Delta Apparel, Inc.

Fiscal 2024 First Quarter Earnings Conference Call

February 12, 2024

Operator: Thank you, and good afternoon to everyone participating in Delta Apparel, Inc.'s Fiscal Year 2024 First Quarter Earnings Conference Call. Joining us from management are Bob Humphreys, Chairman and Chief Executive Officer; Justin Grow, Executive Vice President and Chief Administrative Officer; and Nancy Bubanich, Vice President and Chief Accounting Officer. Before we begin, I'd like to remind everyone that during the course of this conference call, projections or other forward-looking statements may be made by Delta Apparel's executives. Such projections and statements suggest prediction and involve risk 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 Annual Report on Form 10-K and Quarterly Reports on Form 10-Q. These documents identify 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, except as required by law, the Company does not commit to update or revise any forward-looking statements even if it becomes apparent that any projected results will not be realized.

I'll now turn the call over to Mr. Humphreys.

Robert W. Humphreys

Good afternoon. Thank you for joining us today and for your interest in Delta Apparel. Before we review our first quarter results, I would like to once again express gratitude to our teams throughout the various countries in which we operate our business for their hard work, flexibility and dedication through what remains a challenging period for our company as well as our industry. As we highlighted on our fiscal 2023 year-end call, we were faced with uniquely unfavorable market dynamics throughout most of last year and many of those dynamics continued to impact our business in the first quarter of our 2024 fiscal year. Our teams have approached these prolonged difficult business conditions with determination, and taken decisive and effective action to shore up our balance sheet and significantly reduce our debt, working capital, and cost structure.

The plan we initiated during fiscal year 2023 to optimize our cost structure and streamline operations is now substantially completed. At a high level, our plan included exiting Mexico and reducing our offshore manufacturing footprint from three countries to two and from six facilities to four. As a part of that restructuring, we transitioned our Mexico sewing and screenprint capacity, as well as the more expensive third party fabric production we had to source in Mexico, into our more efficient Central American manufacturing platform. When we can ramp our manufacturing volumes back up to more normalized levels, we expect this restructuring to generate approximately $6 million in annual run-rate savings.

Our plan included some similar consolidation activity in our DTG2Go digital print business, where we closed a legacy print facility in Clearwater, Florida, and absorbed its capacity into our more efficient "On-Demand DC" footprint throughout the United States combining our DTG2Go and Delta Direct businesses under the same roof. In addition, we significantly reduced other areas of our U.S. workforce as well as our workforce across our Central American manufacturing platform to better align with the lower demand we continue to see across our business. All told after these actions, we reduced our overall workforce by over 20% and took approximately $20 million out of our cost structure in annualized labor savings. This heavy-lifting across our Company was challenging, but it was necessary for us to become a leaner organization better positioned to navigate the tough operating environment we continue to see across our business.

Despite our success in executing on these important restructuring initiatives, we were disappointed in our overall results for the first quarter, which, as a reminder, is typically our slowest overall quarter due to the seasonality of our various businesses. The muted demand we saw across most of our Activewear business's markets in fiscal year 2023 continued during the quarter, which pressured inventory turns. Although it appears that many of our customers have de-stocked to more normalized inventory levels, the activewear supply ecosystem as a whole still has some ground to cover to return to pre-pandemic activity levels. These market dynamics impacted both our top-line and bottom-line performance for the quarter and unfortunately resulted in more below-capacity production volume in our Central American manufacturing platform and more de-leveraging of our significant fixed cost structure in those countries.

In light of the challenging start to our new fiscal year, we continue to take steps to reduce our working capital and focus resources in our core businesses where we can generate positive cash flows. We are also looking at other areas where we can create cost efficiencies and potentially further streamline our operations. In addition, we continue to evaluate all of our strategic assets across the organization. We are committed to fully exploring opportunities to monetize our owned real estate portfolio and recently completed the sale and leaseback of our distribution center in the Knoxville, Tennessee area. This transaction generated gross proceeds of approximately $6.2 million and we believe that a sale-leaseback transaction involving our manufacturing and distribution campus in Fayetteville, North Carolina should generate additional gross proceeds of between $20 and $23 million in the current environment for industrial properties of that size and scope in Sunbelt markets. We are currently in serious discussions with a potential buyer for our Fayetteville campus and believe we have the potential to monetize that asset and continue our operations there uninterrupted going forward.

As you know, we received an unsolicited offer to purchase our Salt Life business back in October. Our Board of Directors recently concluded a thorough review of our strategic options for Salt Life and decided to continue negotiations with a selected entity. I can assure you that our Board is committed to maximizing value for shareholders and taking the course of action we believe is in their best interest with respect to our Salt Life business. We look forward to updating you once these negotiations conclude.

With the start to our fiscal year more difficult than originally anticipated, we are keenly focused on managing our working capital and costs across all aspects of our business on a day-to-day basis. Our overall debt was down 22% year-over-year at the end of our first quarter and we have made more progress on that front to start our second quarter. Similarly, our inventory levels were down 24% year-over-year. We will continue to prudently manage the business with a heightened focus on liquidity, while evaluating our assets and making investments in areas that position us to generate returns for our shareholders.

Nancy will provide more detail on our results in a moment but let me now turn the call over to Justin to walk you through our business highlights in more detail. I'll join them at the end to open the call up for questions. Justin?

Justin Grow

Thanks Bob.

Our Salt Life business during the first quarter registered year-over-year sales growth in what is traditionally a slower quarter due to the seasonality of that business and also tracking to achieve sales growth for the full year. The recent softness in Salt Life's wholesale channel continued during the quarter but was counterbalanced to some degree by more year-over-year growth in Salt Life's direct-to-consumer retail and eCommerce channels.

Salt Life recently expanded its branded retail footprint with the opening of its first location in Virginia and the new store, in Williamsburg, has exceeded expectations to date. The brand's retail footprint now consists of 28 stores, including 16 full-price stores and 12 outlet stores across the country. Same store sales across all Salt Life stores for the first quarter were down approximately 2% from the prior year quarter, with the drop due to more sporadic travel activity as well as colder and wetter conditions in the coastal areas where our stores are located. Salt Life's stores continue to consistently achieve solid performance across retail KPI's such as conversion rates, which were up relative to the prior year quarter, and average transaction value.

Sales on Salt Life's eCommerce website continued to grow during the quarter and its performance across other key metrics such as conversion, units per transaction, and average order value were all up favorably over the prior year period. We were also pleased to see several states in the Northeast market as well as several inland states continue to be among the top 10 markets for Salt Life's eCommerce channel.

Turning to our Activewear business, we continued to see sluggish overall demand across its three go-to-market channels and the general industry expectation is for activewear demand to remain relatively flat throughout the year. Given these market conditions, we continue to run our vertical manufacturing platform at below-capacity levels which, as Bob mentioned, reduces our fixed cost absorption rates and generates unfavorable manufacturing variances. In the Delta Direct channel, where we provide blank garments on-demand to a variety of supply chains, overall units sold were up year-over-year, but the amount of under-utilized manufacturing capacity across this channel resulted in more price deterioration, particularly on core styles, which impacted overall sales dollars. Demand in the Delta Direct channel's largest verticals, Retail License and Regional Screenprint, continued to be inconsistent relative to pre-pandemic levels while the eRetail and promotional channels continued to strengthen and perform well year-over-year.

Excess global manufacturing capacity also continued to drive pricing pressure in our Global Brands channel, where we provide custom decorated activewear to major brands and the U.S. military, with much of that pressure coming from producers in Asia. In addition, the inventory levels at retail continued to impact demand in the first quarter as expected in this channel and Global Brand sales came in well below last year's record first quarter sales. We saw similar dynamics and performance in our Retail Direct channel, where we provide decorated apparel fully ready for the retail floor to brick and mortar and online retailers.

Despite the challenging business conditions across our Activewear business in the first quarter, the team continued to make substantial progress in reducing inventory levels and its efforts were instrumental in the success of our plans to reduce overall working capital and debt and streamline operations.

Turning to our DTG2Go business, we continued to take meaningful strides in improving our on-quality performance, on-time delivery, and labor efficiency rates during the quarter, and shipments to our digital first customer based exceeded our internal plan. However, overall demand during the holiday season came in below forecast. In addition, we continued to see some downward pressure on pricing, particular on basic products, which, along with highly elevated U.S. labor costs compared to only a few years ago, impacted profitability during the quarter.

Let me now pass it over to Nancy for a detailed review of our financial results.

Nancy Bubanich

Thanks Justin.

Please note that we will discuss a variety of financial measures that are adjusted to account for the cost impacts of production curtailment activities and the strategic cost optimization initiatives Bob referenced earlier. We believe these measures may be useful in evaluating our operating results for the quarter in light of the impacts of these unique events. We will also discuss non-GAAP measures such as earnings before interest, taxes, depreciation and amortization, or EBITDA, and adjusted EBITDA, which are measures that we believe can allow analysts and investors to better understand the financial performance of the Company by computing earnings from core business operations, without including the effects of capital structure, tax rates and depreciation. Listeners may access a reconciliation of these non-GAAP measures to gross margin, operating income and net income, the most directly comparable GAAP measures, on the investor relations page of our website at www.deltaapparelinc.com.

For the first quarter ended December 30, 2023, net sales were $79.9 million compared to prior year first quarter net sales of $107.3 million. Salt Life Group segment net sales were $10.3 million and up slightly compared to prior year first quarter net sales. Net sales in the Delta Group segment were $69.6 million compared to $97.0 million in the prior year first quarter.

Gross margins were 10.9% compared to 12.7% in the prior year first quarter, driven primarily by production curtailments. Adjusted for the cost impacts of the product curtailments, first quarter gross margins were 12.6%. Delta Group segment gross margins for the quarter were 5.8% compared to 8% in the prior year period. Adjusted for the production curtailment cost impacts, Delta Group segment gross margins were 8%. Salt Life Group segment gross margins for the quarter were 45.4% versus 57% in the prior year period. Salt Life's gross margins for the quarter were negatively impacted to some degree by the timing of inventory receipts, which should reverse in the second quarter.

Selling, general, and administrative expenses decreased from $18.9 million in the prior year first quarter to $18.6 million, while SG&A as a percentage of sales increased over the prior year period to 23.3%. SG&A was negatively impacted by higher audit and professional services fees as compared to the prior year.

Other income for the first quarter includes a $5.4 million gain on the sale and leaseback of our Knoxville, Tennessee area distribution facility as well as income of $0.3 million related to our Green Valley Industrial Park equity method investment.

Operating income declined year-over-year from an operating loss of $2.6 million to an operating loss of $4.9 million. Adjusting for the production curtailment and strategic initiative cost impacts, first quarter operating loss was $2.8 million. Delta Group segment operating income for the quarter improved from $0.1 million to $0.5 million. Adjusted for the production curtailment and strategic initiative cost impacts, Delta Group segment operating income was $2.7 million, or 3.8% of sales. The Salt Life Group segment experienced an operating loss for the quarter of $2.1 million, compared to operating income of $0.3 million in the prior year period.

Net interest expense for the first quarter was $3.6 million compared to $2.9 million in the prior year first quarter. This increase in interest expense is primarily due to the elevated interest rate environment offset by lower borrowings.

EBITDA for the first quarter was a loss of $1.3 million. Adjusted for the production curtailment and strategic initiative cost impacts, first quarter EBITDA was positive at $853 thousand. Delta Group segment EBITDA for the quarter was $3.5 million. Adjusted for the production curtailment and strategic initiative cost impacts, Delta Group segment EBITDA was $5.7 million. Salt Life Group segment EBITDA was a loss of $1.6 million.

Net income decreased to a loss of $8.5 million, or $1.22 per share, from a loss of $3.6 million, or $0.51 per share. Adjusted for the production curtailment and strategic initiative cost impacts, first quarter net loss was $6.6 million, or $0.94 per share. Net income for the quarter was also significantly impacted by the elevated interest rate environment, with our interest expense for the quarter increasing significantly over the prior year quarter.

Net inventory as of December 30, 2023, was $196.3 million, a sequential decrease of almost $16 million, or 8%, from September 2023 and a year-over-year decrease of $62.5 million, or 24%, from December 2022. The inventory decrease was a product of our team's continuing excellent execution on an ongoing high-priority working capital efficiency initiative.

The debt outstanding under our U.S. revolving credit facility was $110.8 million at December 30, 2023, a reduction of $31.5 million from the prior year December and $42.3 million from March 2023. Capital lease financing totaled $20.3 million at December 30, 2023, a decline of $6.8 million from December 2022 and $6.1 million from March 2023. Our other debt, which is secured by certain assets in Central America, totaled $13.7 million at December 2023, a decline of $2.4 million from December 2022 and $1.7 million from March 2023. Our total net debt, including capital lease financing and cash on hand, was $144.4 million as of December 30, 2023, an approximate 26% reduction from $194.3 million at March 2023 and an approximate 22% reduction from $185.2 million at December 2022.

Cash on hand and availability under our U.S. revolving credit facility totaled $7.4 million as of December 30, 2023, a decrease of $19.8 million from December 2022 and $6.8 million from September 2023, with the decrease from December 2022 principally driven by investments in the business to support working capital needs as well as higher interest expense.

Capital spending was $300 thousand during the first quarter compared to $2.1 million during the prior year first quarter.

Now I'll turn the call back over to Bob.

Robert W. Humphreys

Thanks Nancy.

Following our execution on significant structural changes across our business in fiscal 2023 and to start fiscal 2024, we have made substantial progress in streamlining our organization and creating more efficient operating platforms. Concurrently, we have made steady progress on working capital and cost structure optimization and in reducing both our debt and inventory levels. That said, we know that we are facing an uncertain environment and will remain steadfast in our commitment to further streamline our operations, identify more efficiencies, and fully explore opportunities to unlock value across our strategic assets.

Given the headwinds in our business and, particularly, the limited access to capital that we currently have available to us, we believe we will need to obtain additional liquidity in the near term to fund our operations and meet the obligations specified in our U.S. credit agreement going forward. We are currently exploring a variety of options toward that end. Please refer to the Company's next quarterly report on Form 10-Q to be filed with the SEC for further details. We will continue to be laser focused on managing all operating aspects of our business segments, with a focus on improving our liquidity position and investing in areas that position us to maximize value for our shareholders.

And now operator, you can open up the call for any questions we may have.

Operator

(Operator Instructions)

Your first question comes from the line of Dana Telsey from Telsey Group. Please go ahead.

Dana Telsey

Hi, good afternoon, everyone. Given the priority of debt paydown that is ongoing, how are you thinking about the end of the second quarter and third quarter? Are there any specific markers that we should be watching for as we move through this upcoming quarter? Then I have a couple of follow-ups. Thank you.

Robert W. Humphreys

Dana, I'm not sure I understand your question. Are you talking about debt levels or...?

Dana Telsey

Yes. Debt levels.

Robert W. Humphreys

Yes. Yes. I think more to come on that as we just work through the options that are accessible to us and work with our lenders and other sources of liquidity.

Dana Telsey

Got it. Then on the Activewear business, where does the demand profile stand relative to maybe how it was three months ago or six months ago? Is it at all changing in terms of what you're seeing out of the industry? How does cotton prices impact margins going forward?

Robert W. Humphreys

I would say the basic demand in Activewear is overall close to where it was a year ago which was not overly strong. I think channels of distribution have changed somewhat. You can see where different types of retailers have reduced inventory and the order flow is more structured and ordinary and other channels of distribution. People are still dealing with heightened inventory, probably see that more in our branded customers than mass market customers; and so, we see that continuing.

Cotton prices got back to what we considered a normalized range since their peak 18 months ago or so and we have our forward commitments committed at what we consider market cotton positions in the last maybe 60 days. Cotton prices have appreciated again. While they're not nearly to the levels they were 18 months ago, they are up 12% to 15% from the lows that we saw just a couple of months ago.

Dana Telsey

Got it. Then on Salt Life, with the gross margin at 45.4%, you mentioned timing of inventory receipts. How do you think of that timing in this upcoming quarter? And how are you thinking about the Salt Life business? Thank you.

Robert W. Humphreys

Yes. Salt Life had some organic growth in the first quarter; so that was encouraging given market demand dynamics. We're seeing our retail stores have better results than most of what we see published out there in the communities that are following that will be up 2% or 3% same-store sales for a week or two, sometimes followed by down 2% or 3%, somewhat timing with holidays and the stuff that we all know from following this. The way our accounting works on Salt Life procurement, there are costs allocated to inventory for merchandising and planning and distribution. When those actually are receded into our inventory, then we actually have a pickup on earnings from having that product go through its cycle and back in.

It's a little bit more of an accounting timing situation and inventory this quarter came in a little later than it did last quarter; so that should reverse itself in our second quarter where those inventories are receded into our ownership.

Dana Telsey

Got it. Then, just lastly on the efficiencies that you've been talking about that there could be more things that you look at. What's the scope of that? What could the magnitude be in terms of those efficiencies?

Robert W. Humphreys

Well, as we get to be a leaner operation, we'll have less employees which we have already reduced a significant amount of employees; I think, quicker decision-making, less overhead. We're really in the early throes of our next level of analysis on that compared to what we completed in our last fiscal year; so, more work to be done there but we know we have to be a leaner, more nimble company to continue to navigate in the marketplaces that we're currently participating in.

Dana Telsey

Thank you. Best of luck.

Operator

There are no further questions at this time. Please proceed.

Robert W. Humphreys

Okay. Well, thank you all very much for joining us today and we'll look forward to another update in about three months. Thank you.

Operator

Thank you. That does conclude our conference for today. Thank you all for participating. You may all disconnect.