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GCO - Q4 2020 Genesco Inc Earnings Call

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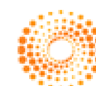

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PRESENTATION

Operator

Good day, everyone, and welcome to the Genesco Fourth Quarter Fiscal 2020 Conference Call. Just a reminder, today's call is being recorded.

I will now turn the call over to Dave Slater, Vice President of FP&A and Investor Relations. Please go ahead, sir.

David Slater - *Genesco Inc. - VP of Financial Planning & Analysis and IR*

Good morning, everyone, and thank you for joining us to discuss our fourth quarter and fiscal 2020 full year results and our full year fiscal 2021 outlook.

With me on the call today are Mimi Vaughn, our President and Chief Executive Officer; and Mel Tucker, our Chief Financial Officer.

Participants on the call expect to make forward-looking statements. These statements reflect the participants' expectations as of today, but actual results could be different. Genesco refers you to this morning's earnings release, and the company's SEC filings, including the most recent 10-K filing for some of the factors that could cause differences from expectations reflected in the forward-looking statements made during the call today.

Participants also expect to refer to certain adjusted financial measures during the call. All non-GAAP financial measures referred to in the prepared remarks are reconciled to their GAAP counterparts in the attachments to this morning's press release and in the schedules available on the company's homepage under Investor Relations in the quarterly earnings section. I want to remind everyone we have posted a presentation summarizing our results and guidance that is accessible on our website.

As another reminder, we filed an 8-K in connection with our Q1 earnings release that contains adjusted non-GAAP fiscal '19 results by quarter for last year, restated to reflect the sale of Lids Sports Group as if we never owned the business per GAAP requirements. You can find this on our website as well.

Now I hand it over to Mimi.

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Mimi Eckel Vaughn - *Genesco Inc. - CEO, President & Director*

Thanks, Dave. Good morning, everyone. Fiscal '20 was filled with many notable successes and important accomplishments. In our first year as a footwear-focused company, we delivered strong results, building on the turnaround and profitability that began in fiscal '19. We strengthened our organizational capabilities through investments in people and technology. In addition, we made an acquisition late in the year that advances our go-forward strategy to build the branded side of our business and provides Genesco with another growth vehicle as we embark upon this exciting new chapter in our company's history.

Before we get into a discussion of our recent performance and outlook, I'd like to thank Bob Dennis for his decade plus years of leadership as CEO and recognize his tremendous career and considerable contributions to our company. Bob led Genesco through a period of significant change for our industry, overseeing the company's transformation from primarily a bricks-and-mortar retailer to an omnichannel leader. During his tenure, we acquired Schuh, acquired Little Burgundy, sold the Lids Sports Group and launched the footwear-focused strategy we are currently executing.

In addition to the lasting imprint Bob has left on Genesco, he has positively impacted the greater Nashville community in so many ways through his many charitable works. Fortunately, the company and its shareholders will continue to benefit from Bob's wisdom and leadership in his new role as Executive Chairman. Bob, it has been a true pleasure for me and for us all to have had the opportunity to work with you.

Now on to our performance. There is much to celebrate from the past year. A few of the many highlights include: delivering comp sales growth in every quarter, even as we face more challenging comparisons, marking our 11th consecutive quarter of comp sales growth; achieving positive store comps by driving meaningful improvements in conversion while we combated lower store traffic; achieving an all-time high for direct sales penetration, growing by 180 basis points; successfully unplugging Lids to become a more focused company; eliminating more stranded costs associated with the Lids business than expected and continued success with our cost reduction efforts; securing the rights to the Levi's footwear license, along with our execution, our acquisition of Togast, which added important scale and new opportunities to our Licensed Brands business; generating almost $120 million worth of cash flow from operations; returning close to $200 million to shareholders through share repurchases; and increasing adjusted earnings per share by 40% on top of the 20-plus percent improvement delivered in fiscal '19.

We were able to achieve all of this because we have tremendous businesses and great people. As a result of the actions we took throughout the course of fiscal '20, we're an even stronger company than we were a year ago, and our future as a footwear-focused company is bright.

With a very healthy balance sheet, we have the flexibility to invest for growth in new capabilities in our current business, pursue new growth opportunities and return cash to our shareholders.

Full year adjusted EPS of $4.58 was above our guidance range of $4.10 to $4.40, driven primarily by stronger-than-expected results at Schuh during the fourth quarter, coupled with lower-than-planned expenses due to the significant progress we made, removing stranded costs from the Lids divestiture. Exceeding the high end of the range was a fitting finish to an outstanding year.

Later in the call, I will outline the main pillars of our current 5-year plan and selected key initiatives we're executing in fiscal '21, aimed at further advancing our footwear strategies. But now let's turn to Q4 results.

Compared with the previous year, our Q4 performance included positive comps, gross margin expansion and flat expenses as a percent of sales. The combination of these results and our share repurchase activity over the past 12 months fueled Q4 EPS of $3.09, an increase of 40% compared to the year-ago period. The fourth quarter was marked by a pronounced shift from bricks-and-mortar to e-commerce on both sides of the Atlantic. This dynamic was driven, not only by heightened consumer preference for online shopping throughout the holiday season, but also encouraged by retailer offers and promotions, which jump-started the selling period. The shift among our businesses, in particular, was precipitated by technology enhancements we've deployed that have allowed for easier mobile use, helped by increases in digital marketing spend and bolstered by the trust our customers have in our ability to quickly deliver their gifts in time for the holidays.

In the face of lower store traffic, our store selling teams did an excellent job driving higher conversion rates and higher transaction size. However, it wasn't enough to overcome the softer footfall, resulting in our first negative store comp in many quarters.

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As we look to our results by brand, let's start with Journeys and begin by congratulating the team on its impressive full year results on top of last year's strong improvement. Journeys' deep understanding of the team consumer and their fashion preferences, expertise of its merchant teams to interpret these trends and make the right product calls and abilities of its store and e-commerce teams to deliver an exceptional customer experience firmly entrenches Journeys as the leading omnichannel retailer fashion footwear for teens and generated another year of market share and operating income growth. Congratulations to the Journeys team on an outstanding year.

Specifically in Q4, Journeys continued its solid top line growth, posting a positive comp increase on top of a challenging 2-year stack comp in the high teens, which was Journeys' most challenging stack comparison this year.

Sales were driven by strong full price selling, especially within key brands of our boot offering, reflecting a trend right assortment. Journeys' digital growth was a real highlight as we realized a record level of digital sales dollar growth. Journeys' success in digital throughout the year was driven by the investments made on our redesigned website as well as our effective use of digital marketing to increase website traffic. Last year's expansion and upgrade of the Journeys distribution center, including dedicated e-commerce fulfillment, also allowed us to process this record volume and get orders out to customers faster and more cost efficiently. Nonetheless, negative store comps made it difficult to leverage the fixed expense base in the store channel in spite of the robust digital growth and positive digital profit contribution.

Schuh exceeded expectations for Q4 and put a nice finish on the year with comps increasing low single digits for the second consecutive quarter. With its advanced omnichannel capabilities, Schuh was ideally positioned to take advantage of the accelerated shift in consumer purchasing, away from the high street to online, which was an even more pronounced trend in the U.K. Similar to Journeys, boot sales were solid and Schuh Kids business was a strong contributor.

The top and bottom line improvement achieved by the Schuh team underscores its progress, executing the 20-point plan we outlined last year, aimed at turning Schuh's business around, addressing near-term profitability and enhancing Schuh's standing with the consumer and with the brands itself. This plan included an exit from the German market to increase focus on the U.K. In spite of negative store comps, Schuh was able to add to the bottom line in Q4, given both the profitability and the scale of its digital business. These results are particularly encouraging as they were delivered in the midst of an extremely challenging holiday season in the U.K. Congratulations also to the Schuh team.

Turning now to Johnston & Murphy. Comps improved on a sequential basis, but were still negative, down low single digits on top of a mid-single-digit increase last year. Positive performance in apparel and outerwear could not offset the impact on consumer demand for footwear. As we discussed on our Q3 call, fiscal '19's introduction of premium sport casual footwear provided a tremendous boost to J&M's results. Last year's footwear introductions did not have the same impact, which became even more apparent in the back half of the year.

In the footwear market currently dominated by sameness, the team is working diligently on product innovation and new product introductions for the coming year to inject greater freshness into the assortment. This should better position and differentiate J&M among its footwear competitors and drive greater traffic and consumption for the brand in seasons to come.

Post-holiday, both traffic and sales slowed in our North American business. For Journeys in particular, boots are an important sales driver, which coupled with an injection of cash for the consumer from tax refunds, drove brisk -- boot sales last year in Q1. This year's temperate start and unseasonably warm weather in many parts of the country has contributed to less robust boot sales than we had planned, and we have experienced a notable drop in store traffic. At Schuh, post-holiday sales have been robust, driven by clearance activity.

Shifting gears now to fiscal '21. These traffic trends, coupled with the timing of J&M's new product innovation and introductions for the back half of the year, caused us to take a cautious outlook for the first half. We also acknowledge the potential for choppiness in the U.K., given uncertainty with Brexit throughout the year.

To touch now on the coronavirus, we have seen store traffic affected, most notably in tourist destinations in both the U.K. and North America and also in our airport stores. This is clearly a fluid situation, which will undoubtedly change, but our comp forecast reflects what we know today on only what we have seen in the trend in our business thus far. We believe many of these factors are transitory, and we currently expect a pick up in our business and the momentum to build in the second half, which is the most important time of the year with Back-to-School and holiday.

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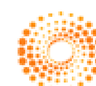

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Importantly, we have EPS upside in fiscal '21 from share buybacks we completed already last year, and we will have new revenue and profit from the Togast acquisition. So taking these factors into account, we are projecting adjusted earnings per share between $4.90 and $5.40 for fiscal '21. This guidance is a range with both upside and downside potential. Something close to the middle reflects our best current belief of where we might come out for the year, which represents a double-digit increase over fiscal '20 earnings per share.

Now let me turn the call over to Mel to review the financials and the guidance in detail.

Melvin G. Tucker - *Genesco Inc. - Senior VP & CFO*

Thank you, Mimi. In fiscal '20, we celebrated another strong year of exceptional performance. For the year, we improved adjusted operating income by 9%, increasing from $91 million to $99 million. We improved EPS by $1.30 year-over-year to $4.58 in FY '20 versus $3.28 in FY '19 and $2.67 in FY '18. We grew comps by 3%, improved gross margin by 60 basis points, with every division showing improvement for the year. We held expense growth to less than 1% and continued our operating income improvement as a result.

As Mimi mentioned, we had a solid fourth quarter, and our performance exceeded expectations, with EPS increasing from $3.09 to $2.18 last year or over 40%, with improvement in our Schuh business, lower corporate and bonus expense and share buybacks, aiding the year-over-year improvement.

The beat to expectations was due to Schuh's performance and the elimination of more stranded costs than we expected. Q4 consolidated revenue was a little over last year's level due to a positive comp and improved exchange rates. This was partially offset by closed stores and lower wholesale sales.

Consolidated comps were 1%, driven by direct comps of 19%, in-store comps that decreased 2%. Direct sales penetration as a percent of total retail sales was 16.6% for the quarter, accelerating 290 basis points ahead of last year.

Our e-commerce business continues to experience robust growth as we invest in digital wallet, at the same time, maintaining profitability in this channel.

Journeys comped 1% for the quarter on top of its highest 2-year stack comparison of the year at 18%. E-commerce grew strong double digits once again, partially offset by negative store comps. Strong in-store conversion and increases in average transaction size were outweighed by continued negative store traffic as a negative trend accelerated during the holiday season.

Schuh recorded a 3% comp for the quarter on top of a 2-year stack of negative 7%. E-commerce continues to lead the comp improvement at Schuh, posting yet another double-digit gain that was partially offset by negative store comps. Store traffic on the High Street continues to be challenged, but was mitigated by improvements in both conversion and average selling price.

J&M posted a negative 3% comp for the quarter on top of a 2-year stack comp of 8%. E-commerce comps were positive, and while J&M overall comps were negative, there was a sequential improvement from last quarter. Negative store traffic outweighed improvements in both conversion and average transaction size.

Moving to margin. In total, consolidated gross margin increased 20 basis points to 46.9%. Journeys' gross margin increased 20 basis points due to fewer markdowns. Schuh's gross margin improved 30 basis points due to higher penetration of full price sales. J&M's gross margin decreased by 50 basis points due to higher markdowns at retail.

Adjusted SG&A expense as a percentage of sales was flat year-over-year in Q4. Without the benefit of lower bonus expense, we would have deleveraged 80 basis points in Q4, as it is difficult to leverage the brick-and-mortar fixed expense base with negative store comps.

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Expense dollars in total were roughly flat in the quarter. Lower bonus expense and improved store rents were offset by increases in marketing as we continue to invest in marketing to drive customers into our stores and to our websites. We continue to benefit from cost-cutting initiatives, and overall, SG&A came in better than expectations as we made great progress in our efforts to remove stranded cost.

Related to stranded costs, we restated adjusted non-GAAP fiscal '19 results to reflect the sale of Lids as if we never owned the business per GAAP requirements. As we have mentioned before, this required us to remove $9 million in shared costs with our Lids business from our financials in fiscal '19, and thus, we needed to actually eliminate $9 million of cost in fiscal '20 to avoid creating deleverage.

So for those of you modeling our business, removal of the first $9 million of stranded cost does not reflect a reduction of last year's expense levels, as they've already been removed in our restatement. Through the efforts across our shared services, corporate and division platforms, we were able to identify and remove the $9 million of stranded costs we needed to in fiscal '20. Our thanks goes out to the many people across our organization who drove these efforts.

Additionally, we continued our profit enhancement program, or PEP, in fiscal '20, identifying over $11 million of cost reduction. Key areas of success included rent reductions, labor optimization through utilization of our workforce management tool, warehouse efficiencies and bright savings. All areas of the company contributed to these savings, and we remain focused on bending the cost curve.

We continue to make good progress on rent reductions, in partnership with our landlords as we renew existing leases. For the year, our real estate team successfully negotiated 160 renewals for an 11% cash reduction or 8% on a straight-line basis in the U.S. Fiscal '20 marks the third year of consistent progress in lowering rents. In fiscal '19, we negotiated an 8% reduction on a straight-line basis on 170 renewals in fiscal '18. In fiscal '18, we negotiated a 13% reduction on a straight-line basis on 192 renewals. With multiple years of progress, we are benefiting from a compounding effect of our efforts and at the same time, working to shorten lease life. Since less than 15% of our leases come up for renewal each year, we will continue to benefit from ongoing opportunity to reduce our rent expense going forward.

In summary, the fourth quarter's adjusted operating income was $59.3 million versus $58.5 million a year ago. Adjusted operating margin came in at 8.8%, which is up 10 basis points over last year. Adjusted operating income dollars increased at Schuh, corporate expenses were lower, and this was partially offset by lower operating income at our other divisions. Another call out is that we successfully terminated our pension plan this year, and the settlement charges are included in our GAAP numbers.

Turning to the balance sheet. Total inventory remains in good shape as our divisions adeptly managed inventory levels with both inventory and sales growth flat year-over-year in Q4. At Journeys, total inventory was up 1% on quarterly sales that were also up 1%. Schuh's inventory was up 15% on sales that were up 1% on a constant currency basis as Schuh pulled forward receipts that were initially planned in Q1. J&M's inventory was down 14% on quarterly sales that were down 4%, ending the year remarkably clean given their challenging back half sales results.

Capital expenditures in Q4 were $8 million, and depreciation and amortization was $12 million. For the full year, capital expenditures totaled $30 million, which is well below budget in last year due to opening fewer stores and plan as well as the timing of IT projects. We expect to make some of this shortfall with higher capital spend that will carry over to fiscal '21.

For the quarter, we did not repurchase any additional shares. For the year, we repurchased a total of 4.6 million shares for $189 million. Since December of 2018, in anticipation of utilizing the sale proceeds from Lids, we have repurchased 5.5 million shares across 3 authorizations for a total of $235 million. This represents a 28% reduction in the average shares outstanding since our last fiscal year. We have approximately $90 million outstanding on our current $100 million authorization.

On our balance -- our balance sheet remains very strong as we ended the year with $81 million in cash and no U.S. borrowings. We have been actively using our cash, paying off Canadian debt of $42 million in the fourth quarter, leaving only $14 million of debt relating to our U.K. business. This reduction in Canadian debt eliminates the negative carry and improves our effective tax rate. In addition to paying down debt, we used $34 million in cash on hand to acquire the Togast assets.

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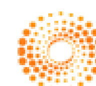

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Turning now to guidance for fiscal '21. We estimate adjusted earnings per share in the range of $4.90 to $5.40, and something close to the middle is our current view of where we may come out. We have not built in any additional impact of the coronavirus to demand beyond what may exist in our current business trend. From a supply perspective, we directly develop and source merchandise largely for Johnston & Murphy and Licensed Brands. Of those goods, less than 1/3 comes from China, resulting in direct sourcing for merchandise, representing quite a bit less than 10% of our sales in total. While most factories are now up and running, and we do expect some delays, it's too early to determine the precise impact. Of the remaining product we source from third-party vendors, we estimate goods representing another 25% to 30% of our sales in total are imported from China. While many of these vendors have dual sourcing from countries in addition to China, we have less visibility here than for product we source directly, so it's also too early to determine the impact on goods we source indirectly.

We have taken a conservative view of the first half of the year, with wider projected comp ranges due to more limited visibility. The comp performance is planned higher in the back half, and given the concentration of our sales at this time of the year, provides upside for the year. An important call out for modeling is that both Q1 and Q2 are low volume quarters, which will make it difficult to make money, especially in Q1 since it will be challenging to leverage our fixed expense base given mostly negative comp assumptions.

For the year, we expect consolidated sales will range from plus 3% to up 6%. Included in our guidance for consolidated sales is between $80 million to $90 million in revenue related to the Togast acquisition. We expect consolidated comps, including direct, ranging from down 1% to a positive 2%. We currently plan to open around 30 new stores, split between 20 Journeys and 10 Johnston & Murphy locations. We continue to learn more -- or we continue to earn more than our cost of capital on our new store openings. Additionally, we are finding opportunities to enter into shared fate deals with our landlords that minimize our risk through landlord support on store build out costs, percentage rent and multiple kick out opportunities. We plan on closing approximately 20 stores. However, we will keep a store open with a short lease term if the rent deal is attractive.

We expect gross margin to be down between 30 and 50 basis points, driven by higher wholesale volume from the Togast acquisition, which carries lower margins. We expect gross margin rates for the balance of the year to improve compared to last year.

Conversely, the additional revenue from Togast and its lower cost structure benefits our SG&A leverage. In addition, for this year, we are targeting $15 million to $20 million in cost reduction, with only part of this built in. We expect our SG&A rate to improve between 20 and 40 basis points. Our baseline business is not expected to leverage due to flat to negative store comp assumptions and expense pressure in the U.K., included in our SG&A expenses and earn-out for potential payments related to the Togast acquisition that are contingent on EBIT growth targets that are not -- that were built into the acquisition agreement. Post earnout, we expect a mid-single-digit EBIT margin for Licensed Brands. This all results in an operating margin within a few tenths of last year's levels and EPS that ranges from up mid-single digits to up in the mid-teens, due in large part to the impact of share buybacks and the benefit of Togast. Share buybacks from last year will benefit our fiscal '21 EPS by approximately 9%.

We estimate that fiscal '21 tax rate will be 26.5%. Capital expenditures will be between $60 million and $65 million, inclusive of approximately $15 million for the build-out of our new headquarters. Our capital expenditures will be centered on digital and omnichannel investments, refreshing our store fleet and building out new stores. We estimate depreciation and amortization of $52 million, close to the level of spending we plan without the headquarters.

Lastly, we are assuming an average of 14.4 million shares outstanding. Our EPS guidance assumes no additional stock buybacks beyond what we've made to date, but we can repurchase availability opportunistically during the year.

Now I will turn the call back to Mimi.

Mimi Eckel Vaughn - *Genesco Inc. - CEO, President & Director*

Thanks, Mel. Following a successful first year as a footwear-focused company, I'd like to touch briefly on the rationale we laid out when we made the decision to pursue our current strategy and discuss the exciting direction we're taking in this new chapter.

Across our company, we aspire to create and curate leading footwear brands that represent style, innovation and self-expression and to be the destination for our consumers' favorite fashion footwear. Each of our businesses has a strong strategic position, grounded in a deep and ever-evolving

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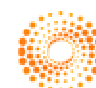

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understanding of the customer it serves. The strength of our concepts and the advantages we have built over time have established long-lasting leadership positions that make our footwear businesses outstanding on their own, but what they share through the benefits of synergies makes them even stronger together.

We're best known for being a retailer, but we have an important and valuable side of our business that successfully owns and licenses brands, giving us a good platform for future growth. Our opportunity to unlock the full potential of Genesco is to accelerate the digital and omnichannel potential in our retail businesses and to grow our branded side. We made substantial progress on this in fiscal '20, and our future plans are to further grow profit in the short-term and strengthen our strategic position for longer-term growth.

Following the recent work on the sale and unplugging of the Lids business from our infrastructure, we believe this year provides a solid baseline from which to build a new growth plan. We updated our 5-year plan in the fall using fiscal '20 as the first year, so I'd like to describe the outcome.

Beginning with the top line, we're forecasting average annual growth in the 3% to 4% range, driven by strong digital growth and robust conversion in stores. We expect operating income to grow at a faster pace than revenue as we move toward an overall operating margin of 6% by fiscal '24.

The plan I just described generates meaningful cash flow in the range of $400 million to $500 million after healthy investments in our current business. This cash flow will be used either to make acquisitions aimed primarily at building a more robust branded platform or return to shareholders, likely through additional stock repurchases.

Based on what I just outlined, we expect average annual EPS to grow in the double-digit range. Even though we expect the first half of this year to be challenging, the strength of our strategic positioning should allow us to achieve these goals over time.

In developing this plan, we aligned our business around 6 pillars, taking the strategies that have been working and adding new areas of focus. The 6 strategic pillars are: number one, build deeper consumer insights to strengthen customer relationships and brand equity; number two, intensify product innovation and trend insight efforts; number three, accelerate digital to grow direct-to-consumer; number four, maximize the relationship between physical and digital; number five, reshape the cost base to reinvest for future growth; and finally, number six, pursue synergistic acquisitions that add growth and create shareholder value.

In our fiscal '21 plan, we developed specific initiatives that tied to each of these pillars, and I will highlight just a few of them. Starting with pillar number one, build deeper consumer insights to strengthen customer relationships and brand equity. We have always had strong customer insights from our interaction in our physical locations, and we are now augmenting this with customer data and analytic efforts.

At Journeys, we recently completed work on a call center platform that gathers information from 8 disparate systems that includes transactional, behavioral and demographic information, such as past purchases, shipping preferences, social preferences and promotion history and consolidates it into a unified view of the customer. While still early, this capability has been very beneficial to our customer service reps that previously didn't have an efficient way to access complete customer data. It has enhanced our ability to timely respond to inquiries, to fix problems and to provide great overall service. With a current Net Promoter Score of 85, Journeys has a high bar to keep jumping over. Phase 2 of this project, which is now in development, will use artificial intelligence to generate insights and recommendations for our CSR team to drive their sales efforts.

Meanwhile, at Schuh, we expect to benefit this year from a CRM implementation, aimed at increasing the frequency of shopping and increasing average order value by leveraging cross-sell opportunities for customers in our database. This has included a customer segmentation effort and the development of specific customer journeys designed to drive conversion. The integration of the data repository, marketing cloud and social studio is now complete, with a go live targeted for the spring.

Moving on to pillar number two, intensify product innovation and trend insight efforts. At Johnston & Murphy, the team has refined its brand architecture and product assortment across all categories, with a focus on 3 key collections. The core J&M line continues to be the largest revenue driver, offering a broad assortment across footwear, apparel and accessories. Based on its recent success and strong trajectory, the brand is also putting more development behind its innovative XC, extreme comfort offering, which now accounts for over 20% of footwear sales and offers tremendous growth potential. Lastly, the product team's attention is focused on broadening Johnston & Murphy Collection, which represents the

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brand's most premium proposition and creates the brand halo with products sourced primarily in Europe. With additional clarity around brand architecture, J&M is ramping up its new product introductions, with a 30% increase in new footwear SKUs planned for fiscal year '21 in the fall, led by a 70% increase in our technical XC collection. To support the refreshed assortment, J&M will execute an integrated marketing program to drive awareness, to tell stories and to activate customers across distribution channels. This will feature 6 unique product launches throughout the year, delivering more frequent launches than ever before and will encompass J&M stores, digital catalog, wholesale partners and social.

At the same time, Schuh is making a concerted push to broaden its private label offering. With a keen eye to what the customer is picking, the product will be created using Schuh's own handwriting, focused on quality. Taking advantage of our newly constituted product team, design and development expertise, an ability to identify key trends in the market, the goal is to offer a range of styles to complement our third-party branded offering and to drive margins higher.

Turning to pillar three, accelerate digital to grow direct-to-consumer. We're working on a number of initiatives, including introducing deferred payment options at all divisions. Schuh has already rolled out a deferred payment option, which has proven to drive increased conversion and an increase in average basket size of 20-plus percent. With an eye towards Schuh's success, both Journeys and Johnston & Murphy are testing online deferred payment options. We will measure the impact on conversion, average order size and new customer acquisition and will roll out in the back half of the year. We're optimistic this will drive sales, while offering our customers a much sought after payment method.

Materially increasing Journeys e-commerce penetration is also a top priority for fiscal '21, building on 5 years of strong increases, capped with fiscal '20's 20-plus percent growth. Last year, Journeys drove a substantial amount of additional website traffic through a combination of paid media activities. This was also its first holiday season with its newly designed website that both improved functionality and optimized for mobile-first, which was especially effective since mobile is the device of choice for the Journeys customer. To fuel e-commerce in the coming year, Journeys will once again significantly increase its investment in digital marketing.

Shifting now to pillar 4, maximize their relationship between physical and digital. Fiscal '21 is all about building the capabilities for buy online and pick-up in store, or BOPIS, in North America. This is an offering we've had for some time at Schuh, which drives around 20% of Schuh's online purchases and steers customer traffic into its stores. We anticipate piloting BOPIS during Q4, with the aim of a complete rollout in the first half of fiscal '22. BOPIS functionality will be achieved through the execution of a series of projects throughout the year, including enhancing the speed of inventory updates to get to real-time inventory, replacing our store special order system and upgrading both POS software and hardware.

On to pillar five, reshape the cost base to reinvest for future growth. Our profit enhancement program has become a routine part of how each of our divisions now operates, recognizing the need to reduce the fixed expense structure of our store channel, given the growth of online. We have a number of savings priorities for fiscal '21 that Mel discussed that will constitute version 3.0 of our profit enhancement efforts.

And finally, pillar number 6, pursue synergistic acquisitions that add growth and create shareholder value. We significantly bolstered the prospects for our Licensed Brands division by securing the rights to the Levi's footwear license for men's, women's and kids in the U.S., along with our acquisition of Togast late last year. There were a number of factors that made this an attractive acquisition. For starters, Levi's is one of the most recognized apparel brands in the country, with a heritage dating back almost 170 years. The Levi's brand halo and casual aesthetic is an excellent launching point for footwear and drives consumer awareness and consideration across the spectrum of footwear categories from canvas to boots.

The acquisition also provides sourcing and operational strengths. Togast has a highly capable sourcing office in China with full product development capabilities. The combination of the Licensed Brands and Togast businesses gives us considerable scale and access to a wider range of constructions and price points that complement our existing range of products.

In terms of synergy, Levi's current distribution is weighted towards the value channel, which unlocks new distribution for our existing licensed brands portfolio, while our higher-tier retail channel relationships and sourcing provide Levi's with potential new door growth. Importantly, this transaction strengthens our relationship with Levi's and enhances our sourcing platform, giving us the ability to add more brands and licenses in the future. We are truly excited about the Togast addition, and we welcome its talented people to our company.

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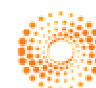

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With the entire organization aligned on these 6 strategic pillars, Genesco is prime for a successful future. Before we move on to fiscal '21, we have a lot to celebrate about fiscal 20. Together, we've accomplished so much, and I'd like to extend a sincere thanks to all of our very talented people across our organization for their dedication and hard work. Our success speaks to the value of the skill and the experience and commitment to excellence of you all.

Before we close, I'd also like to thank everyone for their concern about last week's devastating tornadoes here in Nashville. We're pleased to report that none of our people or their families were hurt and none of the company's facilities were damaged. We have some employees who sustained damage to their homes, and we're doing all we can to help our people and the wonderful community we live in, get on the path to a speedy recovery. Our hearts go out to those who have been impacted by the devastation and losses.

And now I'd like to turn the call over to the operator for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We will take our first question from Mitch Kummetz with Pivotal Research.

Mitchel John Kummetz - *Pivotal Research Group LLC - Senior Analyst of Footwear, Apparel Vendors and Retailers*

So Mimi, I know you don't like to speak to quarter-to-date trends, but given the special kind of circumstances here, I was hoping you can maybe address a few things. You called out in your release, also in your comments the impact on COVID-19 on airport and tourist stores. Could you maybe speak to how those are trending versus maybe the balance of the change? Can you talk about maybe how many of your stores you would characterize as airport and tourist? And then if you could talk a little bit about what you're seeing elsewhere within the business, particularly in some of those areas that have been maybe most affected, like, let's say, at Seattle, so maybe we could start there.

Mimi Eckel Vaughn - *Genesco Inc. - CEO, President & Director*

Yes. So Mitch, I -- thanks for your questions, and I know there are a lot of questions about the impact of COVID-19 and the coronavirus, and I want to start by just talking a little bit about our trend. And starting with the trend in January and February and March, we can typically sell a lot of boots at Journeys if the weather is cold, and February is usually helped by tax returns. Last year, we did exactly that, we sold a lot of boots. This year, the weather was warmer, and we didn't sell as many boots as we would have if the weather had been cold. We saw a decline in store traffic at this time really over the late January into February time period, and maybe the customer decided that I'm going to perhaps wait until spring. I'm going to wear what I have now and wait until the season turn if the winter isn't going to last for long. So then we ask to what extent is coronavirus having an impact on consumer demand, and we have to really discern how much is trend and how much is the impact from the coronavirus. We certainly have been seeing an impact on traffic and tourist locations, really in places in the U.K. like London and Edinburgh, and places they call the pretty cities, which are places like York and Bath, where lots of overseas tourists come to visit.

On the West Coast in the U.S., we've also seen some impact, mostly from tourists, and as I mentioned, in airports. And wherever we have an airport location, we've been impacted. I'd say we've started to see some impact beyond tourist locations recently, but it is fairly recently that we've seen that impact. So it's a matter of discerning how much is trend and how much is impact from the coronavirus. So we've built in only what we've seen so far in guidance. This is very obviously a dynamic and evolving situation. We don't know how far it will go or exactly how long it will last, and it's too soon to know how much this will specifically affect consumer spending.

So we've been through situations like this before, Mitch. It might hurt mall traffic for a time, but it will eventually be under control, and we're going to benefit on the other side of this from pent-up demand, and we typically tend to come out stronger on the other side.

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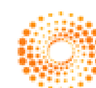

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In the meantime, our digital business can pick up some of the slack. We haven't had that tool at our disposal in prior times when we have seen a demand shock. So we think that we can benefit from some of the pent-up demand that will come out of the other side. So in the meantime, it's a rapidly evolving situation that we're paying attention to, and we are customizing our responses to what we see.

Mitchel John Kummetz - *Pivotal Research Group LLC - Senior Analyst of Footwear, Apparel Vendors and Retailers*

And can you say how many stores are tourist and airport?

Mimi Eckel Vaughn - *Genesco Inc. - CEO, President & Director*

We have a handful of airport locations, in the neighborhood of 20 to 30 locations. And our tourist stores, really, a lot depends on how you define it, define those. We would define those as big cities like New York and L.A. and San Francisco, and Orlando would be one of those as well. The vast preponderance of our stores are in non-tourist locations. It's really the -- a smaller portion of the number of our stores are in tourist locations.

Mitchel John Kummetz - *Pivotal Research Group LLC - Senior Analyst of Footwear, Apparel Vendors and Retailers*

And then on Journeys for Q1, you're guiding to a comp of down 7% to down 3%. I was hoping you could kind of break that out a little bit. How much of that is the softness in boots to start the quarter versus any kind of drag from COVID-19 that you're seeing versus just the underlying trend within kind of the core nonseasonal part of your business?

Mimi Eckel Vaughn - *Genesco Inc. - CEO, President & Director*

Sure. So just to start with boot performance. Boots gave us a solid performance during the course of the holiday, but it was very brand specific. We started out with a burst of cold weather at the beginning of November, and the update we gave you at ICR at the beginning of January, we said we were really pleased with how boots has sold over the holiday season. I think that a lot of the softness that we saw in late January to February was due to weather, among other things, and we didn't see the same sell-through on boots that we would have otherwise seen. Most of what we sell when it comes to boots is fashion, but it helps to have cold weather. Some of the more fashion-related boots sold through nicely. Some of the more weather-dependent ones, not so much. And so that really is what we took as a trend going into the first quarter.

As far as you know, we sell a lot of retro athletic product. When the cycle first started, there was a lot of upside to sell something new into people's wardrobes and into their closets. We like the cycle because of stretches across a number of athletic brands. We have a lot to work with in the catalog of retro product. We still do see legs to this cycle, but it's very brand-dependent, there are some are performing well and some, not performing well. We are also very excited about the more casual side of our business, both what sells in the summer and also fashion boots in spite of what happened over the late winter seasons, and it's good to see this casual growth. We've been very athletically driven over the course of the last few years, but casual to the diversification.

Operator

We'll take our next question from Jonathan Komp with Baird.

Jonathan Robert Komp - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Maybe, first, just a follow-up to the last discussion there. Just more along kind of the casual assortment at Journeys. When I look at the website today, there's a lot of Crocs, Doc Martens and even Converse. Are those the types of brands that you think can keep the assortment fresh and working as you look ahead in what's embedded in the outlook for Journeys? Or just any thoughts on kind of the sustainability of the current assortment that you have?

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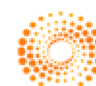

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Mimi Eckel Vaughn - *Genesco Inc. - CEO, President & Director*

Sure. So I would start by saying that I think looking at Journeys' overall performance in the fourth quarter, we were going against a 2-year stack of '18 and put a positive 1% on that. So when you think about 3 years, we gained 20% in our Journeys business, which I think is really a measure of gaining market share. And fashion is constantly rotating at Journeys. We are selling what that teen consumer wants to buy. And when we look at our assortment, certainly for the spring, we see some really nice opportunities in some of the brands that we're offering. And interestingly, what we see is that we have -- we still have nice conversion in our stores. It really has been a function of traffic. And so I think strong conversion in our stores is a measure of when people walk into our stores and cross the lease line, they like what they see. It's really a matter of traffic is the issue that we have been facing over the more recent weeks.

Jonathan Robert Komp - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay. That's really helpful. And then maybe a broader topic, understanding this is probably difficult to answer and maybe shifting day-to-day, but just curious maybe how you think more broadly about contingency planning and protecting the business when you have a 4% operating margin and yet, seemingly, pretty low visibility in terms of the near-term demand and some of the macro factors out there. Just how do you conceptually make sure you're protecting the business in that environment?

Mimi Eckel Vaughn - *Genesco Inc. - CEO, President & Director*

Yes. It's a great question, and I think that's top of mind for many companies these days in terms of what to do in reaction to the current virus situation. And Jon, I'd say the really good thing is that we have really experienced teams who have been through lots of cycles over the years, whether it be The Great Recession or product rotations, we -- you know our teams, we've got a lot of long tenure in our teams. The health and safety of our people is really most important, and we're taking all the necessary actions here. We have traffic counters in stores. We can react and adjust to staffing levels as needed, and we're going to manage expenses and capital spending very carefully. It's a matter of really managing your business carefully through all of this. Again, over the long term, I think that the situation -- situations like these hurt mall traffic in -- for a time. But eventually, when these situations get under control, we will benefit from the pent-up demand that's out there. And long term, the strength of our businesses and the strategic positioning is what helps us to get to the other side of these things. The retail environment typically has a shakeout during these times, and strong retailers do well and weaker retailers find it hard to survive.

Operator

And we'll take our next question from Janine Stichter with Jefferies.

Janine M. Stichter - *Jefferies LLC, Research Division - Equity Analyst*

I just had 2 more clarifications on the guide, if you could just help me understand what's embedded. So you mentioned the slowdown in airport and tourist locations, are you embedding any broader slowdown outside of those stores in your comp guidance? And then on the gross margin guidance, is there any impact from either needing to help expect goods that you source directly or from name to markdown product that maybe arrive a little bit late? Just help me understand kind of what's in there.

Melvin G. Tucker - *Genesco Inc. - Senior VP & CFO*

So just on the sales guide, Janine, we didn't build anything incremental into what the guide is beyond what was in our current business related to the trends within our business, so nothing additional built into that.

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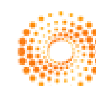

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Mimi Eckel Vaughn - *Genesco Inc. - CEO, President & Director*

Yes. And just before we answer the rest of the question, Janine, there are so many permutations of what could happen that we can only build in what we know. As far as -- and I'll turn it back to Mel to just talk about expediting product and adjusting for gross margin from late product deliveries.

Melvin G. Tucker - *Genesco Inc. - Senior VP & CFO*

Yes. So we really, from an expediting product, we don't really think that we have too many issues there. I think, from a supply perspective, it's from peaking to our divisional prices, we feel pretty good about being able to get product in, so I don't think there's going to be any supply constraints. Probably the only real issue on the margin line in the front half of the year is we have a little bit more cost of inventory in our Togast business, which was acquired in Licensed Brands. So our margin profile will be a little bit lower in the front half of the year. And as we sell-through the inventory we have on hand, the margins in that business will improve. So the margins will be a little bit lower in Q1 and Q2. And also, we're clearing additional product at Schuh, as we mentioned, and it's driving a lot of incremental revenue in the first quarter. But I think the first 2 quarters, a little bit challenged on the margin line, but it's built into our full year guide.

Mimi Eckel Vaughn - *Genesco Inc. - CEO, President & Director*

Yes. So for now, I think, and to sum that up, when you think about Chinese New Year, we had a lot of product that was completed and put on the water. And so we tend to be in a good inventory position at the present moment, as Mel said. On the supply side, we -- most factories are up and running for a product that we source directly. We have good visibility into the things we source directly. What we get from third-party vendors, we've not heard of many delays yet, Janine, and that's the large majority of our business, but it's a bit too soon to tell. As we get into the second quarter, May and June are lower-volume months for us, and so we're in stock for much of what we need for spring. May and June will be lower volume months for us. When we need to start building inventory is a few months from now, which is really back into June and July for our Journeys business when we begin to stock up for Back-to-School. We're landing a lot of fall product at that time, too, in addition to Back-to-School product. And so time will tell the extent to which we've got to expedite additional product, and to the extent that, that happens, it will be into the second quarter.

Janine M. Stichter - *Jefferies LLC, Research Division - Equity Analyst*

Okay. Great. That's helpful. And then just shifting gears a little bit. You've had some pretty consistent success with reducing rents and now we're hearing even more so than ever, some of the balance of power shifting back into the hands of the tenant. So just any update on kind of what you're seeing in your conversations with your landlords? And if you feel like there's an opportunity for even maybe more significant rent reductions?

Mimi Eckel Vaughn - *Genesco Inc. - CEO, President & Director*

Yes. I think I'll give some commentary, and then let Mel just talk about what we have been seeing. But we have been paying a lot of attention to our fixed rent expense structure for really the last 3 years. We have had quite a lot of success here on, not only getting rent reductions, but on shortening lease life, and what's important is that we are working to variabilize rent expense to the extent we can, and that's the whole reason behind the shortening of the lease life is that if we can sign a shorter-term renewal, then if traffic goes up and sales go up, we're happy to pay more rent. And if it doesn't, then we have an opportunity to adjust again.

Some of what we've been seeing Mel made reference to in our prepared remarks, where we are entering into agreements with some of our landlords on these shared fate deals, where they help us with capital, they actually give us variable rent upfront. We have an opportunity to have multiple kickouts, and that is a way to just minimize risk, and so we can move rent expense up and down according to how sales unfold. And to the extent that we find ourselves in a situation where we don't want to be in a store, we have the flexibility and the opportunity to exit. Mel, would you add anything to that?

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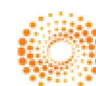

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Melvin G. Tucker - *Genesco Inc. - Senior VP & CFO*

Yes. I mean I think you nailed it. I mean I'd say that one more thing I'd add to it is this we hit about 15% of our stores per year, so we've got quite a few more years of getting 2 stores and having a chance to renegotiate these renewals, and I'm especially excited by the fact that more and more of these deals we're entering into can be shared pay deals. And the more we can do that, the more we can protect on a downside as well. So we're making good progress, and I think we've got plenty of runway to keep doing that.

Operator

We'll take our next question from Steve Marotta with CL King & Associates.

Steven Louis Marotta - *CL King & Associates, Inc., Research Division - MD & Director of Research*

First, just to put a fine point on -- I know you don't provide quarterly guidance, but you've provided a little bit of color. Assuming negative EPS on a year -- literal negative EPS, not just the comparison on a year-over-year basis, in the first and second quarter is not unreasonable, correct?

Mimi Eckel Vaughn - *Genesco Inc. - CEO, President & Director*

Yes, that's correct. We were expecting that it's going to -- we had a really strong first quarter of last year, and we're expecting to go backwards. So I think we said that we think it might be -- it will be difficult to make money in the first quarter based on the current negative comp projection. And then even into the second quarter, we expect that we will go backwards. And depending how far backwards we go, it may also be challenging. These are just simply very low-volume quarters where we are hanging on with our fixed expenses to try to get to the back half of the year with Back-to-School and holiday, where we make a lot of our profit.

Steven Louis Marotta - *CL King & Associates, Inc., Research Division - MD & Director of Research*

I wanted to put a fine point on that. And then you've mentioned that your annual guidance assumes nothing incremental outside of the current trends, but it does assume some sort of normalization at some point. Is that a normalization assumption starting tomorrow to mean to the average comp expectation for the balance of the year? Or is that something that starts at the end of the first quarter or at the end of the second quarter? When is your inflection point to what would be considered normalized trends?

Mimi Eckel Vaughn - *Genesco Inc. - CEO, President & Director*

Yes. So I think what we've done is we have -- if you look at our overall comp guidance we've given by quarter, we have been most conservative with comps in the first quarter. And even getting into the second quarter, we think that there is a possibility that we could have negative comps, but there's also a possibility that we start to round out at the end of the second quarter, but the whole situation with the coronavirus' dynamic. And I would say -- it would be safe to say that if the situation unfolds further that we haven't built in any additional impact. So our guidance reflects what we've seen so far, and what we've seen so far says that the first half is going to be challenging, but that we have a chance in the back half based on the product trends we're seeing and then also based on the compares. If you look at fiscal '20, we had our strongest comps in the first half of the year, and towards the back end of the year, we gave back a little on comp, so we expect the opposite to happen this year. A couple of other things that I'd point out is that the Togast business that Mel gave you, the economics about we need to add in, and that adds to both the top line and the bottom line we expect for this year. The year we've just finished had quite a bit of bonus built into our numbers, and so we never like to give back bonus, but it does provide some cushion to the extent that this year faces some challenges.

And then finally, the share buybacks that we've had out there that we've completed already has about 9% to this year as well. And so when you look at our overall guidance, it assumes the addition of some new revenue. It's actually at the midpoint assumes that our base businesses go back a little bit. And then we've got some cushion from the bonus. And then finally, share buyback is a help on the EPS side.

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Operator

The last question comes from Sam Poser with Susquehanna.

Samuel Marc Poser - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

I've got a couple. Can you give us some idea of the range of volume out of Togast? And how much you're foreseeing that business as a -- how many bps that alone may impact the gross margin, let's say, in the first quarter as it liquidates, not sort of taking away the fundamental issue that the gross margin there is lower than other parts of the business?

Mimi Eckel Vaughn - *Genesco Inc. - CEO, President & Director*

Yes. So I'll start with the color, and then I'll turn it to Mel to give you the specifics in the first quarter. But this Togast opportunity is a great opportunity. We really like the fact that we've added Levi's as a brand to our portfolio, and we've brought on board a terrific team to complement our Licensed Brands team. Our Licensed Brands business is more front-end, front-of-the-year loaded. The Togast business was more back-end of-the-year loaded. We have some nuances in the acquisition where we bought some pressure on gross margin in the first part of the year, as Mel mentioned. And in the back part of the year, we'll work through some of the inventory that we're taking on, which gives us more upside for gross margin. But Mel, if you want to talk specifically about where we see the first quarter gross margins?

Melvin G. Tucker - *Genesco Inc. - Senior VP & CFO*

Yes. So for the year, we guided 30 to 50 basis points down in gross margin rate, and a lot of that is due to the addition of Togast and wholesale business, lower margins, $80 million to $90 million of revenue. But as I mentioned with Janine is that there are additional royalties and commissions and cost of goods that we have in the front half of the year, that as we cycle through that inventory, our margins as the year progresses. So if you think about that 30 to 50 in the front half, it's probably twice that as far as the pressure in the front half, and it gets better as the year progresses, and it actually flips in the back half.

Mimi Eckel Vaughn - *Genesco Inc. - CEO, President & Director*

Yes, and even more pressure probably in the first quarter than in the second.

Melvin G. Tucker - *Genesco Inc. - Senior VP & CFO*

The first is the worst.

Samuel Marc Poser - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

And could we see gross margin down like 80 to 100 basis points in total in the first quarter?

Melvin G. Tucker - *Genesco Inc. - Senior VP & CFO*

Yes, yes.

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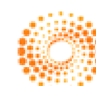

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Mimi Eckel Vaughn - *Genesco Inc. - CEO, President & Director*

And even a little more than that.

Melvin G. Tucker - *Genesco Inc. - Senior VP & CFO*

Yes.

Operator

That concludes today's question-and-answer session. At this time, I would like to turn the conference back to Mimi for any additional or closing remarks.

Mimi Eckel Vaughn - *Genesco Inc. - CEO, President & Director*

Thank you all for joining us today, and we look forward to giving you updates on our next earnings release.

Operator

That concludes today's presentation. Thank you for your participation. You may now disconnect.

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