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PRESENTATION

Operator

Good morning, everyone, and welcome to Unifi's First Quarter Conference Call. Leading today's call is A.J. Eaker, Vice President Finance and Investor Relations. A.J.?

A.J. Eaker ***Unifi, Inc. - Vice President of Finance and Investor Relations***

Thank you, operator, and good morning, everyone. On the call today is Kevin Hall, Chairman and Chief Executive Officer; Tom Caudle, President and Chief Operating Officer; and Jeff Ackerman, Executive Vice President and Chief Financial Officer.

During this call, management will be referencing a webcast presentation that can be found at unifi.com and by clicking the first quarter conference call link.

Management advises you that certain statements included in today's call will be forward-looking statements within the meaning of the federal securities laws. Management cautions that these statements are based on current expectations, estimates and/or projections about the markets in which Unifi operates. These statements are not guarantees of future performance and involve certain risks that are difficult to predict. Actual outcomes and results may differ materially from what is expressed, forecast or implied by these statements. You are directed to the disclosures filed with the SEC on Unifi's Forms 10-Q and 10-K regarding various factors that may impact these results.

Also, please be advised that certain non-GAAP financial measures, such as Adjusted EBITDA, Adjusted Working Capital, Adjusted Net Income and Adjusted EPS may be discussed on this call, and non-GAAP reconciliations can be found in the schedules to the webcast presentation.

I will now turn the call over to Kevin Hall.

Kevin Hall ***Unifi, Inc. - Chairman of the Board and Chief Executive Officer***

Thanks, A.J., and good morning, everyone, and thank you for joining us today. The first quarter of fiscal 2019 saw revenue growth of more than 10% year-over-year. This marked the sixth consecutive quarter of year-over-year top line growth for Unifi.

While sales growth is ahead of our expectations, we experienced another sudden jump in raw material cost globally - which has impacted our profitability in the short term, most notably regional Polyester - which was down more than 20% in gross profit. To put this cost increase in context, we have seen a sustained rise in our raw material costs globally for the past 4 quarters, and we have been chasing these price increases for some time now. When costs stabilize, we are optimistic that our revenue growth will translate to earnings growth as well.

Global PVA sales were up 10% year-over-year, or 14% on a currency-neutral basis, and represented approximately 43% of consolidated net sales during the quarter. Our strategic focus on our PVA portfolio is driving overall sales growth across the globe and we believe building a platform for long-term success.

Part of our success within the PVA portfolio has been driven by our increased engagements with the design teams and sustainability leaders of our brand and mill partners as well as our own branding efforts, such as participation at recent industry trade shows like the Outdoor Retailer and Intertextile events in Shanghai.

With sustainability at the core of our growth efforts, we are really excited about what can be accomplished with a circular economy - or closed-loop method for creating stronger end-to-end recycling partnerships. Many of our circular economy solutions revolve around collecting bottles recycled at specific locations, converting those bottles into performance fibers and ultimately transforming those bottles into exciting products that relate to the community where the bottles were originally sourced.

For us, closing the loop is opening doors and securing exciting new relationships.

For example, in partnership with the Pac-12 Team Green, the University of Colorado, The City of Boulder and League 91 Collegiate apparel, we have created the first of several circular economy solutions leveraging Unifi's unique capabilities and partnerships. Through this program, we have taken bottles collected on campus, shipped them to our recycling facility in North Carolina and provided to League 91 with a REPREVE Performance yarn for use in a new Colorado University collection of apparel for their bookstores. We expect this will be expanding to other Pac-12 universities as well.

An example of a unique program is The North Face Bottle Source program. The North Face Bottle Source Collection, supporting the National Parks Foundation, has diverted more than 160,000 pounds of plastic bottles from park waste streams including, Yosemite, Great Smoky Mountains and Grand Teton National Parks. The North Face is extending a lifecycle of these plastic bottles by taking them from the waste streams of the parks, and then working with Unifi to recycle them into fibers, which the North Face makes into T-shirts, hoodies and totes. For every Bottle Source product sold, The North Face is donating $1 to the National Park Foundation to support recycling and reuse programs, so that consumers can feel good in their T-shirt in more ways than one.

Turning our attention to retail, we continue to see great adoption of REPREVE and increased programming arriving on retail shelves.

REPREVE and our TruTemp365 technology are weaving their way into more and more Denim offerings this holiday season. We will be bringing some examples to our Investor Day in 2 weeks - items that you can find today at Macy's, Kohl's, Levi's, Target, Abercrombie, Hollister and Express.

Another great example of recent REPREVE adoptions currently available at retail includes t-shirts from Jockey. These t-shirts highlight our high-value REPREVE filament yarn and boast heather effects, generating an exciting apparel launch with recycled attributes.

We will be talking more in the future about our REPREVE PLUS ONE strategy, adding consumer-meaningful attributes to our recycled platform - such as the Dockers brand, introducing a new innovation in fall 2018, called All Seasons Tech - engineered fabric for warm and cold conditions. The line includes REPREVE plus Sorbtek365 technology, which helps to keep the wearer comfortable year-round. The collection of All Season Tech products will be co-branded with REPREVE and Sorbtek365 hangtags, and the thermal comfort benefits are featured in an educational product video created by the Dockers brand.

We are also excited to be working with Inditex. This is a new partnership as we share a strong commitment to sustainability. One recent example of our work together is the use of REPREVE recycled fiber in the padding of Zara kid's winter jackets. REPREVE Fiber Fill is a newer product, which is gaining significant traction and includes co-branding with REPREVE.

We have talked previously about the strong adoption of REPREVE into apparel brands of Target, such as Cat & Jack. This year, you can also find REPREVE at Target in denim, socks and hosiery, and across many products at home, such as sheets, pillowcases and soft side storage units. Target continues to be a terrific partner for REPREVE and a true Champion of Sustainability.

Now moving onto the high-level review of our operational results during the quarter.

Our regional Polyester business had strong sales growth, driven by a few factors: an additional week in fiscal 2019 which fell into this quarter, pricing actions that have taken place over the last 9 months, increased sales of Chip and Flake from our recycled operations and the integration of the recent dyed business acquisition.

On profitability, while the first 2 months of the quarter were right in line with our profit expectations, higher-than-expected integration costs associated with the dyed business acquisition and the acceleration of raw material pressures in September were a headwind. We expect the raw material cost increase to unfavorably impact the second quarter as well.

Our Regional Nylon sales were up 4%, driven by improved volumes and the extra week. However, profitability was impacted by a comparatively weaker product mix and cost pressures. Pricing actions are underway in this business as well.

The International Segment saw revenue grow more than 7% year-over-year. Excluding the impact of FX changes, sales growth was $10.3 million or 21%. Sales growth in Asia for the quarter was again significant, and we are proud of these efforts. Despite strong sales results in Asia, quarterly gross profit for the International Segment was even with the first quarter of fiscal 2018 due to cost and foreign exchange headwind.

A note on Brazil, where we are managing the business tightly through this period of economic and political volatility. During the quarter, we saw a decrease in volume, which we attribute to the local economic and political environment. In combination with the FX pressure in Brazil, this translated into lower sales compared to a year ago. Considering the economic and political backdrop, our team in Brazil delivered solid margins and executed quite well.

Beyond our segments, I'd also like to note that recent hurricanes have impacted our community and our customers, where flooding and high winds have made circumstances difficult in multiple places. I'd like to thank our employees who have been on the front lines during the recent storms, working diligently to meet the needs of our customers during challenging times. Despite these storms, we did not see a material impact from them on our business in the quarter.

I'd now like to take some time to talk about the trade environment. With the new Section 301 tariffs that were put in place by the Trump Administration in September, the industry has seen a 10% tariff that applies to all fibers, yarns and fabrics and some finished goods being imported from China. This tariff is scheduled to automatically increase to 25% on January 1, 2019. From a macro-level perspective, these tariffs have served as a catalyst for sourcing conversations to take place throughout the supply chain of our customers.

Our customers are looking to leverage their global supply chain to meet rapidly changing situations.

Unifi remains uniquely positioned with its global supply chain and commitment to quality to service the industry and our partners wherever they operate.

I'd like to close my remarks by discussing the announcement we made in mid-October that we have filed trade petitions with the U.S. Department of Commerce and the U.S. International Trade Commission, alleging that dumped and unfairly subsidized imports of polyester textured yarn from China and India are causing significant injury to the U.S. market. These petitions relate specifically to polyester textured yarn, our largest product line in this region. As this is typical with governmental and regulatory investigations, situations like this take time, and we are not yet able to provide comments around the expected impact to our business or the industry.

With that, I'll pass the call to Jeff to go into more detail on our financial results. Jeff?

Jeff Ackerman ***Unifi, Inc. - Executive Vice President & Chief Financial Officer***

Thank you, Kevin, and good morning, everyone. As Kevin noted, our margin and profitability performance this period was lower than anticipated. However, we understand the drivers and are taking action to mitigate these current headwinds.

Like Kevin, I am proud of the sales we saw this quarter. Underlying momentum continues. And while we did benefit $8.3 million from an additional fiscal week domestically, our international operations were unfavorably impacted by foreign exchange headwinds to the tune of $6.7 million.

With sales outperformance as a backdrop, I will move on to our profitability walk through. My discussion will begin on Slide 3 of the webcast presentation, where you can see a high-level overview of these results.

Net sales were $181.6 million, which was a 10.6% increase from first quarter 2018. The top-line growth was primarily driven by volume increases related to global PVA growth, and domestically by an additional week in the quarter, partially offset by foreign currency translation.

Gross profit was suppressed by raw material cost increases as Kevin discussed, disproportionate growth on lower margin products and integration costs for the recently acquired Dyed business.

Within operating expenses, SG&A came in as expected, and the increases were primarily due to investments made in fiscal 2018 to support expansion of the Company's commercial capabilities in the form of increased customer engagement, marketing efforts and our innovation pipeline.

Also in the first quarter, we realized a net foreign currency transaction gain versus a loss in the first fiscal quarter of 2018.

The decline in net income related to equity affiliates resulted from a $2.9 million difference in pre-tax earnings from Parkdale. In the prior year, Parkdale experienced a more favorable price to cost relationship on sales, contrasted against the current period, where they continue to chase raw material costs with pricing actions.

Lastly, we were impacted by a higher effective tax rate and an increase in interest expense with a combined total impact of $1.8 million. Compared to a year ago, we saw a large swing in our tax rate due to the unfavorable impact of the recent tax reform. The tax rate was also impacted by our decision to repatriate foreign cash in preparation for the upcoming refinancing of our credit facility. We expect to see significant improvement throughout the rest of fiscal 2019 and in fiscal year 2020, as we work to trim the effects of Tax Reform. In the meantime, it may be more helpful to think about our cash tax rate, which we expect to be in the mid-30% range.

Slide 4 shows the sales and gross profit highlights for the first quarter.

Total segment net sales were up 10.5% from the prior year on 12.4% higher volume, while gross margin declined 320 basis points.

Sales results of our Polyester polymers and International Segment continued to drive underlying revenue growth. Sales in Asia were strong on both staple fiber and filament programs. These sales are a key component to long-term relationships based on sustainable solutions and our PVA portfolio globally.

In our Polyester Segment, we saw 14.1% sales growth driven by an extra week and growth in Dyed yarn and lower margin POY and polymers. Balancing the needs of our customers and the regional landscape has been important, so we are encouraged by the continued sales growth of the Polyester Segment.

Nylon sales and gross profit results were in line with our expectations with an increase in sales year-over-year, mostly due to the extra week.

Now, let's look at the components of our gross margin performance, which declined 320 basis points at the company level.

In Polyester, our conversion margin was hampered by the continuing rise in raw material costs, which impacted gross margin by 180 basis points, net of pricing. Additionally, the segment also experienced higher-than-anticipated costs associated with the integration of the recent dyed business acquisition - a 50 basis point impact - and a mix impact of around 90 basis points.

Nylon continued to experience year-over-year degradation due to a weaker mix and higher raw material costs. These factors contributed to the 470 basis point decline in gross margin.

The International Segment remained a margin leader for us, but raw material increases and sales mix resulted in a decline of 150 basis points. The International Segment had strong pull through on filament programs, but even stronger performance on staple fiber to continue driving growth.

Overall, REPREVE and PVA, which carry above average gross margins, are still seeing high demand around the globe.

Slide 5 shows equity affiliates. As we've talked about earlier, earnings from equity affiliates declined due to cost pressures for Parkdale. The joint venture continues to experience a difficult regional environment and chase raw material costs with pricing actions.

Total distributions in the quarter totalled $504,000.

Now Slide 6, which covers a few balance sheet highlights. Working capital was $202 million, and Adjusted Working Capital was $174.3 million. Adjusted Working Capital as a percentage of sales is currently 24.8%, up from 21.3% in the first quarter of 2018, primarily due to selected inventory builds.

We ended the period at [$141 million] (corrected by company after the call) in debt principal and Net Debt was at $98.8 million. Total Liquidity and Revolver Availability were at $88.7 million and $46.5 million, respectively. In addition, using swaps that terminate in May 2022, we have effectively fixed LIBOR at approximately 1.9% on $75 million of our debt principal.

Our weighted average interest rate was 3.9%.

Looking beyond our cash and debt positions, I'll remind you that we still have $27.6 million authorized and remaining under our share repurchase program. While we prioritize growth investments, we remain open to considering multiple levers to drive long-term value.

Looking at the rest of fiscal 2019, we are still on track to achieve our revenue expectations. However, in light of the polyester raw material cost increases last month, we have lowered the top end of our range of expectations for profitability.

Let me provide a few guardrails around the second quarter.

We expect our underlying sales momentum to continue into the second quarter and rest of the year, but the second quarter will see two meaningful headwinds:

One, we will experience our typical domestic shut-down week and will have reduced shipments during the second quarter due to our current fiscal calendar. This event fell into the third quarter last year.

Secondly, since we saw a spike in polyester raw material costs in September, which we believe was driven by higher global demand and tighter supply for polyester feedstocks, we expect gross margin to be negatively impacted in the second quarter. We expect the increase in polyester raw material costs from Q1 to Q2 to be similar to the increase experienced last year at this time.

Then, in the second half of the year, we anticipate an improvement in a relationship between our pricing and raw material costs.

These are the building blocks for our reduction of the range on operating income and Adjusted EBITDA for the full fiscal year 2019.

Our Capex expectations remain at $25 million.

Lastly, I'll shed a little more light on our tax rate, which was outside our range of our expectations. This was due to the lower operating income and the Parkdale miss, in addition to our decision to repatriate some foreign earnings in anticipation of our upcoming debt refinancing. Then, some of the recent tax interpretations came in unfavorable. That said, we are still optimizing the tax rate and working opportunities that push us back into the mid-40% range and toward a more normal tax rate over time.

I'll now turn the call back over to Kevin for a few closing remarks.

Kevin Hall ***Unifi, Inc. - Chairman of the Board and Chief Executive Officer***

As a reminder, we will be hosting an Investor Day, November 15th in New York. The event will provide a platform for a deep dive into our business and the global environment in which we operate. We will further detail our strategic growth plan and will include presenters from across our organization. It will be a great day, and I look forward to seeing many of you there. With that, we'll open the lines up for your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Daniel Moore of CJS Securities.

Daniel Moore ***CJS Securities, Inc. - Director of Research***

I was writing as fast as possible. Jeff, I think you said in the Poly segment, mix was a 90 basis point headwind. Can we break out more generally across the business of the 320 basis points decline in gross margin impact of rising input costs versus mix versus some of the integration costs?

Jeff Ackerman ***Unifi, Inc. - Executive Vice President & Chief Financial Officer***

Yes, polyester's our largest business as you look around the globe, so those raw material costs have an impact. As we said for the Polyester Segment, it was about 180 basis points there, and in mix, it was about 90 basis points. I would say that for Nylon, the impact was primarily on mix. If you looked at our International business that again was really mix, so we continue to see strong growth. In Asia, we're pleased with that. We're pleased really with how Nylon came in and as well as Polyester. Volume growth across the board for Asia, they continue to see strong filament sales but with even stronger growth in the polymers and staple fiber, which carry a little bit lower margin.

Daniel Moore ***CJS Securities, Inc. - Director of Research***

Helpful. And then looking forward, the guidance, I believe, implies a little bit of a leveling off, if not improving of the price input cost relationship. Just talk about trends you're seeing in PET pricing and signs that may give you confidence and ability to hit the lower end of the prior guidance range.

Jeff Ackerman ***Unifi, Inc. - Executive Vice President & Chief Financial Officer***

Yes, as we've been watching what has been happening in the market for the PET costs globally, and what we've seen is looking back historically, we feel like this is at a relatively high level on a historical basis. I won't say it's all-time high, because it has been higher, but given just where it is, we feel like it's at pretty much at a high level. Now if oil goes to $100 a barrel, then of course it could rise again. But at this point just based on historically, the ranges in which PET have moved, we feel like this is at the high end and we're anticipating it stabilizing from here.

Kevin Hall ***Unifi, Inc. - Chairman of the Board and Chief Executive Officer***

Dan, this is Kevin. I'll put a little bit of background from the commercial side of it too. I think as you look across the retail landscape right now, folks are anticipating a good holiday season. As I talked to a lot of the folks that are with different brands and retail partners we call on, their words are the consumer hasn't given them any indication why they shouldn't anticipate that. They really wanted to be prepared this year for holiday, and in general, they moved holiday in pretty strong, shelves are stocked pretty well and they don't want to be out of stock at traditional retail this year. They wanted to really capture that, so I think all those things play very positively. What it did was to put a real pickup in demand in our September period versus what we had seen historically and that really moved the cost higher. So good news demand was there, bad news is the cost really spiked in September, which was frustrating, because we had really just gotten to a place where we were catching up with it and now we've got to move again. But to Jeff's point, we think that this will start to stabilize a little bit. We can't predict commodity prices, so we got to put a caveat on this, which is they can always go up from here, but they appear less likely at this point to move up, because of just the big strong move that we had.

Daniel Moore ***CJS Securities, Inc. - Director of Research***

So most of the price increases up until recently more supply-driven, but you're saying this is a little bit of a demand spike as well?

Kevin Hall ***Unifi, Inc. - Chairman of the Board and Chief Executive Officer***

There were both in there, yes.

Daniel Moore ***CJS Securities, Inc. - Director of Research***

Got it. And then lastly for me. Just Parkdale JV, good color and appreciate it. May be just to remind us of variability to raise prices to offset input cost inflation. Do you expect profitability to remain challenged in Q2 and the balance of the year? Obviously, it is tough to forecast cotton prices, but just help us understand, you've given color in the past and how quickly you can pass along prices in your business. Similar color for Parkdale would be helpful.

Kevin Hall ***Unifi, Inc. - Chairman of the Board and Chief Executive Officer***

Yes, I'll touch on that first and then Jeff can add into. So it's interesting on Parkdale, because in their business, they lock in on a longer-season basis, so this was kind of a worst case for them where they locked in at a price, and as the season went on, the cost went higher through the season. If you think locking the price in spring, as you're making for the holiday season, the costs just continue to go up on you. Then, it came back down right towards the end of the seasonal period. They had a little bubble in there that they had already priced their seasonal operations at, so it was tough for them to digest that. We've been in conversations with them; they're looking to take pricing. As I said before, they are a well-run organization. It's just they're experiencing some of the same commodity issues. I just think they had an even more of an interesting move within their seasonal build pattern this year. Jeff, I don't know if there is anything else you want to add.

Jeff Ackerman ***Unifi, Inc. - Executive Vice President & Chief Financial Officer***

No, there is a lot of similarity there in terms of how they get impacted by their raw material costs and their ability to price, so a lot of similarity there.

Operator

Thank you, and that concludes our question-and-answer session. Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program, and you may all disconnect. Everyone, have a great day.