

# DLTH Earnings Call Transcript

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**Quarter: 3**

Operator: Good morning, and welcome to the Duluth Holdings Third Quarter Financial Results Conference Call. [Operator Instructions] Please note this event is being recorded. I would now like to turn the conference over to Chris Steffes with Duluth Investor Relations. Please go ahead.

Chris Steffes: Thank you, and welcome to today's call to discuss Duluth Trading's third quarter financial results. Our earnings release, which was issued this morning, is available on our Investor Relations website at [ir.duluthtrading.com](http://ir.duluthtrading.com) under News Releases. I am here today with Stephanie Pugliese, President and Chief Executive Officer; and Heena Agrawal, Senior Vice President and Chief Financial Officer. On today's call, management will provide prepared remarks and then open the call for questions. Before we begin, I would like to remind you that the comments on today's call will include forward-looking statements, which can be identified by the use of words such as estimate, anticipate, expect and similar phrases. Forward-looking statements, by their nature, involve estimates, projections, goals, forecasts and assumptions and are subject to risks and uncertainties that could cause actual results or outcomes to differ materially from those expressed in the forward-looking statements. Such risks and uncertainties include, but are not limited to, those that are described in our most recent annual report on Form 10-K and other SEC filings as applicable. These forward-looking statements speak only as of the date of this conference call and should not be relied upon as predictions of future events. And with that, I will turn the call over to Stephanie.

Stephanie Pugliese: Good morning, everyone, and thank you for joining us today. Earlier this year, we outlined a plan to reset the business, focusing on improving gross margin through reducing promotional depth, controlling costs and inventory levels and being more effective operation, all with the goal of delivering on our responsibility to our customers and shareholders. I am proud of the team's commitment to these efforts, and as evidenced by our Q3 results, they are yielding benefits. We are pleased to have delivered a consecutive quarter of improved profitability, building upon our earlier progress from Q2. Let me elaborate further on the areas of improvement. Building upon the momentum we established in the second quarter, we saw success with our pricing strategies by focusing on the balance of promotional frequency and depth. We reduced our global promotional days by more than half compared to last year. And while year-over-year sales declines were consistent with our Q1 and Q2 results, we experienced higher profitability per unit sold. Furthermore, to mitigate the impact of tariffs, we raised prices on select products in July and August. And in Q3, we maintained the sales volume on those styles, further reflecting our improving ability to strategically balance demand and retail. Now let me provide an update on some of our third quarter product wins. Within men's, denim was a strong performer for us, and our decision to amplify this Duluth core product through national advertising led to a 9% growth in sales at higher margins. Men's AKHG was also positive, driven by innovations like After Sweat, AlpineFlex Pants and Renew Bamboo. Within women's, our Heirloom Garden collection continues to be a foundational part of our wardrobe. And we were also pleased with the results of our relaunch of another core Duluth staple, women's denim featuring asset management heritage denim and our Double Flex work silhouette. At Duluth, we take the quality and functionality of our products very seriously, but we also like to have fun, and our customers love it when we put our own Duluth personality into the season. Our Highland Cows print was featured in October and was one of our most successful prints across several product categories. More recently, our November Hasbro

collaboration put Mr. and Mrs. Potato Head, Tonka trucks, Tinkertoys and Lincoln Logs on to our best-selling Buck Naked underwear, bralettes and socks. Customers love the nostalgia leading into the holiday shopping season as it became one of our fastest selling collaborations ever. Turning to our marketing efforts for the quarter. We saw success with a full funnel approach, highlighted by our Q3 men's denim branding efforts, anchored by strong creative on our Double Flex denim and coupled with the strategic linear TV plan that focused on premier college football games within priority store markets. We saw a significant lift in brand consideration. Further, our sponsorship and investments in other media like Spotify and targeted podcasts have increased our brand perception and moved a new audience toward trial of Duluth. Our new mobile retail experience, more affectionately known as the Big Dam Van, visited the Sturgis Motorcycle Rally and NASCAR Cup Series event at the Kansas Speedway, and our 2 new store openings this quarter. In its first 3 months, we've engaged with 650,000 customers and the initial response has been overwhelmingly positive. And speaking of our customers, while total customer counts were down in the quarter compared to last year, primarily as a result of our strategic pullback on promotions, we are seeing key customer metrics remain strong. Sales per customer and margin dollars per customer are up year-over-year as our average order values and units per transaction, reflecting our shift towards higher value customer engagement. Moving on to our retail portfolio. Store sales increased slightly year-on-year, driven by the opening of 2 new stores in priority markets, Kansas City, Kansas and Maple Grove, Minnesota. In those stores, our traffic has exceeded our expectations, and we are seeing a nice flow of new customers who are discovering the brand for the first time. Our retail stores are vital to both our brand identity and the customer experience. The in-store experience continues to drive a high conversion rate among new and existing customers who report 5-star reviews on satisfaction and are purchasing with increasing average order values. Now moving on to our operational improvements. We are dedicated to ongoing process improvements to optimize both current and future productivity while reducing costs. I am pleased to report that we are on track to exceed \$10 million in cost savings in fiscal 2025. In addition to cost reductions, our sustained focus on inventory management and enterprise planning has resulted in more streamlined operations. A key outcome of this cross-functional initiative is a 17% reduction in our Q3 ending inventory, primarily achieved by rightsizing receipts. We expect these continued efforts combined with planned reductions in SKU and style counts for upcoming seasons to drive more clarity in the assortment, more efficient cash utilization, stronger inventory turns and improved margins. And now I would like to turn to our fourth quarter and the results we have seen to date. The holiday season is our most important period, driving customer engagement, revenues and profitability. Leading into this time frame, our focus remains on our turnaround efforts and executing with a clear sense of urgency. Through rigorous preparation and the alignment across all functions of the business including our marketing and merchandising strategies, inventory positioning, systems and supply chain preparedness and customer communication, we entered peak poised to exceed our customers' expectations. First, we implemented enhanced operational protocols and planning processes to optimize unit inventory distribution and depth across our fulfillment center network. This approach has allowed us to capitalize on efficiencies and meet customer demand, specifically by maximizing the output of our fully automated facility in a day or so, which has shipped over 60% of units to customers thus far in Q4, over a 20-point increase from last year's peak season. In addition, we increased our in-store inventory levels, improving availability and enabling healthy conversion rates on foot traffic over the Black Friday weekend and in the weeks leading up to Christmas. Regarding our merchandising plans, we have continued with a disciplined approach that we established over the last several quarters. This means offering focused promotions through more impactful events and maintaining shallower discounts to enhance margin performance. Our commitment to inventory discipline will continue into next year with an enhanced focus on product that is core to Duluth. We have also made adjustments to our advertising mix, strategically rebalancing our marketing spend between branding and conversion. This refinement has improved our traffic and conversion trends in addition to brand awareness, consideration and purchase intent. And on an exciting note, we appeared a few weeks ago on Good Morning America as part of their season of gifting. It was the first time we were live in the GMA studio, which allowed us to highlight some of our best gifts of the season during Cyber Week and drove over 200,000 first-time visits to our website. I am pleased with our holiday performance to date, and I am so proud of the team who has

worked together to get us here. Our sales are in line with our expectations. Our gross margin has greatly improved and our operations are smoother. The team continues to serve our customers with a spirit that makes Duluth great, treating each transaction as unique and each person as a valuable part of our family and brand. In summary, we are pleased with our Q3 results and our peak performance to date. These outcomes reflect the initial phase of our turnaround efforts and are a direct result of the actions the team has been executing on. As we look forward, we are committed to building on this momentum by focusing on the core durable products our customers love and deepening our relationship with long-standing Duluth loyalists while attracting new brand fans. And we will continue to restore price integrity, rightsize our cost structure and most importantly, deliver with excellence on our promises to our customers. Now I'll hand it over to Heena to discuss our financial results for the third quarter and our outlook for fiscal year 2025.

Heena Agrawal: Good morning, everyone. Echoing Stephanie's comments, we are pleased with our Q3 and peak results. At the beginning of this year, we set clear goals to reset our promotions, restore price integrity, improve cash and inventory management and strengthen operational execution. In addition, we successfully mitigated the impact of tariffs through a combination of targeted price increases and cost reduction. By staying disciplined on these goals throughout the year and mitigating macro headwinds with agility, this team has delivered consecutive quarters of gross margin expansion and SG&A leverage. In addition, we have maintained healthy liquidity and lower borrowing costs by effectively managing working capital and moving to an asset-based lending facility. This quarter, our inventory balance improved sequentially and is down 17% versus last year. We ended the third quarter with a strong liquidity position of over \$88 million. I couldn't be prouder of the team's unwavering commitment to our goals and their agility in developing solutions to navigate tariff pressures. We are successfully executing Phase 1 of our turnaround, significantly improving our financial position with enhanced profitability, free cash flow and liquidity. Building on this strong foundation, our turnaround strategy will continue its momentum focusing on 2 key areas: reinvigorating our customer base and streamlining our product selection to emphasize our core offerings. Now to provide a more in-depth update on our third quarter results and peak performance. Today, we reported third quarter 2025 net sales of \$114.9 million, down 9.6%, with gross margin expansion of 150 basis points versus last year to 53.8% and SG&A leverage driven by cost reductions. Our reported EPS loss is \$0.29 and adjusted EPS loss is \$0.23, favorable to last year by \$0.21. Adjustments to EPS include tax valuation allowance of \$2 million. Adjusted EBITDA for the quarter is negative \$0.7 million, an improvement of \$5.5 million versus last year. Starting with the top line. As we reset our promotional depth to drive greater profitability, our Q3 net sales declined 9.6% versus last year and declined 10.1% excluding wholesale. Direct channel sales excluding wholesale saw a 16% decrease, primarily due to a decline in web traffic, partially offset by double-digit growth in average order value from higher AUR and units per transaction. Mobile sales penetration increased by 70 basis points versus last year. Retail store sales increased slightly by 0.4% as we opened 2 new stores late in the quarter and saw growth in average order value driven by both a higher average unit retail price and more units per transaction. As we reset promotions, men's sales declined by 8.7%, partially offset by growth in fall transitional outerwear, denim and AKHG. Women's sales declined by 12.8%, partially offset by strength in the Heirloom Garden collection. Profitability improved across channels and product categories with shallower promotions and higher average prices. Gross margin rate for the quarter was 53.8%, expanding by 150 basis points compared to last year, driven by a rebalancing of promotions to restore price integrity by reducing the depth of discount, the flow-through of lower product costs resulting from our direct-to-factory sourcing initiative and tariff mitigation actions. Average unit retail increased 6% this quarter as we implemented targeted price increases at the beginning of the quarter in addition to shallower promotions and a greater penetration of full-price sale. Average unit cost increased as tariffs offset the benefit of direct-to-factory sourcing. The cost of tariffs was limited to \$3 million this quarter with proactive receipt management and cost negotiations with vendors. SG&A spend was \$70.7 million, which is \$11.6 million or 14.1% lower than last year. SG&A as a percentage of sales improved by 330 basis points to 61.5% compared to last year. Advertising costs were 11.8% of sales in Q3 compared to 9.3% of sales in the first half as we ramped up spending ahead of our peak selling season. This was favorable to last year by 340 basis points, driven by the timing shift of college football media spend from Q3 to Q4.

Variable costs were higher and deleveraged by 150 basis points, driven in part by reticketing labor to reflect price increases coupled with a greater mix of retail sales in the quarter. Overhead leveraged by 150 basis points from reduced personnel and depreciation expenses. As Stephanie mentioned, we are on track to exceed our target of \$10 million in cost savings this year as we rightsize our expense structure. Inventory at quarter end was \$192.2 million, a 17% or \$39.2 million reduction compared to prior year. This decrease follows a 12% year-over-year reduction in Q2, and is the result of better balancing of inventory receipts. The improvement was driven by a 15% decrease in year-round products and a 7% decrease in fall/winter goods. This was partially offset by a 27% increase in spring/summer goods. In addition, effective inventory allocation drove a 300 basis point improvement in in-stock position in stores and maximization of inventory in our fully automated Adairsville fulfillment center heading into peak. Key actions included raising minimum presentation levels in stores and responding with additional replenishment to backfill high-velocity SKUs. Enhanced processes like enterprise planning have instituted greater discipline in optimizing inventory receipts to manage cash and inventory positioning to drive greater availability. At the end of the third quarter, our inventory mix included 92% in current products and 8% in clearance goods compared to 3% in clearance last year. This compares to 22% in clearance at the end of July and 16% at the beginning of September. To build upon the progress, as Stephanie mentioned, we are focusing our assortment to reflect more of our core durable products. We reduced SKUs by 5% in fall/winter 2025. We are on track to reduce SKUs by more than 20% in spring/summer 2026, and are targeting an additional double-digit SKU reduction in fall/winter 2026. Our capital expenditures through Q3 were \$14.3 million compared to \$14 million in the prior year, primarily driven by the opening of our 2 new stores. We ended the quarter with net liquidity of \$88.6 million and net debt of \$36.4 million. Our cash and cash equivalents were \$8.2 million with borrowing on our credit facility at \$44.6 million. As we actively manage our inventory levels, we have improved our net liquidity sequentially in the last 2 quarters. As of this week, post the majority of the peak selling season, we are out of the credit facility with a net liquidity of approximately \$125 million. Now turning to our outlook for fiscal year 2025. We are affirming our 2025 adjusted EBITDA guidance range to the higher end of our previous guidance of \$20 million to \$25 million to now \$23 million to \$25 million. This takes into account several factors. Sales range for the full year of \$555 million to \$565 million versus an initial range of \$570 million to \$595 million. This reflects the impact of our pricing actions, promotional strategy and our commitment to the long-term quality of sales. Tariff impact for the full year is now projected to be down from \$15 million to \$12 million. This is planned to be offset by targeted price increases implemented at the end of the second quarter, management of inventory receipts and cost negotiations with vendors. Cost savings from rightsizing our overall expense structure with the current scale of our business is now expected to exceed the \$10 million target and be closer to \$12 million. We plan to maintain our investment in advertising above 10% of sales. Regarding our balance sheet and capital expenditures. First, we are maintaining our projection for a double-digit decrease in inventory levels at year-end compared to the previous year, driven by ongoing SKU reduction and rightsizing of receipts. Second, we are maintaining our capital expenditure plan at approximately \$17 million for the year. This includes investment in the 2 new stores, Manhattan omni fulfillment software and regular maintenance. Finally, our asset-based lending facility remains a key resource for increased flexibility and access to cash. In closing, we are encouraged by the significant progress we've made in key areas, restoring price integrity, enhancing inventory management and strengthening our operational execution. We've implemented comprehensive measures to offset the impact of tariffs, are making decisive moves to optimize our expense structure, and under Stephanie's direction, are keenly focused on refining our product assortment and strategic brand marketing investments. We have successfully navigated an uncertain environment, emerging in a stronger financial position across free cash flow, profitability and liquidity. With 2025 coming to a close, this team has built a solid foundation, both operationally and financially as we lead into 2026. With that, we will now open the call for questions.

Operator: [Operator Instructions] The first question today comes from Jonathan Komp with Baird.

Jonathan Komp: Yes. Stephanie, maybe stepping back, a bigger picture question. You referenced some encouraging customer and profitability metrics. How are you assessing the progress on your strategy to be more profitable and prioritize higher-value transactions? What are the key metrics that

you focus on the most? And how do you expect that to play out into the holiday period, which typically is more promotional for the industry?

Stephanie Pugliese: Jon, thanks for the question. So we look at some metrics that I think everyone would be familiar with around order transactions. So average order values being up year-over-year, our gross margin rate being up year-over-year. And we're also looking at longer term, our sales per customer or revenue per customer over a period of time. And so what we're seeing and we're encouraged by is our average order values continue to be stronger year-over-year. We are achieving the sales that we have with relatively fewer units. And so it's making the whole machine, if you will, more efficient. When we look at customers and how we are thinking about them or how we're -- what the reaction we're seeing in fourth quarter, you're right, fourth quarter tends to be and is more promotional than other quarters. But we're seeing those same dynamics kind of play through quarter-to-quarter. So we're encouraged by the fact that at the end of the day, while our revenues are down and they've been consistently tracking, if you will, to the down 10% or so year-over-year, it continues to be at a higher quality rate of sale, both on the customer level and on the order metrics.

Jonathan Komp: And maybe one follow-up. I know last year, there was some execution and operational challenges. Just any thoughts as you cycle over some of those periods, how the business is performing? And then maybe stepping back, how long are you thinking that roughly down 10% type run rate continues? Or said differently, when do you start to cycle some of the factors that could start to mitigate those sales declines?

Stephanie Pugliese: Sure. So let me start with some of the proof points, if you will, that we have around our operations. And the comment that I made in our prepared remarks about being smoother, right, in Q4. So just to highlight some numbers, our Adairsville fulfillment center has shipped over 60% of our units to customers so far in this quarter, which is a 20-point increase in terms of percent of total to last year. And we know that when we ship from that facility, we're more efficient and are able to get the packages to our customers faster in many cases and fulfill that obligation that we have to our customers. We have -- our on-time delivery this year has been above 90%. Wait time in our call center calls has been less than 5 minutes on average. And our retail in stocks on Black Friday were 97%. So all of those numbers are numbers that the team is really proud of, most importantly because they serve our customer better than we have in prior years. So those are the places where when I talk about fulfilling promises to customers, it's about building relationships and long-term credibility with the people that we serve. And those numbers, I think, really exemplify the work that the team has done to build that relationship with our customers long term. To answer the second part of your question around the sales declines, we're in this -- for the past 2 quarters since I've been back, the focus of the business has really been around creating a more stable base for long-term growth. And that has been focused around things that we've already talked about, the promotional reset and creating higher value customer interactions as well as orders, cutting costs in the other parts of the business so that we can be more efficient and productive on the bottom line longer term, smoother operations that I just mentioned. And then as we look forward, we know that in order to build the -- continue to build the base for long-term growth, the next part of this is focusing our assortment. As we've talked about before, we have -- we are planning in both spring and fall of 2026 a 20% reduction in our SKUs and styles so that we can be more effective in our messaging, and we can be clearer to our existing customers and future customers what this business stands for and we're able to continue to invest in marketing to help us stand out in the marketplace. So those are the things that we are focusing on right now. I'm proud of the fact that we have strengthened the base and the cost, kind of the cost structure of the business is coming more in line, certainly still have work to do there. But I think that it gives us at least the platform for the future growth that we can build on.

Heena Agrawal: And I would add that as we look at our last 2 quarters' performance, our retail portfolio, we saw a positive comp in Q2 and flat to slightly positive in this quarter. So we see a more stable environment in retail as we reset the promotions. On the online side, there is a greater elasticity with the promotional reset. But we are continuing to see the impact of various marketing efforts around increased traffic that we hope to capitalize on as we move forward.

Jonathan Komp: Okay. Great. Maybe just 2 last ones from me then, Heena. On the fourth quarter implied adjusted EBITDA looks significantly higher year-over-year, maybe as much as double

year-over-year. Could you just highlight the factors driving that improvement?

Heena Agrawal: Yes. As we've been doing the promotional resets, the biggest reset is really coming from the Black Friday Cyber Week, 50% off that we had last year that we did not comp this year, and it was down to 30%, with some 50% Dam Busters. And that's really what's driving the gross margin improvement and gross margin dollar improvement. In addition, because of the smoother operations and how the team has worked on positioning inventory, leveraging and maximizing Adairsville, we are also seeing a greater flow through on the contribution line. And on top of that, the cost savings estimate that we had of \$10 million is expected to exceed and be at \$12 million. So all of those factors are coming together, and the greatest impact is in Q4 that we are seeing, which is driving that higher adjusted EBITDA in the Q4 estimate versus last year.

Jonathan Komp: Okay. Great. And then just last one, balance sheet. I might have missed this in your remarks, Heena. Did you mention having fully paid down the line of effectively 0 debt currently in the fourth quarter here? Just to clarify that. And then any commentary you have looking forward on capital needs.

Heena Agrawal: Yes, we are -- we have had a successful peak and it's been more profitable and smoother, and that's helped us pay down our debt fully. As of this week, we are out of our credit line, and we have liquidity of approximately \$125 million. So we are looking forward to continuing that momentum through the end of the fiscal.

Operator: The next question comes from Dylan Carden with William Blair.

Marcus Belanger: This is Marcus Belanger on for Dylan. During the quarter, I believe you said you cut days of sales in half. So can you tell us the overall depth of promotional activity or maybe what your percentage of full-price sales were? And then how far do you think you are from an optimal level of promo?

Stephanie Pugliese: So I will -- I'll take the second part first, Marcus, around how far we think we are from optimal promotion. At the end of the day, this has been a huge reset for the business. And I just want to highlight one number when you look at the gross margin improvement year-over-year that we saw in Q3, considering the fact that as we reported in last quarter, we came in with significantly more clearance inventory coming out of Q2, and it was the first quarter where tariffs were a part of the gross margin. For the team to be able to achieve 150 basis point improvement, I think, is kind of shows how far along the journey that we've come so far. We do still think there's continued promotional reset as we go into early next year, for example, in the February time period, we were up against a very heavy promotional time or clearance time in our Big Dam Birthday event last year. So that's a place that you will continue to see promotional resets, and we'll be tweaking that along the way. So our goal ultimately is to provide the best value for our customer to recognize that there are times of the year where value is a driver, like fourth quarter that we talked about just a few minutes ago, but to really build back in full price as a core premise of our business outside of those big promotional kind of milestone moments, if you will. So that's how we're looking at the business overall. And we'll continue to refine and tweak those as we go forward.

Heena Agrawal: And Marcus, just to add, to clarify the number of days of promotion we were on in Q3 is what was cut in half. And to Stephanie's point, we are looking to continue resetting promotions. And this time, as we look forward, it's going to come more through reduction in markdowns as we've improved our assortment and inventory buying receipts. We expect to have higher sell-throughs on our products, which will reduce the markdowns and the discount that you see on our products. So we will continue on the promotional reset, but entering kind of Phase 2 where we have greater emphasis on markdowns and higher sell-throughs through a tighter assortment and buying.

Operator: This concludes our question-and-answer session and concludes the conference call. Thank you for attending today's presentation. You may now disconnect.