



Growth At An Unreasonably Cheap Price

Delta Apparel (NYSE: DLA) Investment Thesis



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Executive Summary

Delta Apparel (DLA) currently trades like an undifferentiated legacy manufacturing business in a commoditized industry (~7x forward P/E assuming a reasonable FY22 estimate) despite its competitive advantages in digital garment printing, unique vertical integration, and healthy growth prospects for two key business segments.

- » While its stock trades at a fraction of market multiples, DLA is well-positioned to sustain double-digit earnings and FCF growth rates for the next 5 years
- » I have a DCF derived \$65/share price target and see significant upside in the stock because:
 1. DLA's core business benefits from a multi-year **industry shift toward supply chain near/on-shoring** to North America in order to reduce exposure to overseas shipping delays, cost inflation, and unpredictability
 2. DLA enjoys a **strong pricing environment** where they can price to more than offset input cost inflation and still be extremely competitive vs Asia-originated product given recent freight increases there
 3. DLA's **digital printing business DTG2Go is expected to grow ~20% annually (at 20%+ EBITDA margins)**, benefiting from industry-wide shifts toward digital printing, sustainability, and customization
 4. Favorable **business mix will drive accelerated EBITDA growth** as DTG2Go and Salt Life (**margin accretive segments with long runway of re-investment opportunities**) makeup ~25% of revenues but may reach ~40% by FY26 given current guidance.
 5. Management is currently **authorized to repurchase \$7.5mm worth of shares** (~12 days of trading volume) and DLA could also benefit from passive buying if it can **re-join the Russell 2000** in June

Why Does The Opportunity Exist?

- » **Microcap company (\$220mm market cap) that was removed from the Russell 2000 Index in 2021**
- » **Only 1 analyst (Telsey Advisory Group) covering the company via sponsored research**
- » **Consolidated financials mask high growth prospects of two margin accretive businesses (DTG2Go & Salt Life)**
- » **Lack of consistent disclosure of DTG2Go financials, making it difficult for the market to place a multiple on this high growth, high margin business**
 - Company does not break out DTG2Go from 'Delta Group' segment, which includes legacy Delta Activewear business

Introduction to Delta Apparel

Delta Apparel is a vertically integrated apparel company that designs, manufactures, sources and markets activewear and lifestyle apparel products.

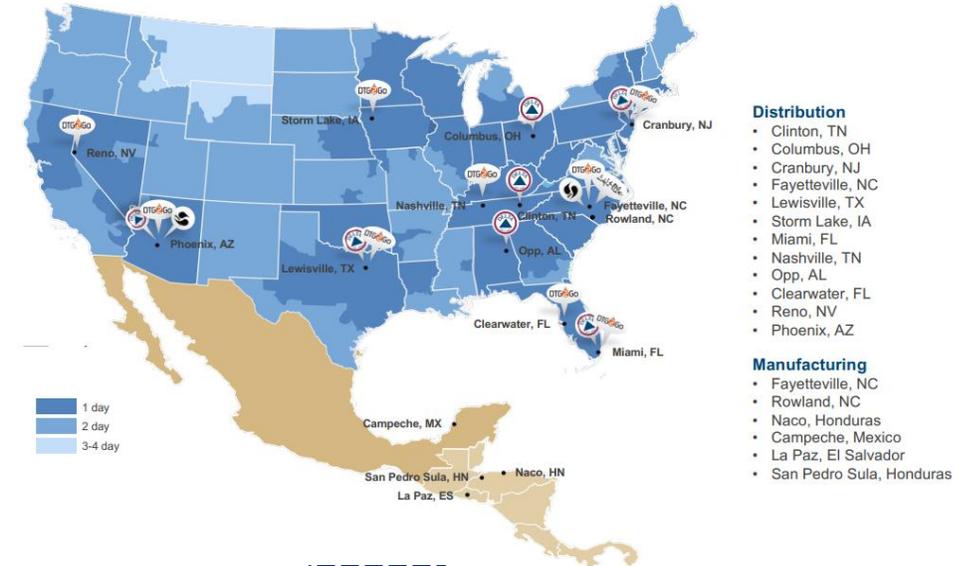
Delta's manufacturing footprint in North America and extensive distribution network within the US enable significantly shorter lead times vs orders originating from Asia

Delta is unique to other vertically integrated players given their digital printing capabilities as well as ability to fulfill single unit orders directly to consumers

The company has three primary business lines:

- » **Delta Activewear (~75% of Sales):** Selling casual athletic products through variety of distribution channels (outdoor/sporting goods retailers, mass/specialty/dept stores, eRetailers, B2B, US military)
- » **DTG2Go (~14%):** The only large-scale vertically integrated digital apparel printer capable of manufacturing and shipping custom graphic products within 24-48 hrs to the consumer; Market leader in digital printing
- » **Salt Life (~11%):** Aspirational lifestyle brand that "represents a passion for the ocean and the salt air" with strong brand presence in Southeast and rapidly expanding in both e-commerce and retail (expected to triple branded retail store count in 5 years)

Delta Apparel November 2021 Investor Presentation



	The Delta Model	Vertical Incumbents	Specialist Producers	Apparel Distributors
Owned W. Hemisphere Manufacturing	✓	✓		
Core Basics	✓	✓		✓
Fashion Basics	✓	✓	✓	✓
Supply Chain Manufacturing Partner	✓	✓		
Retail Technology Support	✓	✓		
Owned Distributor Model	✓			✓
Ability to Fulfill Single Units	✓		✓	✓
Digital Print and Fulfillment	✓			

Introduction to Delta Apparel

Business Segment



<p>Description</p>	<p>Vertically integrated core business benefiting from pricing power and macro industry tailwinds</p>	<p>Leading digital apparel printer; total digital market share ~3% and rapidly growing</p>	<p>Emerging lifestyle brand with long runway of growth ahead in retail & e-commerce)</p>
<p>Long Term Financial Profile</p>	<p>HSD revenue growth 12%+ EBITDA Margins</p>	<p>20%+ revenue growth 20%+ EBITDA Margins</p>	<p>10-15% revenue growth 15%+ EBITDA Margins</p>
<p>FY21 Actual % of Sales¹</p>	<p>75%</p>	<p>14%</p>	<p>11%</p>
<p>FY26 Est % of Sales¹</p>	<p>61%</p>	<p>24%</p>	<p>16%</p>

1) Author's estimates

Delta Apparel Benefiting from Secular Industry Trends

Trend	Description
Shipping Disruptions to Continue	<ul style="list-style-type: none"> Harbor shutdowns, port congestion, container shortages, capacity issues w/sea and air freight expected to persist in 2022 & beyond Zero-COVID policies in China continue to result in factory shutdowns, leading to uncertainty and volatility
Supply Chain Nearshoring / De-Globalization	<ul style="list-style-type: none"> 70%+ of Apparel Chief Procurement Officers plan to increase their share of nearshoring operations in 2022¹ McKinsey: "For US companies, Central America is highest on the list for future near-shoring activities"¹ AlixPartners: "The more global supply chains are, the more things can and will go wrong"²
Sustainability & Excess Inventory Reduction	<ul style="list-style-type: none"> Industry currently experiences 30% excess production: 21mm tons of textile waste, 28 trillion liters of water wasted³ 2/3 of consumers say sustainability is an important factor when purchasing apparel⁴
Need for Flexible & Agile Supply Chains	<ul style="list-style-type: none"> Increasing focus on DTC and e-commerce, alongside rising volatility, last year drove a shift to more agile and more efficient supply chains Leaders are seeking vertically integrated suppliers closer to the end consumer markets in order to reduce disruptions

Opportunity for Delta Apparel to gain market share given its:

- Exclusively North American manufacturing footprint
- Vertical integration that minimizes supply disruptions
- DTG2Go digital printing capabilities and "on-demand DC" model that enable inventory reduction



Short Term Shipping Cost Inflation Is A Positive Catalyst for Delta Long Term

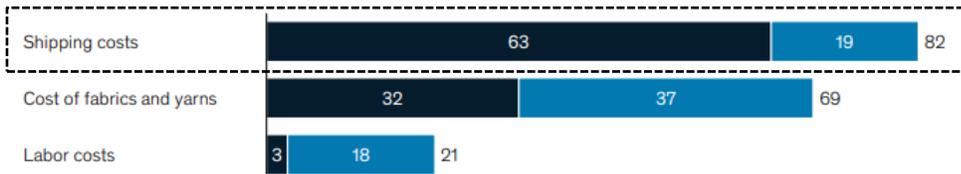
Shipping costs remain the #1 concern in 2022 for Apparel company procurement leaders ¹

T-shirt shipping costs from Shanghai to the US have increased 184% (Sept '18-Aug '21)

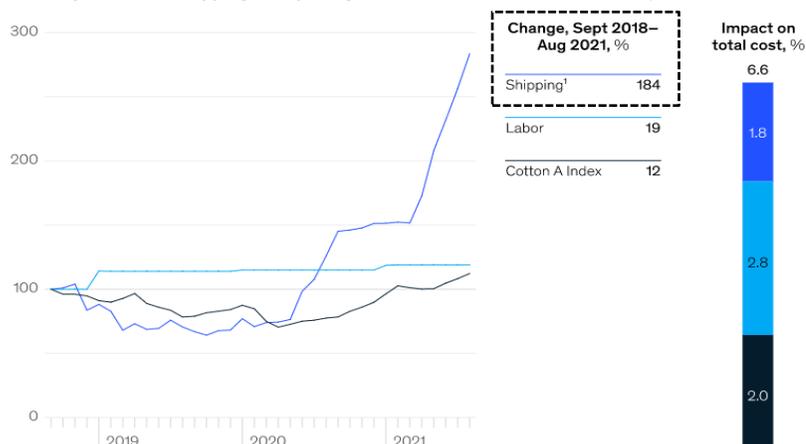
"Which drivers do you expect to have the highest impact on sourcing cost development within the next 12 months?"

Percentage of respondents

Very high impact High impact



Commodity, labor, and shipping-lane pricing for a 100% cotton T-shirt, index (Sept 2018 = 100)



¹Average of ocean container costs, Shanghai to US West Coast and East Coast. Source: Emerging Textiles; Xeneta; McKinsey analysis



The need for nearshoring operations has now accelerated

Previous cost advantage of producing in Asia vs North America is rapidly shrinking

CEO Bob Humphreys on Q4 FY21 Earnings Call:

"What's happened is with the increase in freight costs now, it's really brought Asian labor rates much closer to our costs when you get it back to North America, much closer to cost out of Central America. Obviously, much shorter lead time and a more robust supply chain and capability where retailers and consumers can make their final decision of what a product is going to look like closer to when the consumer is ultimately going to buy and receive that garment.

So a tremendous shortening of the supply chain and time, **it's things we've been working on for decades in this industry, and with our digital print capabilities, we've brought these several months lead times into several days now to the end consumer.** So certainly, dramatic changes in all that. And I think we're really just **at the very early stages of people figuring out what that means for them and how it's going to change the business model**".



Core Activewear Business Poised for Margin Expansion

Delta Activewear is “a preferred supplier of activewear apparel to regional and global brands, direct to retail and through wholesale”

- » Activewear industry consistently growing faster than US GDP
- » National distribution footprint; diversified customer base including relationships with 8,000+ customers

Revenue Growth Drivers:

- » Positioned to benefit from secular industry trends, as previously mentioned
- » Benefits from DTG2Go growth as the majority of DTG2Go orders are fulfilled using Delta Activewear blanks

EBITDA Growth Drivers:

- » Delta’s expected completion **integration of their Softe business** (an old acquisition) into the Delta Activewear ERP & all operations (\$0.12-\$0.15 FY22 EPS benefit)
- » **Rational pricing environment** moving forward, with competitors announcing price increases
 - Gildan (TSX/NYSE: GIL): We “lowered pricing last year in order to drive market share”; “we will take whatever price we need as we move into 2022 in order to manage our margin profile” (Q3 2021 Earnings Call)
 - Hanesbrands (NYSE: HBI): “We are going to be taking price globally in 2022...We're executing that plan already. It will be broad-based across brands, channels, and product lines” (Q3 2021 Earnings Call)

Potential Headwinds:

- » Higher cotton prices (~20-25% of COGS) and labor shortages/wage inflation

DT2Go is a differentiated business with long runway of margin accretive growth

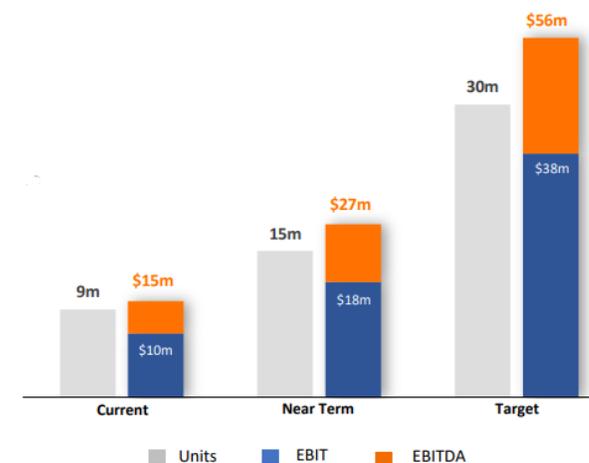
- » DTG2Go is a market leader in on-demand, direct to garment digital print and fulfillment
- » Business expected to grow top-line 20%+ annually for foreseeable future with 20%+ EBITDA margins, given:
 - » Large and expanding TAM (Current digital printing penetration: <3%; expected to double in 5 years)
 - » DTG2Go's Unique Competitive Positioning
 - Highly automated factory processes and proprietary software
 - Leverages Delta Activewear distribution network and blank t-shirts
 - "On-demand" DC where DTG2Go is fully integrated in customers' DC's (currently doing this with Hot Topic)
 - Competitors include Merch by Amazon (not vertically integrated; brands may be hesitant to share data with them) and Printful (geared toward single orders)
 - DTG2Go is able to capture small one-off orders but also larger orders
 - Nearly two decades of experience and know-how in the space
- » Result = It is difficult for new entrants or competitors to replicate the distribution network, vertical integration, capacity, and expertise that DT2Go brings today

- » Demonstrated history of growing digital print revenues profitably
- » DLA has expanded digital printing capabilities through M&A, first getting into business with an acquisition in 2009 – growing the business from no revenues to ~\$60mm today

	Historical				Projected
	FY18	FY19	FY20	FY21	FY22
DTG2Go Revenues	27.0	60.0	64.5	58.1	79.8
DTG2Go EBITDA	4.9	11.6	13.0	12.1	18.2
EBITDA Margin %	18%	19%	20%	21%	23%

Source: Author's estimates, 2020 Annual Meeting presentation, earnings transcripts

- » In March 2021, DLA shared its "target" EBITDA was \$55mm+ or about 3x my projected FY22 EBITDA



Salt Life: Lifestyle Brand Early in Growth Cycle Worth \$10/Share+ Alone

- » Salt Life is an authentic, aspirational and lifestyle brand that embraces those that love the ocean and everything associated with living the "Salt Life".
- » Strong brand equity and social media following
 - Over 2 million 'Salt Life' car decals sold
 - 1.2mm Facebook likes, 322k Instagram followers, 43k Tiktok follows
- » Company plans to accelerate branded retail store growth
 - 13 locations at the end of FY21 with plans to build 6-8 new stores each year
 - Strong unit economics: \$550K new unit build-out cost (incl. inventory) with \$800K annual avg unit revenue
 - Top stores doing \$1.5mm+ in sales with 30% operating margins
- » E-Commerce expected to contribute 1/3 of revenues LT
 - DTC e-commerce operating margins of 20-22%
- » Long runway for the brand, including national expansion outside Southeast
 - Revenues are still a fraction of similar lifestyle brands such as Tommy Bahama (\$670mm+ pre-COVID) or Vineyard Vines (est. ~\$500mm)
- » Estimating \$77mm valuation for Salt Life business alone (or ~\$11/share)

	Historical				Projected
	FY18	FY19	FY20	FY21	FY22
Retail	2.4	3.2	4.8	10.3	14.4
DTC E-Commerce	4.1	4.2	6.3	5.5	6.8
Wholesale	32.9	35.2	26.1	33.9	35.6
Total Salt Life Revenues	39.4	42.7	37.1	49.7	56.9
<i>Total Growth</i>	<i>(33%)</i>	<i>8%</i>	<i>(13%)</i>	<i>34%</i>	<i>14%</i>
Total Salt Life EBITDA	6.2	7.3	1.4	7.4	8.6
<i>EBITDA Margin %</i>	<i>16%</i>	<i>17%</i>	<i>4%</i>	<i>15%</i>	<i>15%</i>
FY22 EBITDA Estimate	56.9				
EV/EBITDA Multiple	9.0x				
Salt Life Valuation	77.3				

Comparable LTM EV/EBITDA Multiples:

Oxford Industires (NYSE: OXM)¹ 9.4x

Southern Marsh² 9.5x

1) Brands include Tommy Bahama, Lilly Pulitzer and Southern Tide

2) Estimate via PrivCo

Posted by u/aaronseal 4 years ago

Why did so many people put stickers on their car/truck back windows that say "salt life"? I believe that this is some sort of clothing company, but I've never seen so much dedication from customers to advertise for them

DCF Derived Valuation of \$65/Share Represents ~100% Upside

	Historical				Forecast					Growth Rates	
	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26	FY18-21	FY21-26
Salt Life	39.4	42.7	37.1	49.7	56.9	67.6	80.0	94.8	112.4	8.0%	17.7%
DTG2Go ¹	27.0	60.0	64.5	58.1	79.8	95.8	114.9	137.9	165.5	29.1%	23.3%
Delta Activewear	329.0	329.1	279.4	329.0	361.9	387.2	406.6	418.8	431.3	(0.0%)	5.6%
Total Revenue	395.5	431.7	381.0	436.8	498.5	550.6	601.5	651.4	709.2	3.4%	10.2%
<i>Growth</i>	3%	9%	(12%)	15%	14%	10%	9%	8%	9%		
EBITDA	25.0	28.1	30.7	44.9	56.0	64.4	73.6	83.6	93.9	21.5%	15.9%
<i>Margin %</i>	6.3%	6.5%	8.1%	10.3%	11.2%	11.7%	12.2%	12.8%	13.2%		
Net Income	1.3	8.2	(10.6)	20.3	25.4	30.7	36.7	43.5	50.3	147.4%	19.9%
<i>Margin %</i>	0.3%	1.9%	(2.8%)	4.6%	5.1%	5.6%	6.1%	6.7%	7.1%		
Diluted EPS	\$ 0.18	\$ 1.17	\$ (1.53)	\$ 2.86	\$ 3.59	\$ 4.33	\$ 5.18	\$ 6.14	\$ 7.10		
Unlevered FCF	17.6	4.5	40.6	18.9	14.2	24.9	28.1	35.1	40.1	2.3%	16.3%
<i>Margin %</i>	4.5%	1.0%	10.7%	4.3%	2.9%	4.5%	4.7%	5.4%	5.7%		
<i>FCF, Ex Chg in Inventory</i>	18.0	8.7	7.1	35.1	42.9	50.4	52.8	60.4	69.7	24.8%	14.7%

DCF Summary

Implied Enterprise Value:	630.2
(+) Cash & Cash-Equivalents:	9.4
(+) Other Non-Core-Business Assets:	-
(-) Total Debt:	(179.1)
(-) Other Funding Sources:	-
Implied Equity Value:	460.5
Diluted Shares Outstanding:	7.1

Implied Share Price from DCF:	64.9
Current Share Price:	31.6
Premium / (Discount) to Current:	106%

Terminal EV/EBITDA Multiple:

Salt Life	8.0x	15%
DTG2Go	8.0x	37%
Delta Apparel	3.0x	48%
Total	5.6x	100%

Discount Rate: 10%

EBITDA margin acceleration driven by strong pricing environment and favorable business mix

1) 1) DTG2Go FY17 thru FY19 revenues are from 2020 Annual Meeting presentation; FY20 estimated based on F20 Q4 management comments; FY21 is estimate

Putting It All Together...

Attractive Risk/Reward profile given that DLA is trading at 5 year low multiples (Trailing EV/EBITDA) despite

Entire Delta Apparel business benefiting from secular industry shifts (ie. nearshoring) & strong pricing environment

Accelerated growth in DTG2Go and Salt Life will lead to:

- » Increasing profitability given more of business will be DTC vs wholesale
- » Higher ROIC given the better re-Investment opportunities in the growth businesses
- » Increased differentiation and wider long-term moat, justifying future multiple expansion

Short Term catalysts include execution of authorized share buybacks and passive buying from potential re-inclusion in the Russell 2000

Investment risks include increased cotton/input cost inflation that cannot be passed on to customers and a weaker consumer spending environment (durable goods -> services shift)

5 Year DLA Mean LTM EV/EBITDA: ~10x, Currently at ~8x



Today
75% Legacy Business,
25% High Growth +
High Margin



2026:
60% Legacy Business,
40% High Growth +
High Margin

