Delta Apparel, Inc.

Fiscal Second Quarter FY17 Results Earnings Conference Call

May 8, 2017

Operator:

Thank you and good afternoon to everyone participating in Delta Apparel's Fiscal 2017 Second Quarter Conference Call. Joining us from management are Bob Humphreys; Chairman and Chief Executive Officer; and Deb Merrill; Chief Financial Officer and President Delta Basics.

Before we begin, I'd like to remind everyone that during the course of this conference call, projections or forward-looking statements may be made by Delta Apparel's Executives. Such statements suggest predictions and involve risks 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 from 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. Also, today's call is being recorded.

Now your host for today's conference Delta's Chairman and Chief Executive Officer, Bob Humphreys. Mr. Humphreys, please go ahead sir.

Bob Humphreys:

Thank you and thank you all for joining us for our second quarter conference call. We've been busy over the last few months and are pleased to report strong results for our second quarter. As you are aware, at the end of the second quarter, we sold the Junkfood business a niche participant in the licensed-graphics space.

Over the years, this has been a good business for us and we enjoyed nurturing it and see it more than double its revenues while we owned it. That being said the retail environment in marketplace for licensed-graphics tees has been changing and being a niche player in this space has become increasingly challenging.

The sale puts the Junkfood brand in the hands of others more focused on this space, who can continue to grow and develop the brand. For us to sell the business worked our well, yielding us a gain of $0.11 per diluted share and enabling us to further narrow our focus on the areas of our business that we believe will have the most significant impact on our growth and profitability. The $28 million of proceeds of which $25 million we received at closing are being used to fund increase share repurchases and deleverage our balance sheet, giving us more flexibility to fund both organic and strategic growth opportunities.

I'm going to let Deb, tell you more about our financial results and then I'll return and take you through our outlook for the business.

Deborah Merrill:

Thanks Bob. This was indeed a good quarter for Delta Apparel. Our net income increased to $4.5 million or $0.58 per diluted share, a 35% increase from $3.4 million or $0.43 per diluted share, for last year's second quarter.

More significantly even after excluding the gain on the sale of Junkfood, our earnings were nearly 10% higher than those in the prior year. As Bob mentioned the Junkfood business has recently been very challenging, culminating in the 40% sales decline in the March quarter and $1.2 million in operating profit. Adjusting to quarter to remove the Junkfood operating results as well as the gain on the sale of the business and what have achieved 8% operating profit, 160 basis point or 25% improvement over the prior year quarter.

This is a significant improvement in profitability especially given the relatively flat sales versus the prior year's quarter. As reported our operating profit was $7.5 million or 7.2% of sale. Net sales for the 2017, second quarter were $104.1 million compared with a $109.2 million in the prior year's period. Decline resulted from considerably lower sales of Junkfood and lost revenue at Soffe from This Sports Authority bankruptcy.

Gross margins increased year-over-year in all of the businesses with the exception of Junkfood in the March quarter and on a sequential basis expanded 270 basis points. Overall gross margins were 30 basis points lower year-over-year at 23.3%, but excluding the impacts from Junkfood, which have shown a 50-basis point improvement over the prior year.

Basis segment net sales grew 1.4% to $70.8 million in the fiscal 2017 second quarter, from $69.8 million in the prior year's quarter. ArtGun shipped a record second quarter units of 18%, driving sales growth of 11% with margins expanding 480 basis points. Activewear sales grew 1% during the second quarter driven from a 7% increase in private label sales and a 40% growth in fashion basics.

This was partially offset by continued softness in the retail licensing sales channel, although this channel did start to stabilize a bit as the quarter progress. We have a good inventory position that should allow us to service the overall catalogue market well, during this spring selling season. Net sales for the branded segment were $33.3 million compared with $39.3 million in the 2016 second quarter. The decrease was primarily related to the significant sales decline at Junkfood, and the lingering impact of the bankruptcy of This Sports Authority.

The loss of This Sports Authority not withstanding Soffe enjoyed a 150-basis point margin expansion, as it continued to build solid relationships with strategic and independent sporting goods retailers and e-retailers. Soffe had strong e-commerce growth with its B2C sales increasing 38% for the quarter and 34% year-to-date.

Salt Life also had expanded margins on a 10% revenue increase, a second quarter record. Operating profits were further enhanced our leveraged administrative expenses and lower distribution cost. Helping drive Salt Life to an all-time record EBIT. Growth continues to be driven by Salt Life expanded product line and brought in distribution.

Salt Life e-commerce business also did exceptionally well, growing 42% for the quarter and 46% year-to-date. Capital spending for the quarter was $2.2 million, bringing the total so far, this year to $3.9 million. This was principally related to e-commerce upgrade; retail store build out and manufacturing expansion. We anticipate capital spending for the full 2017 fiscal year to be somewhat lower than that of 2016, and should be around $10 million.

Depreciation and amortization, including non-cash compensation was $2.9 million in the second quarter and $5.8 million year-to-date. During the second quarter, we repurchased 49,400 shares of Delta Apparel stock at an average price of $16.24 per share, for a total cost of about $800,000. So far, this year, we've invested $1.6 million to repurchase 96,043 shares at an average price of $16.90 per share.

At the end of the second quarter we have $7.5 million remaining of our Board authorization for share repurchases. We continue to believe that the current share price range does not accurately reflect the true intrinsic value of the Company, and planned to pursue our share repurchasing program more aggressively in the second half of the year.

With few expectations, our March quarter met our expectation, and we look forward to a strong second half of the year. Bob will now take you through more about our strategies for growth and our outlook for the business.

Bob Humphreys

Thanks. As Deb, just reviewed with you we had a strong second quarter with earnings of $0.58 per share a 35% increase over the prior year and excluding the gain on the Junkfood sale, earnings were up nearly 10%. As a result of our expanded sales and marketing strategies, new product introductions in our manufacturing realignment completed last year, we achieved significant improvement in the Activewear business during the second quarter.

Introduction of Activewear's 2017 fashion basics product is going well, particularly the Delta Platinum line which feature softer fabrics, a refreshingly different color pallet and great price points. Continued growth in programs with some of our international brand partners bolstered our private label business as there a solid demand for our specialized vertical manufacturing capabilities, combined with our sensitivity to social and environmental compliance, they are so important to major brands and retailers.

In that regard, I'm pleased to report that we made our production and cost goals that we sat for our manufacturing realignment. We saw the initial positive results in the March period and expect all of them to become increasingly apparent in the second half of the fiscal year.

ArtGun achieved outstanding results for the first half of the year, positioning itself for a strong 2017 performance. ArtGun's e-commerce fulfillment and digital print model provides a unique service model to the new retail landscape where products or virtual until sold. We already have additional equipment on order to expand ArtGun's capacity to keep pace with demand particularly during the upcoming holiday season.

Over the next several quarters, we'll also be expanding our geographic footprint with ArtGun, utilizing our existing distribution facilities to better service customers with reduced shipping time and getting products to the end consumer faster are also allowing us to leverage existing inventories.

Soffe which is rebuilding volume through several emerging channels of distribution, is gradually overcoming the difficulties posed by some of its traditional retail customers. We are building our direct-to-consumer business at Soffe, achieving double-digit growth on our Soffe website. We opened a new Soffe retail store earlier in the year and planned to open two more during the remainder of this year.

Retail stores are expected to be profitable and used to reinforce the Soffe brand identity and connect directly with our consumers. We are seeing profits at Soffe although still well below our long-term goal. We'll continue to build on the strength of the Soffe brand and leverage our strength in Made in America and Military product. With this focus combined with continued improvement on the operational front, we believe Soffe can improve its profitability to meet our goals for the business.

During the quarter, Salt Life experienced strong shipments for the initial spring store sets and early indications point to good spring sell-through. Our product expansions in ladies and youth products were driving growth in these channels and our performance products continue to be a strong product category.

Salt Life has attracted a large Internet followings towards YouTube and other social media outlet achieving over one million followers across social media.

Our new YouTube shows including our recently launched Yoga series are attracting new subscribers. We now have nearly 50,000 subscribers on the YouTube channel and with nearly 18 million minutes of viewed content. California remains one of the top three states that views on the channel and interestingly the State of Illinois was in the top five in March. The traffic on the Salt Life website was up 24% and through higher conversions and larger purchases, sales on the website grew by over 40%.

We also have just introduced a new Salt Life rewards program that provides a bonus incentive to consumers to shop on the Salt Life website. Overall, we anticipate continued double-digit growths through Salt Life Omnichannel model in its branded e-commerce site.

This was a good quarter by a lot of measures and it demonstrated the values of the strategic initiatives that we embarked upon and completed several quarters ago. More importantly it's just a stage of what we believe we can achieve in the second half of the year.

We expect Salt Life and ArtGun to continue their double-digit growth and should see continued improvements in Activewear and Soffe. Our e-commerce businesses should continue to expand and we expect our new branded retail stores to build incremental revenue.

All the while, our product call should improve as we receive the full benefit from our manufacture and realignment over the next several quarters. While the retail environment continues to be a challenge, we believe that the strategic initiatives that we completed over the last several years, combined with our broad channels and distribution will result in the future of solid performance for Delta Apparel.

Operator, you can now open up the lines for questions please.

Operator:

Thank you, sir. Ladies and gentlemen, if you would like to ask a question 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 that your mute button is disengaged to allow your signal to reach our equipment. Again, press start, one to ask a question and we will pause for just a moment to allow everyone the opportunity to sign for a question. Again, that is star, one to ask a question. For our first question, we go to Dave King with ROTH Capital.

Dave King:

Hi, Bob and Deb.

Deborah Merrill

Hi.

Robert Humphreys

Hi, Dave.

Dave King:

Maybe first on the margins, are we able to quantify how much of the–I think of a 60 basis points of year-on-year improvement on the basics side was due to the manufacturing realignment? Then Bob, based on your remarks, it sounds like you have hit your targets, is it fair for us to still be assuming kind of $8 million in annual savings from that or is there a potential for that to maybe even be higher? Thanks.

Robert Humphreys

Yes, so I think some of that margin was from the manufacturing realignment but remember we really just started seeing that in the March quarter, I mean the March period, based on where we are seeing today, we would expect to be at that $8 million of cost savings from that project.

Dave King:

So, it sounds like you haven't seen much of that yet, and a lot of it so–(inaudible) through.

Robert Humphreys

Exactly. It's basically sitting there on the balance sheet and lower cost inventory that we started shipping in March and will continue to ship.

Dave King:

Okay, that helps. Then and what are sort of your updated thoughts on the move and in cotton prices, any potential for pricing actions on that front and then, how should we be thinking about the impact on margins, from that, if at all?

Robert Humphreys:

Yes, so from where we sit today and where cotton is today, I think it's in our manageable area. There's been some price increases through the, basic undecorated tee (phon) market. There will be price increases going through the private label market and we are thinking other places of our business. We got some opportunities to raise prices as well. So, more to come based on consumer demand and a lot of other stimuli, but I would say cotton prices today should be mutual loan margins over the next 12 months to 18 months.

Dave King:

Okay, that helps. In terms of the $25 million in cash generated on Junkfood. Sounds like share repurchases and de-leveraging and Deb, I think maybe from your comments it sounds like, I think you said aggressive on the share repurchase front, which I think would be welcomed. I guess how should we be thinking about just the prioritization of those–of the uses of that cash and then maybe even versus kind of reinvestment in the business?

Robert Humphreys:

Well, somewhat opportunistically we're definitely bullish on buying back our shares and we do that through the Safe Harbor process and we'll continue to do that, but this will give us more varied liquid money to apply to that. So, we will be more aggressive. Then obviously, the easy thing to do short-term, is pay back debt, but we're always willing to invest in a current business or a complimentary business, if we think the opportunities for the right returns are there.

Dave King:

Okay. But actually–so that was my last question, so maybe along those lines with Junkfood now sold. I guess what are your updated thoughts on potential for selling any other brands at this point and then, you sort of eluded to it but, what are your thoughts on acquisitions out there, how are the bid/ask spreads and how is the pipeline look for doing that and what's the appetite?

Robert Humphreys:

Okay, that's a long list. So, our thing with our businesses is when we don't have what we consider a good vision for success, then we should move them on to someone who has a different vision or more focused on that part of the marketplace. Really that was–where we were with first The Game, from the Collegiate license business and then ultimately Junkfood, we think is under great hands and I think they will do well with it. But are very focused on that space and we were not. So, Junkfood made good money for us over the years and so we were able to harvest that, those retained earnings and now turned them into cash, which we think was the right thing to do.

Right now, we think that we have a pretty good vision of success for our current inventory businesses. So, our focus is on working on those and making them better and becoming better users of working capital and that sort of thing. So, from a pipeline, there is lots of stuff out there. To me it's generally expensive compared to what we have historically paid for businesses and I can't think of any that at the end of the day we thought we underpay. So, and I have seen a lot of deals go down that we were glad we weren't a part of. So, we'll remain, confined by our expectation of evaluation on these things over time. We'd want things I think to make sure that our core got better versus getting our efforts diluted on some small outliner.

Dave King:

Okay, that is great color. Thanks for taking on my multi-part questions and thank you.

Bob Humphreys:

Thank you.

Operator:

As a reminder ladies and gentlemen that is star, one to ask a question. For our next question, we go to Jamie Wilen with Wilen Management.

Jamie Wilen:

Hey fellows, nice shop out there. A couple of questions first starting with the buy back. I was surprised that how late it was in the quarter, given what you see within your business and obviously, the closing of Junkfood didn't happen till the end of the quarter, but you probably had a decent understanding that it could come to pass. I was just surprised that you wouldn't have been more aggressive in the current quarter.

Bob Humphreys:

Well again, we go by a Safe Harbor process to repurchase our shares, so we follow the same blackout periods any other insider would. So, that and capital available versus other things we are doing is what ultimately manages what we can go after during a quarter.

Jamie Wilen:

But how can you be more aggressive?

Bob Humphreys:

Then we can reset what we are doing.

Jamie Wilen:

Okay.

Bob Humphreys:

Under getting out of a blackout period.

Deborah Merrill:

Yes Jamie, it is just a matter of resetting when we are in a window that we can reset with those parameters are. So, by all accounts that those would be reset, which would then allow us to open up and be able to get back more shares.

Jamie Wilen:

Got you. Have you reset those already?

Bob Humphreys:

Well, we will when, in three days–past from our earnings.

Jamie Wilen:

Okay. On the Soffe side, was Soffe indeed profitable in this quarter?

Bob Humphreys:

Yes.

Jamie Wilen:

You would expect Soffe to be nicely profitable–or profitable for the year and in subsequent quarters, so it is now moving in the right direction certainly cost wise.

Bob Humphreys:

Yes, we still got a lot of work to do at Soffe. We got inventories starting to move in the right direction and I think some good initiative and it is encouraging to see the product is selling when it gets in front of consumers. Our e-commerce business is very strong.

Some of our most successful sporting goods retailers, our business is growing nicely with the military business is improving for a number of reasons. So, we have got some good initiatives with Soffe and we are encouraged with the value of the brand and our military business, some other unique offerings we have, but we got work to do to get better volumes and lever our overhead.

Jamie Wilen:

Did you say you were opening up some retail stores in Soffe as well?

Bob Humphreys:

Yes, Soffe has had retail stores since our acquisition of it. We just opened up an additional one, which brings it to three. There is a new small site near Fort Bragg and that military draws a lot of our Soffe business. We have another one scheduled to open near another military base on Jacksonville, North Carolina and we are going to do one more in a large college town in North Carolina where East Carolina University is.

Jamie Wilen:

Got you. These are just strictly Soffe, you don't disperse any of your other brands in there?

Bob Humphreys:

That's correct and that would be our intent for the foreseeable future.

Jamie Wilen:

Okay and Salt Life, you opened up another store but there is another, there are several additional retail stores that you will open later this year?

Bob Humphreys:

That's correct. So, we opened on Huntington Beach in California, so we have two stores in California. We are opening a store near our Columbus Headquarters in the downtown river front section of Columbus, Georgia. Then we are going to do an outlet store on I-95 just north of Daytona Beach, in a new hanger outlet. So, those will be open certainly by calendar year end and hopefully by fiscal year end.

Jamie Wilen:

Okay, when you first started opening stores, they were kind of merchandising stores to show the retailers how to do it. It sounds like these stores are full profit enterprises.

Bob Humphreys:

Yes, and that first store in Jacksonville Beach is profitable and is having, this is our seventh year I guess, and is still having good organic growth in that store, so that is encouraging. But yes, we are opening for profit stores, certainly the California stores also have a strong, we want to build the brand in California the right way. Show the product being merchandised but long-term we expect them to be profitable as well.

Jamie Wilen:

The growth in Salt Life is it through the number of doors or it more sells through the existing doors or both.

Bob Humphreys:

So, I think it is actually a somewhat complex mix to be honest with you. We are selling more products and the retailers who are expanding there, products offerings are seeing great results. Retailers who are building out Salt Life selling space are seeing outstanding results.

Our e-commerce business is growing very nicely. Now remember we are also up against the headwinds that so many people are facing in retail this last year, This Sports Authority going away, who was a growing Salt Life customer and then Gander Mountain just going away, who had some big stores that were really good Salt Life stores. So, it is that complexity of the major retailers going away, but us being able to trump that with growth in other areas.

Jamie Wilen:

Okay, on the manufacturing cross realignment, you expect on an annual basis to achieve $8 million?

Deborah Merrill:

Yes, that is correct.

Jamie Wilen:

So, it is starting to really come into play in the June quarter, we'll start to see basically $2 million a quarter moving forward and we have seen very little so far?

Bob Humphreys:

Yes, seasonally adjust that just with our stronger quarters, it will be basically as units go out the door, but, yes, we will see a significant amount of that in the June quarter.

Jamie Wilen:

Okay, excellent results and I hope you re-jigger the buyback program to as much as you possibly can do.

Bob Humphreys:

Thank you.

Deborah Merrill:

Thank you.

Operator:

As a final remainder ladies and gentleman, that is star, one to ask a question and again, if you are on a speakerphone, please make sure that your mute button is disengaged so that your signal can reach our equipment. Once again, that is star one to ask a question.

With that ladies and gentleman, we have no further questions on our roster, therefore Mr. Humphreys, I will turn the conference back over to you for any closing remarks.

Bob Humphreys:

Okay, thank you all for joining our call today and we look forward to update you on our third quarter earnings in just a few months and give you a further update on how our business is progressing.

Operator:

Once again, ladies and gentleman this will conclude today's conference. Thank you for your participation.