue to invest in many areas from new machinery and equipment and strengthening our environmental and social responsibility in the various regions.

Keep in mind, with technology and, of course, strong people, we have now reduced our manufacturing from about 30 manufacturing plants only 10, 15 years back to about 10, but it's in North America.

Now as you know, with all the conflicts taking place in the world, the international freight has increased. Again, as we make 75% of our furniture in North America, the impact has been less, mostly on products that are coming from overseas, access and some furniture.

So overall, we are well positioned. Our interior design network has been redesigned. In terms of the projection, very important. We have continued to have strong interior designers and technology in all areas.

With that brief overview, I'd like to open it up for your questions or comments.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question today is coming from Taylor Zick from KeyBanc Capital Markets.

Taylor Zick - *KeyBanc Capital Markets Inc., Research Division - Research Analyst*

It's Taylor Zick on for Brad Thomas. I just wanted to ask about cadence of the business for the quarter. You had mentioned that January was kind of weak because of weather, but some of the trends have seem to get better as the quarter has moved along. So curious to what you have seen during the quarter. And then if you have any thoughts on how April is trending.

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

Yes. I think that in this quarter, we did have the impact of weather in the middle of the month. It really had an impact, and that created issues. And on top of it, as I said, with our focus, with the consumers' interest in other areas, that also impacted. But as we went into -- towards March, we did start seeing some improvements. And in April, as we said in our press release, we have seen more interest in the consumers getting back into the home from travel and all other areas.

Taylor Zick - *KeyBanc Capital Markets Inc., Research Division - Research Analyst*

Great. And then maybe just on the refresh of your design stores. You mentioned you're complete on most of those refreshes. I'm curious on what you're hearing from your customers or maybe your designers there. And any feedback on some of those updated products as well?

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

Yes. This is really -- it's almost like a revolution. Five years back, folks in New Jersey thought they needed something very different than in Connecticut, and forget California or Texas. But the fact is good design is good design. And we decided that we will, along with -- we have to make sure that all our key designers, that our folks are managing are on board because they have to -- they have one right in the feet. They all love what we did.

We introduced it last April actually in our Danbury headquarters design center. And then it took us close to a year in implementing it across. Very well received by consumers, very well received by our designers because they have good design. And of course, what differentiates us is that 75% of our furniture is made custom when they come in. So if we were in a business of selling this product alone, what we show on the floor, it will be a different model.

We need to make sure we have the best representation of our products on the floor and then have the ability of our designers through the use of technology of creating room setting. Five years back, you do not imagine that the amount of virtual business we are doing combined with technology. Personal service and technology is making a big difference.

Operator

Our next question is coming from Cristina Fernandez from Telsey Advisory Group.

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

I wanted to follow up on the first question and your comment about seeing improved interest in the home. If I understand your comment correctly, it seems like you're seeing some sequential improvement in March and April. Can you talk about what you're seeing year-over-year? Are the declines lessening? And I guess, what is giving you the confidence to -- kind of what green shoots, what are you seeing with the traffic to feel confident that the consumer is, in fact, kind of back purchasing for the home?

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

Yes. Cristina, the issue is really what I was referring to is the fact the improvements are from the last 6 months or 9 months because that's when we saw consumers' interest go to other areas. And before that, we are back, there was a lot of interest in the home. So you've got to compare this more to the last couple of quarters or 3 quarters at most. Then a lot of interest, COVID sort of debated. There's a lot of interest into other areas. We are now seeing that people have traveled, able to spend money in other areas, and they are now looking back into the home. But keep in mind, during the COVID period, a lot of folks did spend a lot of money on home. There's a lot of attention. So this is going to be relative to see how much better we are going to do. But certainly, we're going to do better than what we did in the last couple of quarters.

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

Okay. And then I want to ask about the order intake, the spread between retail and wholesale was wider than what we've seen in the past couple of quarters. So is it the timing of the state department contract. Or I guess, what other factors are at play in that wholesale order intake?

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

Yes. That's all that is important. There are two important factors. One is our government business. This conflict is taking place, a lot of interest -- I mean, a lot of attention from the government into spending money on security in other areas, that's what we understand. The good news is recently now, in the last couple of weeks, they've started to pay more attention to their furniture needs. So we've seen increased business back.

For the last 3, 4, 5 months, there was a lot of attention going to other areas, and our business was substantially down. Then, of course, also our international business was down quite a bit, especially in China. Good news is that the China is now, they started the process of creating this Interior Design Destination in design centers there in China. Still, the business has started to improve. But the factors of our international business, China being the #1, but our business in other countries also was down. Our state department business was down. That was the big difference between our wholesale and retail.

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

And then the last question I have is in relation to the SG&A dollars. You've been able to reduce those. You were down 10% year-over-year this quarter. Where are you flexing the SG&A? Is it mostly the head count reductions in the last year? Or are you also pulling back on marketing or other sort of expense buckets?

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

Yes. Actually, it is mostly head count, and that is both in manufacturing and retail. The combination of technology has really had a tremendous impact in the business we are doing. We have actually somewhat increased our marketing relative to what we did in the previous quarters. Matt, how much -- in this quarter, how much did we then get, 3%, 4%?

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

Yes. Marketing is actually up 24% year-over-year and was 3.4% of sales versus only 2.2% of sales last year. So we've increased it.

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

So we increased our marketing. Of course, comparing to some lower sales, but marketing has increased. It really was what you mentioned, the reduction in head count has been a major factor.

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

I would also add to some of that flexing down is variable in nature. So as sales -- delivered sales do come -- or were down lower this year, variable compensation comes down, whether it's designers' selling compensation or delivery costs, and we're benefiting from lower fuel costs year-over-year. So that's coming down on the SG&A line.

Operator

Our next question today is coming from Budd Bugatch from Water Tower Research.

Budd Bugatch - *Water Tower Research LLC - Head of Consumer Hardlines*

There you go, sorry for that. Can you hear me now?

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

Yes. Budd, I can.

Budd Bugatch - *Water Tower Research LLC - Head of Consumer Hardlines*

I want to punch into that retail, the consumer adding back to the home. And I hear you, and it's one of our true failings. We try to put numbers on things. And you're good with numbers, and you're also good at sidestepping us when we want numbers. So let me see if I can get a couple of them.

The backlog increased from the last quarter to this quarter by about, if I do it right -- not the backlog, but the customer deposits increased about \$17 million from the second quarter to the third quarter. Is that about right, Matt? Is that -- do I have that correct? And last year, it was about a \$29 million increase. And is that reflective of what's going on in terms of retail orders? How do you look at that?

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

Yes, that is correct. Yes. Sorry, go ahead.

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

Go ahead, Matt, yes. Matt, go ahead.

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

Yes. So what I was saying, yes, our deposits are up year-over-year. Part of that was timing of when the orders come through in the quarter, but also is reflective of, as Mr. Kathwari said, an increasing focus on the home and a higher dollar volume of orders that we saw this past quarter compared to the last 6 to 9 months. So the customer deposit balance did increase and also backlog.

Budd Bugatch - *Water Tower Research LLC - Head of Consumer Hardlines*

I see. You gave us a backlog number for wholesale. If you gave us one for retail, I missed it. What is the retail backlog at the end of the third quarter?

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

Yes. We typically do not disclose the retail backlog, although we do say it is approximately 2x that of customer deposits on hand.

Budd Bugatch - *Water Tower Research LLC - Head of Consumer Hardlines*

Okay. So the customer deposits is about 50% of what the backlog is, okay, of what an order is. And so when you look at -- you're talking about increased attention to the home. Are you really talking about what you're seeing in April? Or are you seeing -- or what you saw at the end of March? How do you -- when did that begin? And help us account for it.

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

Well, during March, we just remarked as somewhat unique because Easter fell on March 31. And we were closed and closed on the last year, the month is not particularly closed on. So that did impact the numbers in March. Now, of course, this is going to be in April, this month.

What we did say was just in the beginning, right after the end of Easter, there was -- we could see more increase in business because the timing of the Easter did impact March. But I think that some of that business did also go into April. So I see that what we are seeing is it's still a start from -- we still have to watch this carefully, but it's somewhat of a positive start in April.

Budd Bugatch - *Water Tower Research LLC - Head of Consumer Hardlines*

Okay. That is helpful. When I had my retail business, I would always say that Easter or Passover was either late or early, but it was never on time. And that's one of the...

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

Having it on March 31 is not a good day to have it.

Budd Bugatch - *Water Tower Research LLC - Head of Consumer Hardlines*

No, no. It's not. It's never good for the business. Okay. Well, that really gets to the heart of my question, which is really -- and I think that's the key for Ethan Allen going forward as to what is the viability. What's the vibrancy you're seeing in the consumer? And I know you've got a big plan to reduce the size of design centers and make them more efficient. So we'll see how that portrays into the numbers.

Operator

We have reached the end of our question-and-answer session. I'd like to turn the floor back over to Mr. Kathwari for any further or closing comments.

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

Well, thanks very much. I'm pleased that we have this opportunity of discussing, and a lot of challenges in our industry, the economy. However, with all the great work that our team has done, that is at the time and really others increased their expenses. We were able to reduce it, but in a positive manner. We didn't reduce it for the sake of reducing it. It was a combination of great talent, technology and the last 10, 15 years of reducing our manufacturing to a more sensible operating model that we have. So all of those things are impacting, and we look forward to continued progress as we move forward. So thanks very much everybody, and look forward to talking to you next quarter.

Operator

Thank you. That does conclude today's teleconference webcast. You may disconnect your line at this time, and have a wonderful day. We thank you for your participation today.

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