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EDITED TRANSCRIPT

GCO - Q1 2016 Genesco Inc Earnings Call

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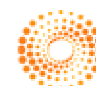

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PRESENTATION

Operator

Good day, everyone and welcome to the Genesco first-quarter fiscal 2016 conference call. Just reminder, today's call is being recorded. 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 to the Company's SEC filings, including the most recent 10-K filing for some of the factors that could cause differences from the 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 schedules available on the Company's home page under Investor Relations. I will now turn the call over to Bob Dennis, Genesco's Chairman, President and Chief Executive Officer. Please go ahead, sir.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Good morning and thank you for being with us. I am joined today by Chief Financial Officer, Mimi Vaughn.

The first quarter played out almost as we had expected. Adjusted earnings per share were $0.51 compared to $0.81 last year, but $0.04 below our internal expectations and roughly $0.03 of this shortfall was related to an unpredicted and substantial spike in medical and workers' comp claims. Therefore, our operating businesses in the aggregate pretty much delivered the performance we anticipated.

Total sales increased 5% to $661 million with consolidated comps up 4%. Performance was once again driven by strong trends in our direct businesses. Direct comparable sales grew 27% and stores were up 3%. Direct as a percentage of our retail businesses increased to over 8% this quarter. The annual EPS outlook we announced on our last call reflected expectations that the quarter and indeed the first half would be down considerably compared to last year.

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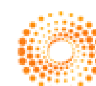

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The difference in our year-over-year earnings for the quarter was driven by a handful of anticipated factors heavily weighted to the Lids Sports Group. Before we run through these factors, I want to reinforce our conviction that the Lids Sports Group that we are seeking to capture a significant strategic opportunity represented by becoming the leading omnichannel provider of licensed sports merchandise in the US. The road to this compelling strategic goal has been bumpy and it is likely to remain bumpy for the next several quarters, but this does not diminish our enthusiasm for the long-term prospects of what we are building at Lids.

That said, here are the most significant challenges that we foresaw going into the quarter. First, we expected substantial gross margin pressure in the Lids Sports Group due to higher promotional activity and we actually experienced even more than we expected as we executed our plans to rightsize inventories. Simply put, we are doing what we need to do to get clean and fresh.

Second, the licensed sports merchandise category is predominantly a fourth-quarter business and yet we carry store and other expenses throughout the year. There was a substantial weight on earnings during the first-quarter results from the addition of 78 Locker Room by Lids stores and 154 Macy's shops to the store base since the end of last year's first quarter. As we have grown Locker Room by Lids through new and acquired stores and launched Locker Room by Lids at Macy's, the deleverage from lower sales during the, quote, off-season as reshaped the quarterly breakdown of our earnings as we carry the expense through the year. And many of these new stores have underperformed their pro forma, which is in our guidance, exacerbating the impact on the first half. This overall dynamic has moved a greater percentage of our annual earnings out of the first half and into the second half and particularly into the fourth quarter.

Third, in order to grow our overall e-commerce business, meaning all of Genesco, as aggressively as we have, we experienced a significant decrease in gross margin in certain of Genesco's businesses due to promotional activity and increases in expenses due to freight, warehousing, marketing and infrastructure.

Now let's turn to some better news. Journeys' performance was once again the highlight of this quarter. Despite challenges from the West Coast ports, Journeys delivered a solid comp benefiting from continued strength in casual footwear plus newness on the fashion athletic side, which is particularly important as we transition into spring and summer. This favorable fashion cycle, augmented by superb execution on a number of important strategic initiatives, has fueled the sales momentum Journeys is experiencing once again this year. And we believe this demonstrates the long-term viability of Journeys and its strategic advantage as the only nationally scaled fashion footwear retailer for teenagers and young adults.

Given that comps for the quarter would have been even better without the West Coast port delays, as evidenced by a solid rebound as we caught up on the inventory shortfall, Journeys feels increasingly confident about the trends in the second quarter and its prospects for back-to-school and the balance of the year.

Looking ahead for the total Company, the second quarter is off to a good start from a top-line perspective. Through last Saturday, comps were plus 7% companywide with stores up 5% and direct sales up 28%. While our overall first quarter came in close to plan and we are pleased with the sales trend in May, we are injecting more caution into our outlook for the Company over the balance of the year. Mimi will go through guidance in more detail in just a moment, but, in short, we believe that the remaining work to be done on the Lids turnaround will entail more pressure on gross margin and more incremental expense than we originally thought.

To be clear, we are determined to do what it takes to have Lids inventories in good shape by year-end. That is our priority. Although the work to be done at Lids accounts for most of the reduction from previous guidance, we are also flowing through the $0.04 miss versus our internal plan from the first quarter and are taking a more conservative approach to shoe based on mix-related gross margin pressure and choppy sales.

In total, we are lowering our full-year EPS range by a little under 8% from $5.10 to $5.20 per share down to $4.70 to $4.80 per share. While we are certainly disappointed with our reduced outlook, especially given our previous downward adjustments, we are confident that the steps we are taking at Lids are the right actions to get the business back on track and to capitalize on the strategic opportunity to build the leading omnichannel retailer of licensed sports merchandise in the country. We believe strongly in the opportunities in the Lids businesses and have confidence that when the turnaround is behind us, we will be back on the path to profitable growth for Lids.

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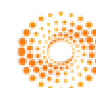

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Now Mimi will walk through the financial results for the quarter and take you through our guidance, after which I will come back and add a little more color on performance and outlook for each of our businesses. Mimi.

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

Thank you, Bob and good morning, everyone. As a reminder, we have posted more detailed information online in our CFO commentary, so I will highlight a few important points from the reported results. In the first quarter, we had solid sales across all of our retail businesses with total sales up 5% over last year to $661 million. This was driven by a 4% increase in consolidated comp sales, an increase in non-comp sales of approximately $6 million, including the opening of 15 new stores and an increase of 4% in wholesale sales.

By division, total comps were up across the board, up 5% at Journeys, 4% at Schuh, 3% at Lids and 3% at Johnston & Murphy. Consolidated store comps were up 3% and direct comps were up 27%, which pushed direct as a percent of total retail sales to over 8% for the quarter compared to 7% a year ago. Sales ticked up after the Easter offset driven by warmer weather and the receipt of spring and summer goods and these solid trends accelerated into the second quarter. Consolidated comp sales for the second quarter to date through last Saturday, May 23, are up 7%. By division for the second quarter to date, total comps are up for all of our retail businesses again, up 7% at Journeys, 4% at Schuh, 7% at Lids and 8% at Johnston & Murphy.

Consolidated store comps for the second quarter to date are up 5% and direct comps are up 28%. The effect of Lids turning on locate and giving online access to an additional 50,000 plus SKUs in the stores continues to be dramatic. As a result of this cross-promotional activity, Lids direct comps quarter to date are up 54%.

Now adjusted gross margin for the quarter decreased 90 basis points from last year, a little more than expected, to 49.4%. As expected, gross margins in all the Lids retail businesses were down as we executed our plan to freshen inventory. This was most evident in Lids e-commerce, which has proven especially effective as a channel to clear promotional merchandise. Margins at Schuh were down in part because the sales mix in the first quarter rotated to a heavier weighting of brands with lower initial margins. Johnston & Murphy margins were down a little due to a heavier weighting of wholesale sales and reductions to clear seasonal merchandise. Journeys' adjusted gross margin was flat on a year-over-year basis.

Total adjusted SG&A expense increased 110 basis points to 46.4%. This SG&A increase was driven primarily by three key factors, which Bob already touched on -- increased square footage largely from new and acquired Locker Room stores, which added rent and selling salaries, increased e-commerce expense, including shipping from stores and marketing spend; and increased investments in technology and distribution centers relating to e-commerce and omnichannel.

Furthermore, our US retail businesses were not able to leverage selling salaries as a result of wage pressure and weak performance of noncomp stores. With the gross margin and SG&A headwinds, adjusted operating income for the quarter decreased by $12 million, or 37%, to $20 million. Operating margin decreased 200 basis points versus last year to 3% and first-quarter adjusted EPS was $0.51.

Turning now to the balance sheet, inventory was up 8% year-over-year with retail square footage up 7% and sales up 5% for the quarter. Journeys inventory was up 7% on a square footage increase of 1%. Journeys was affected by the port situation during the quarter. Journeys not only caught up with the delayed receipts, but actually brought their inventory up over last year by the end of the quarter by pulling forward product to capitalize on anticipated strong second-quarter sales.

Lids' inventory was up 12% on a square footage increase of 17%. Our plan to rightsize inventory at Lids is making good progress. To reiterate what Bob said, we are firmly committed to do what it takes to hit the inventory targets at Lids and we now expect to reduce inventories to the higher end of the targeted 10% to 15% range by year-end.

Finally, capital expenditures were $24 million and depreciation and amortization was $19 million for the quarter. We ended the quarter with $90 million in cash with no borrowings under our domestic credit facility and $28 million of UK debt. We did not repurchase any stock during the quarter.

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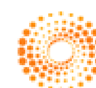

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Next, turning our attention to guidance, as Bob emphasized, we believe the work that remains to be done on the Lids turnaround will cost more in gross margin and incremental expense than we initially expected. We are taking a more conservative approach to Schuh as well given the lower gross margins and choppy sales in the first quarter.

Taking this and first-quarter results into account, we are lowering our full-year EPS range by a little under 8% from the prior range of $5.10 to $5.20 per share to a new range of $4.70 to $4.80 per share. As a reminder, we are benefiting this year from the conclusion of the Schuh acquisition incentive we put in place when we purchased Schuh several years ago. Last year was the final year of expensing the incentive that was earned and there will be no P&L expense related to it in the current year. We will, however, pay out the long-term incentive earned in full during the second quarter, which reflects Schuh's outperformance to expectations since the acquisition. Congratulations, Schuh.

A couple of other reminders from our previous guidance. We still anticipate that the strong dollar will remain a headwind and weigh down earnings by $0.07 per share for the year assuming exchange rates stay where they are. We also still expect that increased expense from a legacy pension plan will reduce full-year earnings by another $0.05 per share. Now, while we do not give guidance on a quarterly basis, we want to highlight that earnings from the third and fourth quarters last year contributed 76% of the earnings for the year. We made the point on our year-end conference call that we expected it to be even more heavily weighted to the back half this year, significantly more heavily weighted thanks to factors including the higher concentration of the Locker Room and Locker Room by Macy's businesses, which are heavily fourth-quarter businesses as we have said; the Lids promotional activity we are conducting most heavily in the first part of the year; and the West Coast port backlog. We would now add to these factors the recently announced shift of some tax-free holidays from the second into the third quarter in several states.

As we predicted, the impact of these influences was acute in the first quarter, but we also expect a substantial impact in this quarter as well. The effects of the Lids initiatives, among others, will be magnified by the fact that Q2 is the quarter with the lowest sales and earnings of the year. Consequently, we expect that earnings will again be down significantly as a percentage from last year in the second quarter of this year. We anticipate that total sales for the year will increase 4% to 6% with consolidated comps, including direct, increasing 3% to 4%. We are planning on opening 115 new stores concentrated in concepts other than Lids.

One thing we would like to mention is that since we now have the capability to ship e-commerce orders out of the Lids stores, we will be putting the expense of the shipments into SG&A consistent with our treatment of store shipments from Journeys. There is no bottom-line impact from this change, but it does alter the breakdowns we gave you on last quarter's call as the expense shifts from gross margin to SG&A. All guidance numbers for this quarter and in the future will reflect this change.

We expect gross margins to be down a little for the year overall for the Company. This includes a gross margin decline at Lids from an already low base and relatively flat margins at Schuh offset somewhat by improvements in other businesses. In our revised guidance for at least the first three quarters, overall gross margins will take a hit as we promote to rightsize inventory at Lids. And then we believe will improve somewhat in the fourth quarter.

Next, we anticipate SG&A expense as a percent of sales will be flat to down slightly in the range of 10 basis points compared with last year. We will have difficulty leveraging comp this year due to the extra promotional activity and expenses we have described. This results in an operating margin that is down slightly for the year. Our fiscal 2016 tax rate is expected to be 36.8% and is a bit lower than last year because of a higher proportion of overseas earnings.

Looking at the balance sheet, we expect inventories at year-end to be flat to up just a little, including up to a 15% reduction at Lids. We are planning capital expenditures in the $115 million to $130 million range, up a bit from last year's levels. We anticipate spending on e-commerce, omnichannel, distribution center and other non-store capital to be a sizable portion of these amounts, but also in line with last year's levels. Depreciation and amortization is estimated at approximately $81 million. We are assuming average shares outstanding of 23.8 million for the year. We have not included any stock buyback in this guidance. However, we have $61 million remaining on our stock repurchase authorization of $75 million. Now I will turn the call back over to Bob.

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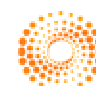

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Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Thanks, Mimi. Let's talk about the key factors in the performance of our individual business units in the first quarter and our current outlook for them starting with Journeys. It was another solid quarter at Journeys after a fantastic record-breaking year as the buying team continues to be on trend with a narrow and deep assortment that reflects the current fashion cycle. The quarter benefited more than usual from the sale of boots, particularly early in the quarter when much of the country was experiencing record low temperatures. These extra boot sales enabled Journeys to end the winter selling season in a very clean inventory position, ready to bring in spring merchandise.

The West Coast port situation was a challenge. Given the strong 16% comp in the fourth quarter, Journeys inventory going into the year already light was affected by shipment delays in March and the beginning of April. We estimate that the delayed deliveries lowered Journeys' comp by about 3 points in the first quarter. Journeys caught up with the delays by the end of April and once spring merchandise hit the selling floor, Journeys' comps accelerated as seen in the second quarter-to-date results.

Importantly, the initiatives we spoke about on our last earnings call continue to fuel gains in traffic and conversion and should be a tailwind for Journeys this entire fiscal year. These initiatives include an increased investment in catalogs and digital marketing where we are seeing a high ROI from driving traffic to both the website and stores and adjustments to the store staffing model to take better advantage of peak shopping hours. One challenge Journeys faces is the wage increases that affect all our selling retail businesses. As expected, Journeys was not able to leverage selling salaries despite its 5% comp in the quarter as a result of higher wages, as well as increased investments in marketing, some of which was quarter-to-quarter timing.

Because of this and other expenses, Journeys was not able to leverage the comp in the quarter. Journeys is testing a specific initiative to address high turnover by bumping up assistant manager pay. If the results of these tests are positive, Journeys plans to roll this out in the back half of the year, which will add to additional wage pressure in the short term. But as I mentioned earlier in the call, Journeys is optimistic about the balance of the year given its first-quarter performance and current trends and higher sales in the back half should enable better leverage.

Now to Schuh. As we discussed, the business was off somewhat to plan during the quarter. Despite the fact that Journeys and Schuh sell many of the same brands, the UK market has experienced a decoupling from certain fashion trends and brands that are driving Journeys' business. In addition, traffic in the London stores of late has been affected by the decline of tourism related to currency in oil prices, which inhibit travelers from the rest of Europe and the Middle East. Sales have picked up following the Easter offset, but we are still prepared for choppy traffic patterns going forward.

Schuh's e-commerce sales continued to be strong in the quarter, facilitated by their new responsive Web platform, which has boosted conversion. Finally, in March, Schuh opened a store at a mall just outside of Dusseldorf, Germany. We are pleased that initial sales have been running above plan for the store. We have been eyeing Europe for some time to see if there's an opportunity for the brands that Schuh carries coupled with a full-service model. While these are early days, if the results in Germany prove out, we will expand our testing on the continent with more store openings.

Turning to Lids Sports, we've been pretty detailed about the promotional activity and the expenses that caused the decline in profitability and disappointing results in the quarter. Focusing on execution instead of square footage growth is an important element of the turnaround plan and has enabled us to get on track to restore Lids' business to a higher level of profitability. However, as we cycle through all the discounting required to rightsize inventory, profitability will be challenged into the back half of the year.

I will walk through the top-line performance of each of the Lids businesses and give color on some of the initiatives to improve financial performance. But overall the Superbowl and the Final Four did not substantially swing the business one way or the other in Q1. In the second quarter, the NHL and the NBA playoff lineups look to be favorable thus far.

In the hat business, comps were negative in Q1, but are now improving. As part of the plan to address inventory, Lids cleaned up merchandise in the headwear stores and shipped a significant amount of product back to the warehouse to clear it online. These actions showed immediate benefit in the hat stores. As a result of a fresher assortment of merchandise and a store that is easier to shop, comps have turned positive and gross margins have improved in the second quarter.

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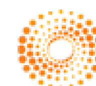
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We have spent time analyzing the overall health of our hat business. The run-up in snapbacks in fiscal 2012 and 2013 turned what was already a good business in the hat stores into a great one. Then what Lids gained in those years it largely gave back in fiscal 2014 and 2015. It is important to note, however, that both gross margins and store four-wall margins in our hat stores are as strong as they were prior to the run-up in snapbacks and a very good business then remains a very good business today.

Importantly, with the growth in e-commerce and the decline in mall traffic, we have been pruning any marginal store locations in the network as leases come up for renewal, which should enhance overall four-wall profitability going forward. And naturally, we have been doing the same thing at Journeys as well.

Next, at Locker Room by Lids, negative comps in February from the anniversary of the Seahawks' Superbowl win last year were offset somewhat, but not entirely, by positive comps the rest of the quarter. The pattern of comps was similar in Locker Room by Lids at Macy's as the business anniversaried both the Seahawks and Broncos Superbowl presence from the year before. And remember, of course, the vast majority of these stores are less than one year old. We continue to do the work to capitalize on the good potential we see in the Macy's opportunity.

We've already touched on the extremely strong Lids direct comps powered by promotions and access to inventory in the stores to relocate. While promotional sales are up strongly, nonpromotional sales have been running up almost 40%.

Beyond e-commerce, store sales are benefiting from locate too. We launched the tagline Any Team, Anytime, Anywhere to alert our customers about our new capabilities. Store associates are now able to quickly and efficiently fill orders that come into their stores from other stores or via the Web and we continue to have success with customer-facing kiosks in the stores to facilitate sales, especially to displaced fans. With the system up and running, our focus shifts to fine-tuning locate's algorithm in an effort to maximize profitability.

One goal obviously is to have as many multiple unit orders as possible leave from the same location to reduce our shipping expense. And while we are updating our systems initiatives, we are pleased to report progress on auto store, a robotic system that facilitates picking to expedite both e-commerce orders and store replenishment. This system is fully constructed. We have tested it to ship selected orders and we are now in a slow controlled rampup. We expect ultimately to save significantly on warehouse labor when we are fully live with the system.

Turning briefly to Johnston & Murphy, after a slow start to the quarter due to weather, which particularly affected J&M given its concentration of stores in the Northeast, J&M's comps accelerated in each subsequent month and results in the second quarter-to-date show an even stronger trend. Men's footwear sales have been good, especially in the dress casual category. Despite these gains, lower comps in the stores made it challenging to leverage higher rents and investments in e-commerce, warehouse and omnichannel initiatives challenged higher profitability in the quarter as well.

Sales in the Licensed Brands group were down in the quarter due to concerns with a major account and fewer closeout sales, but we are excited by our plans to assume the Bass brand in our portfolio beginning with shipments of a spring line next year. We remind you that Licensed Brands' profits are pressured this year by the startup costs associated with Bass.

So before we close, I'd like to thank the entire Genesco team for their efforts this quarter, but in particular the Lids team, which is working hard to affect the turnaround and realize the significant potential upside of the business. We are committed to finishing the work necessary to allow us to enjoy stronger performance in the quarters to come and are motivated by the longer-term opportunities in all of our businesses. Thank you for joining us on the call today and now we are ready to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Jay Sole, Morgan Stanley.

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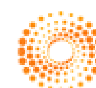

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Jay Sole - *Morgan Stanley - Analyst*

On the Lids inventory issue that caused you to take down the guidance, is the message that the Lids story is the same as it was last quarter, but it is just going to take -- it's just going to cost a bit more than expected to clear the inventory and you still think the business will be on track by 2016? Are you pushing out the timing of when the Lids business gets back on track?

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Well, I think we are obviously looking to try and get that inventory to a target level by the end of the year and as we said, that is the number one priority. We are working on monthly year-end inventory targets as measured both by quantity of inventory and quality of inventory, which means fresher. And so the learning that we came through in the quarter is that we can achieve that and so -- but it took a little more margin dollars to get there than what we had planned out and so the guidance reflects the fact that we are going to be cautious that that extra juice that we need to keep the clearance at the rate we are targeting will bleed into the second and third quarters.

We think the fourth quarter is less affected simply because Locker Room is a fourth-quarter business and so we could keep the same rate of liquidation going in order to get to our target, but the change in gross margin will get muted by the fact that we have so much full-price selling going on in the fourth quarter because that is when the business really takes off. And our expectation is that we are setting ourselves up for a much stronger year next year.

Jay Sole - *Morgan Stanley - Analyst*

Got it. Now if we can talk about just the dotcom part of the Lids story. The improvement you are seeing, is it really driven by conversion, the locate system is helping customers find the products that they want, or is there also a traffic element where you are seeing more visitors to the site, which is also part of the enhancement that you made to the system as well?

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Jay, great question. It ties to your note. Thank you for that note that you put out. It is both. So we are getting a substantial uptick in conversion, which we expected because we are not only showing more SKUs, but we are showing an improved in-stock position on sizes as we have accessed all of our inventory. And so there was no surprise that we were going to get that. What we didn't see coming was the bump in traffic that we got and what we are learning is that we are scoring better position in natural search because we are more relevant. So the algorithms that are driving our ratings are giving us -- just bringing us more traffic.

And so if you look at the 60% increase that we are getting, very round numbers, it is half conversion and half traffic. Just to stay with that thought a little more, there's a number of things -- the way we are thinking about it, there are a number of other things that we can do to drive the business, which we're not doing because we think 60% gains operationally are all we want to handle right now. We really want to make sure that we are satisfying our customers so that we become a preferred place to shop and as such, we think 60% is just great.

So one place you go there is when you get higher conversion, you are naturally tempted to then drive more investment dollars into marketing your position on the Web. We are choosing not to be crazy aggressive with that yet because we don't want to have to try and absorb more business than what we are trying to transact right now. So when you think about the point at which we anniversary turning on locate, which is essentially the beginning of the next fiscal year, we believe we have two other dials to dial-up, if you will. One is marketing and so we can start seeking to drive more traffic.

And the other one is the adaptation of [Hybris] as we replatform. We are in a replatforming exercise right now. We are not on the best performing site that is out there, for sure. It was built many years ago and at the time was terrific, but now we lag what a lot of other people have as capability. And so when we go to the most recent form of Hybris, we believe that is another driver of conversion. We have had some hiccups in the process

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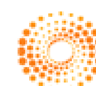

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of getting that tied into our systems and so we don't think Hybris is going to make it for this holiday. We are not going to make a fourth-quarter launch. We don't think that is logical.

So if you think about the opportunities for Lids to have major gains, this year, it is locate; next year, it is Hybris, we hope; and the following year, it is marketing. So we think we have a very long run of some pretty serious gains in Lids.com and the other associated websites that we operate. Our whole dotcom business includes operating sites for, as you know, universities, a couple of pro teams and then a couple of vendors. So all of that is benefiting from the sequential advances that we are making in the quality of the site and our aggressiveness in marketing it.

Jay Sole - *Morgan Stanley - Analyst*

Great, got it. And then maybe if I can just ask one last one on Macy's. Can you just connect the inventory issues at Lids with the Lids at Macy's initiative? Does the inventory issue kind of limit your ability to start adding stores at Macy's again? And just can you talk in general about what your learnings have been in the last few months about putting the stores in the right place and getting the conversion there, etc., etc.?

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Yes, well, let's first start with the understanding that Macy's is a baby and it's a baby in the incubator right now, so we are really working it very hard, but the majority of the stores opened in the third quarter, so they are a little over half a year old. So you have to think about it in that context and also in the context that it is new territory, so it's not as if you could point to the model and say this is how it's going to work.

So we are running under plan in general. We have some great stores and we have some stores that aren't doing well. And that contributed to the inventory problem because we had both in aggregate underperformance and at the same time a lot of those stores opened late, so we had ordered more merchandise for Macy's than was necessary given the ultimate opening schedule that we lived with.

We are learning a ton. So we are learning about assortment and what works. We're learning a lot about location and in fact the initial pieces on where we performed best in the store, which we really sought out is a good location, but it turns out not being the best location and there are some locations that don't work at all. To Macy's credit, they are great partners with us and they are being very supportive in our efforts to try and find where to put the stores. The great thing about the design of the stores is that they are extraordinarily mobile. So we have done really no meaningful physical buildout that isn't transportable to another part of the store. It is largely a fixture package and so we have already made some moves with stores and it is a pretty seamless event. We haven't even changed the floors. If you look at a few of the other people who have partnered with Macy's, they made a more aggressive buildout and I think they had reasons to do that to distinguish that their store starts here. We chose not to do that, so we are living with the same carpeting, the same flooring and everything, same ceilings. And so we are very mobile and that is giving us the chance to move.

And then the other thing -- we agreed with Macy's that we would fully staff the stores through the end of the first year. I think that is the appropriate call so we can learn about how to maximize the performance, but they have already given us the ability to test other staffing models. And so it is a work in progress and again, I've got to emphasize, for most of these stores, we are sort of six months in and six months is not a very long time for a brand-new business to figure it out. We have no plans right now to add stores. We've actually closed a couple and so the process of fine-tuning this business is well underway.

Jay Sole - *Morgan Stanley - Analyst*

Okay. Got it. Thanks so much.

Operator

Erin Murphy, Piper Jaffray.

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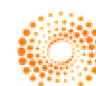

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Erin Murphy - *Piper Jaffray - Analyst*

Mimi, I was just hoping you could help us just understand on the guidance a little bit more about the cadence throughout the year. I know you talked about kind of Q2 being the lowest sales base quarter and really the earnings growth or I guess earnings skewed to the back half. Could you just help us think about Q2? Should the level be worse than where Q1 was down 37%? And then is Q4 the quarter you are anticipating to return to growth to kind of get to that midpoint of flat for the year?

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

Yes, Erin, this is a good topic for us to talk about and for all the reasons that we described, we are much more heavily weighted to the back half of the year. We were last year, as I said, 76% of our earnings were in the third and fourth quarter and given some of the promotional activity and the new stores, which are weighted to the fourth quarter and the shift in tax-free holidays, for all those reasons, we will be even more heavily weighted to the third and fourth quarter this year. So year-over-year, we expected that first quarter was going to be hit the most heavily. Second quarter, we also expect that we are going to be down on a year-over-year basis quite a lot, not to the same extent that we were in the first quarter. We see things getting better in the third quarter and then even better in the fourth quarter.

So the strength of our business, and we put up a great fourth quarter last year, the strength of our business when consumers are out in the mall added to the gains that we have had in the direct business, gives us the optimism that, as we clear through the Lids inventory, that we will be able to see a lessening of the promotional activity as a percentage of the overall business and that that will take less of a hit on margins as we progress through the year.

Erin Murphy - *Piper Jaffray - Analyst*

Okay, thank you. That is super helpful. And then I guess on the Schuh business, I guess you guys talked about a little bit of choppiness in terms of the sales. Are you seeing the volatility in traffic in cities outside of London? I recognize the tourist loads have been fairly volatile on High Street, but just would love to just maybe have a compare and contrast between kind of what you are seeing in the inner-city London stores versus outside in the broader UK market.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

The word choppy is the one we have used and that is kind of what we see. We have good weeks and then we have soft weeks. In aggregate, it has been so-so in terms of store traffic. Obviously, Schuh.com based on those numbers is doing very nicely. So the choppiness is most extreme from when you look at the numbers in London and that's why we called that out. But we just haven't seen steadiness and as we also called out, surprisingly, some of the trends that are driving Journeys' business are not driving business at Schuh and so they are having to go through more of a brand rotation and they are finding some things that are working, but they were committed to some brands that are not performing to the levels that we were hoping they would. And so when you are in that situation, you are handcuffed a little bit on performance until you can get the shape of your inventory commitments more in line with your sales trends.

So the team is doing great work and they are making all of those transitions. The dotcom business is doing terrific. They continue to build their omnichannel capabilities. They've got the excitement of store number one in Germany looking, based on a very, very short run, but even with the short run, it is nice to see positive numbers, so there's lots of good going on there. We just would love to see just a little more juice in traffic, sales and conversion in the stores.

Erin Murphy - *Piper Jaffray - Analyst*

No, that is super helpful. Maybe just the brand mix comment, if you could just elaborate on that? You talked about lower margin business is driving that. Is that some of the athletic brands you have in Schuh in the UK that you don't have here in the United States and Journeys, whether it is Nike

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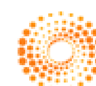

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or some of the other athletic brands, which are probably lower margin for you guys there? And is it a fall-off to the private label in Schuh? Would love to kind of hear kind of what the decoupling is between the Schuh versus the Journeys business on a margin brand mix profile perspective.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Nice try, Erin. As you know, we don't call out brands. So there are some brands where, as it rotates, that have slightly lower margins than some of the brands that had been stronger performers. I'm going to leave it at that. The private-label business has not been a stellar business, as you know. A lot of the girls who would be buying fashion have been buying canvas and have been buying brands and so that to some extent has been an impediment to private label performing at some of the levels that we've seen historically.

Erin Murphy - *Piper Jaffray - Analyst*

Okay. And then just last, a follow-up on Jay's question on the Macy's business. And I apologize if I missed this, but how many relocations do you see happening this year for the stores that you aren't pleased with the total -- the current location?

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Don't know yet. That is going to be a discussion with Macy's and again, I'm going to sound like a broken record. A lot of these stores are only four or five months into their life, so let's give them a little time for customers to find them. If they are in a more challenging part of the store, there might be a longer period of discovery for them. Each of Macy's stores -- they don't have a standard footprint, so it's not as if you can say let's move all the stores here. So they are one-by-one decisions. So I just can't give you a number. Obviously where we are not performing up to the level where either we or Macy's would like to see it, there will be discussions about what our options are.

Erin Murphy - *Piper Jaffray - Analyst*

Got it. Thank you, guys.

Operator

Edward Plank, Jefferies.

Edward Plank - *Jefferies & Co. - Analyst*

I guess just following up on the Macy's question, do you have maybe any updated thoughts on the profitability trajectory of the business, what you might see this year and then over the longer term, is it still potentially a high single digit EBIT margin?

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

It is a -- in the near term, as we have said, it is not going to be profitable this year and it tilts as much as all of our other Locker Room business into the fourth quarter. So think about that as the shape of the curve and our target for the business has been to get it to a strong return on invested capital. That doesn't require quite the same operating margin that we target in fully builtout stores because the capital commitment is lower. So mid to high single digit operating margins is kind of where we would like to get to and right now, we are just trying to go north.

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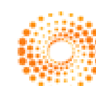

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Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

I think an important part of being able to accomplish that, as Bob referenced, is the staffing model and the number of hours -- the traffic certainly picks up a lot on the weekends in department stores and during the week, it is very quiet. So being able to pare back staffing levels when it is not important to be staffed in those stores is going to enhance profitability quite a lot.

Edward Plank - *Jefferies & Co. - Analyst*

Got it. Understood. And then another follow-up here, it looks like you might have trimmed the comp guidance for Journeys in the second quarter from what you gave last quarter. Yet the comps are trending up 7% quarter to date. I guess I'm just wondering what the disconnect is there. And then, Mimi, can you quantify maybe what the dollar impact is from the tax reshifts out of 2Q into 3Q? Thanks.

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

Sure. So on the Journeys guidance in Q2, it really is a shifting of the tax-free holidays out of Q2 into Q3. There are a number of states that have announced that they are moving and there are a couple in the balance that haven't announced definitively, but we are betting that they are going to end up moving. And that is entirely the reason for the move and what we took out of the second quarter we added back into the third quarter. So again we feel like Journeys' trends are on. We were affected by the port issue in the first quarter. Journeys' comp was 5%. We think we gave up 3% to the ports and we are back in the 7% range quarter to date. And so we feel like the trends that have been sustaining Journeys will continue through the course of the spring and the summer and that we will have another strong back-to-school and Christmas.

We are going against a 16% comp in the fourth quarter, so that has caused us to moderate Q4 relative to Q3. But we -- just to give you a sense of the tax-free shift, we anticipate that altogether about $4 million worth of sales are going to shift out of Q2 into Q3 and because Q2 is such a low quarter for us, we really don't see the effects of back-to-school until Q3. That is the reason for the shift in the comp.

Edward Plank - *Jefferies & Co. - Analyst*

Got it. That is very helpful. And then if I could, just one last one. So then I guess following up on the SG&A a little bit, do you think with the shift and just the compare you have to last year, might there be an opportunity for leverage in the third quarter on SG&A or is it too optimistic to think it would be before the fourth quarter?

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

I don't think we get to leverage in the third quarter. I think we are going to have to get out into the fourth quarter to really see some leverage.

Edward Plank - *Jefferies & Co. - Analyst*

Got it. Okay. All the best, guys. Thanks.

Operator

Taposh Bari, Goldman Sachs.

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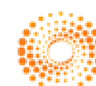

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Taposh Bari - *Goldman Sachs - Analyst*

Bob, a couple of questions for you on Lids. So it sounds like the issues that you are seeing currently are a function of both indigestion as you grow, or as you grew in competition. So I was hoping you can help discern the magnitude of each, which is a bigger issue for you today and hoping you can provide an update on what you are seeing on the competitive front as well across the different types of banners within the Lids segment.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Sure. So yes, there's two factors going on; you are right. There is the self-inflicted wounds and then we are being -- I don't like war analogies -- but you can see we've got two battles going on. The self-inflicted one is the one that we are probably more affected by right now. We are just really focused on getting more aged goods liquidated and, as you heard us say several times, it is a do whatever it takes philosophy and it took a little more in the first quarter and that will continue to be where we go.

Parallel to that, there's two levels -- there's two parts of competition. There is store-based and there is online-based. So the store-based portion of it, as you know, Taposh, we have talked about it; we believe that the retailer who is taking an omnichannel approach, who can use their inventory in the store to both sell to the traffic in the store, but also make it available online gets a big leg up and then the reverse of that, which is the traffic you get to your store who are looking for goods that are not in that store because they are a displaced fan, we get to capture that. If you add those two things up, the productivity of our store pretty much trumps what is traditionally a mom-and-pop industry and we have a great example of that here locally in Nashville. We have a good presence in Opry Mills. When I shopped Opry Mills in February, I noticed that the main mom-and-pop competitor had closed. So I called Lids, found out that they had closed in January and from that date forward, Lids Locker Room that was down the hallway was up -- I think year-to-date they are up around 26%. So there's a competitive dynamic that, in the long run, as our stores win, and we believe they will, we have massive share gains available to us.

And then there's an online competition and online, there is really two major players. You have the same visibility that we have to the promotional cadences that are going on. We are committed to go pursue online share. We are up on our full-price business 40% and we are going to continue to do what it takes. That is taking some margin hits because, in order to compete for that business, we need to be relevant on price and we are going to continue to do that and so -- but that will be in our economics and we think that the growth we get off of that makes up for what we are doing for our online-only offers. So overall, we think that we have a model that is the winning model and so we have two different forms of competition and we think we are well-positioned to compete on both sides.

Taposh Bari - *Goldman Sachs - Analyst*

That is helpful. And then just another follow-up on Lids, so I get the indigestion and competition piece, but wanted to pick your brain on your thoughts on the health of the category at large. So licensed sports apparel and headwear, what do you think of the category today? And I guess ultimately do you think that the category needs to be in a good place for Lids Sports Group to succeed? Because it sounds like part of the bet that you are making is consolidation in economies of scale and making one plus one equal three. And I guess I wanted to get your opinion on whether you think the actual category needs to be healthy for that operation to actually succeed.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Well, the answer to your yes question is yes you need a healthy category. We don't see a lot of evidence that the category is unhealthy. I know several analysts have quoted retailers who do not focus on licensed sports as being challenged there. I don't take that as evidence that the category is challenged. I take that as evidence that the consolidators are going to win the space. We learned that in the hat business. When we were in the hat business, many of the major broad line sporting goods guys were in the headwear business and many publicly acknowledged that it was more difficult for them to compete because the authority in the space, which was Lids and Hat World, was gaining share and it just made it a challenge. And I think there's a good chance that what you are seeing in the commentary coming from those who aren't fully committed to the space, that's the dynamic.

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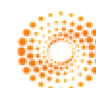

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So if you generally look -- as you know, it's hard to get really good data on the size of the category and certainly very hard to get year-over-year trend data on the size of the category. So we sort of reference our vendors as the proxy for that and the vendors are seeing that the industry is pretty solid. What is interesting about -- two things that are interesting about it. One is it is not a feast and famine business. It's an ordinary business that occasionally becomes a feast and that is when fashion grabs licensed sports and makes it part of the package. We are not there right now, so we are living in a world where fashion, other than in headwear, where it still has relevance, but, for example, there was a period where jerseys became a big part of the fashion uniform and that is not the case at the moment. And so that represents upside to the category. Does that help answer your question?

Taposh Bari - *Goldman Sachs - Analyst*

Yes, it does. I appreciate that. And the last one and I will pass it along. For Mimi, can you provide some context, guidance, whatever you want to call it, on the spread of sales, revenues versus comp growth in the fourth quarter? I know that continues to be a dynamic part of the algorithm, but on the surface it seems like the guidance is pretty fourth-quarter weighted, more so than it was last year when you were obviously performing quite well in terms of comp growth. And I think if you can help provide some context there, it would help us in our modeling.

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

Sure. So in the CFO commentary, we break out comp by division and we have said, for Journeys, it will be 4% to 5%. For Lids, it will be 3% to 4% and then total Genesco will be 3% to 4% in the fourth quarter and that is on top of a strong fourth quarter again last year.

Taposh Bari - *Goldman Sachs - Analyst*

Yes, that's helpful. But I was asking specifically for the spreads, so just trying to get a better sense of how much higher revenue growth will be versus comp growth in light of the fact that you have a disproportionate amount of, call it, non-comping growth that comes in the fourth quarter.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

We don't have a lot of non-comp growth (multiple speakers).

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

In the fourth quarter, yes, we had most things open in the fourth quarter --

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Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Not much open in the fourth quarter, Taposh. Most -- like Macy's stores were mostly open by the end of the third. I think maybe a few bled into the fourth quarter, but even they'll go comp early, pre-Christmas.

Taposh Bari - *Goldman Sachs - Analyst*

Got it.

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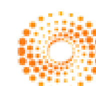

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Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

A large majority of our sales in the fourth quarter are comp sales. And one thing -- I wanted to amend what I said to Eddie. In the third quarter, we actually do anticipate that we are going to see improvement and get some leverage on SG&A. And so the way we see that the year is going to unfold is that we are going to start to see improvement in SG&A in the third and also in the fourth quarters because of the strong comp and some of the moderation of the promotional activity.

Taposh Bari - *Goldman Sachs - Analyst*

Thanks, guys.

Operator

Scott Krasik, Buckingham Research Group.

Scott Krasik - *Buckingham Research Group - Analyst*

So a couple questions. First, how do you approach pricing? As you pointed out, there is a promotional aspect to the online, but then it seems like your primary online competitor and Lids is also trying to just underprice you even if it's by a nickel on every item. So how do you approach that and how do you combat that?

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Scott, we are in there trying to compete in order to gain our fair share. Scott, we are up 62% year to date. I don't -- we don't feel the need to price any more aggressively because 62% is pretty challenging to keep up with. So for the moment, we are feeling like we are pricing just fine to achieve what we want to achieve.

Scott Krasik - *Buckingham Research Group - Analyst*

Right. Except you have too much inventory and your margins are down significantly.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Well, if I price more aggressively, I get more sales and take my margins down; that's not a direction that makes sense to us right now. We are happy with our sales rate. We are liquidating our inventory on the plan that we design, which is a month-by-month plan and so we don't need to go ahead of that if it means that we have to get that much more aggressive on pricing. And again, we are also being mindful that, in the online business, we want to not overstrain our operations. We want to keep customers happy by delivering what they order on time in good shape.

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

And it is not just promotional sales that are up online; it is also what we consider to be non-promotional sales were up 40% there. The amount of inventory and again e-commerce is just a terrific vehicle for liquidating inventory, so we have been pushing our liquidations out there as well, but we have seen a lift overall in our non-promotional sales. So if we've got what the customer wants, they are willing to pay the price, particularly the displaced fan who doesn't have much of a choice.

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Scott Krasik - *Buckingham Research Group - Analyst*

Okay. No, that is fine. And then can you just dig in a little bit more into your comment that the gross margin at Journeys was flat this quarter given the strong comp? And is it IMU, is it mix. You're not really promotional there, so what is the dynamic?

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

Yes, the mix at Journeys changes from the -- in season and the margins were strong and they continue to be strong.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

They were strong last year and they are strong this year.

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

Yes, it's not a promotional quarter. It's not a particularly promotional quarter and Journeys has just a fantastic track record over the past several years of maintaining a strong gross margin and have done a good job of not really having to promote. So they are in great inventory position. Their inventory is clean. They were actually low through the quarter and feel positive about the pace of sales.

Scott Krasik - *Buckingham Research Group - Analyst*

Okay. And then just last, Bob, I think it has been a while since we talked about an operating margin target. I think the last time it was 9.5%, maybe 9%. I might be wrong. But just in terms of the pressure you have seen at Lids the last year or so, how do you view that going forward?

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Yes, we still think that, in the long run, Lids -- we are doing this because we think Lids tracks still to at least a high single digit operating margin. The wildcard on that obviously is timing, how long does it take us to get there. As I think you know, Scott, we work on a five-year plan over the summer. We are going to spend a lot of time looking at that and figuring out what that pattern looks like. It is going to be multiyear in order to start trending in that direction. Some of the inventory fix is one where we've got to handle and I think we have better visibility on the timing. Some of the weaker stores that we opened in the Locker Room group, they're going to take a little more time to rightsize.

The good news is of the -- if you take the 30 worst stores, I think it is something like -- the number is something like in the mid-20s out of 30 stores, we have kickouts in the leases over the next three years. So over a three-year period, we get to address another part of what the drag is on performance and either close the stores or work with the landlord to rightsize the rent. So that will take a little more time. We'll have probably better perspective on that in the fall.

Scott Krasik - *Buckingham Research Group - Analyst*

Okay. Thanks. Good luck.

Operator

Steve Marotta, CL King & Associates.

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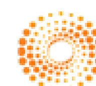

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Steve Marotta - *CL King & Associates - Analyst*

A couple of very quick questions. First, you mentioned that the comp came in relatively in line with expectations in the first quarter. Sales happened to have been a little bit below the consensus, in my estimate. When you think about new store productivity, did that change as the quarter progressed? I know that there are some issues, of course, with the Macy's stores, but did they perform even below expectations from the beginning of the quarter to the end of the quarter?

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

Our new store performance has, as we talked about in past conference calls, has not been performing to our expectations --

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Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Within Lids.

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

-- within Lids. To our expectations in the quarter, we performed about -- we have a good sense of where those levels are at this point and we didn't experience any big gaps in our noncomp stores for the quarter.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Yes, and just to be clear, I want to make the distinction between Lids Locker Room and then the rest of our Company, which would include Lids hat stores. Our new store performance throughout the rest of the business is pretty good and that is why we are opening 115 stores this year. It is supported by the fact that the last wave of stores are giving us an adequate return. So it is very narrowly defined on the Macy's and the de novo Locker Room stores that we opened up where we've got the non-comp performance issues.

Steve Marotta - *CL King & Associates - Analyst*

That is helpful. Thank you. As it pertains specifically to the point in time during the year where you have endeavored a new promotional strategy at Lids, I believe it was during the football season, would you say it was by October 1, so that all of the issues will be lapped by the fourth quarter, or did you hold out on some of those promotions deeper into the season where it would not fully lap in the fourth quarter?

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

I don't think we will be fully lapped in the fourth quarter. What we did do in the fourth quarter, and we have called this out before, is, in recognition that we've got to be faster with our clearance cadence, we used the example of the NFL and we started taking marks on teams as they missed the playoffs as opposed to a practice of taking marks on football across the board at a certain date late in the season. And we saw that that was effective. We came out of the season cleaner on football than we had in previous years, but the actual attack mode on more aged goods that we felt that we needed to really aggressively get rid of went full force in the first quarter.

The reason in the fourth quarter that we think we have an improvement opportunity on margin is simply because the fourth-quarter business, and especially within Locker Room, the full-price business takes off. It is a fourth-quarter business. So we might continue to clear some aged goods in the fourth quarter, but when you do a blended average, you're going to be blending with a much, much higher level of full-price sales and that is the reason that we think that you end up starting to see some moderation in the spread between this year and last year. Does that make sense to you?

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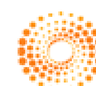

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Steve Marotta - *CL King & Associates - Analyst*

It does. That's helpful. One more quick question. Reading between the lines -- I think I know the answer, but just to clearly delineate it -- would you say the competitive environment online for Lids was better or worse in Q1 versus Q4, or the same?

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

I'm just going to say it moves around so much, it is hard to judge. I'm going to duck that. I don't really know. It is hard to judge.

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

Yes, I think everybody tends to be pretty promotional in the fourth quarter as they just try to drive e-commerce sales, but e-commerce online is always a pretty promotional activity.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Yes, you have a mix of stuff. What is a promotion? You've got -- a lot of them are very hard to measure because it is the classic up to 30% off. And unless you really go into the site and do a pretty rigorous analysis, up to 30% can be a huge promotion or it a can be a nonevent, depending upon how many items you threw into the box. You know what I am saying?

And the other thing is the other device when you're online which is sort of unique to online is free shipping. So free shipping gives you a promotional posture that is a different kind of posture that you don't really see in the store environment. And as you know, free shipping becomes a more frequent promotion during fourth quarter.

Steve Marotta - *CL King & Associates - Analyst*

Right. Okay, that's helpful. Thank you very much.

Operator

Pam Quintiliano, SunTrust Robinson Humphrey.

Pam Quintiliano - *SunTrust Robinson Humphrey - Analyst*

I also have a few, but I will try to keep it brief. So sorry if I missed this or as a point of clarification, when I think about markdown pressure at Lids, is there any way to think about the composition of the product? And is this just a new way you have to do business based on the competitive environment and the longer-term market profile has changed? Or do you just have some product that needs to be flushed through, you are done, and then you take the learnings and you run the business more efficiently going forward?

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Much more of the latter. Not to suggest that you are ever, in retail, out of a markdown cadence. But we are in a much heavier markdown situation because we allowed -- for a variety of reasons -- we allowed some older goods to linger, which in the headwear business was not anywhere near as risky as it is in the Locker Room business where it is a faster business.

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And then we had all the things that we already called out. We had substantially lower performance in a number of our Locker Room stores, particularly the new ones. We had the Macy's stores underperform and open late and you sort of roll up each of these items and you ended up with a chunk of inventory that required special treatment. So we are in special treatment territory and we are hopefully by next year in a markdown structure that is more in the ordinary course.

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

Yes, and I think the example that Bob talked about is a good one where we took a lot of product out of the Lids headwear stores just to freshen them up during the course of the first quarter and we had negative comps in those stores and really interestingly when we got that product out and made the stores easier to shop and delivered some fresh merchandise, we have seen both sales and margins improve. So that really is the idea; for us to clear through the inventory that doesn't need to be in the stores and for us to get on track to a better sales and margin position.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Yes, and actually, Pam, that is actually a great Genesco story because that pattern got demonstrated by Journeys who have gotten much more aggressive in bringing out, taking out markdown goods and keeping the stores fresher and finding other vehicles for exiting the deeper markdown product.

Pam Quintiliano - *SunTrust Robinson Humphrey - Analyst*

Great. Thanks for clarifying that. And then when you think about the tools you use for inventory management, do those need to be updated or are you readdressing how you utilize the data you have just given the profile of your store base has changed so dramatically over the past several years. How we think about that so you don't necessarily get in the same situation again going forward?

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Excellent question; it's the right question. We have a project going on that addresses that head on and so we expect that we will be working with a different set of processing procedures and a different goalpost in terms of measuring when we need to take action. Obviously that will move towards doing things more quickly than we have in the past. And of course, I'm talking about Lids.

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

And the complexity, it is a problem that really becomes a great situation for us because there are 0.5 million SKUs to be managed within the Locker Room business and therefore, the need for robust systems to be able to manage those effectively we have been investing in and because of that complexity, we think that over the longer term that it will be difficult to compete against us who has gotten those systems and those processes down well, so that's an important point of focus for us and we are spending a lot of time developing those refined systems and processes.

Pam Quintiliano - *SunTrust Robinson Humphrey - Analyst*

And even though I see that as ongoing adjustments with the business as you continue to grow, when I think about the stores and the inventories, when do you think there is more of a meaningful impact based on readjusting your approach?

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Well, in terms of it being visible in the financial results, next year. So the project -- with the projects going on now, we have -- we are using some outside help. So we're bringing in people who have really been there, done that, to help us get it right. We do have to clear through what we've

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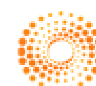

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got and that is what is going to be the pressure on this year's profits. We hit our inventory target by the end of the year. That inventory number is still not quite where we need it to be, where we wanted to be in the long term, but it is close enough that we can then sort of ease our way to further improvement without a lot of pain. And from that point forward, we should be operating in a model where we are persistently aggressive on attacking slower moving goods in a more timely way and that is the key thing.

Pam Quintiliano - *SunTrust Robinson Humphrey - Analyst*

Great. And then turning quickly to Journeys. Is there any way to think about the magnitude of what you had to pull forward and just ability to chase? Not asking what is hot, what is not, what you pull forward, but just if the trends you are seeing continue to be doing very well for you. Do you have the ability with some of those vendors to get more of those goods in?

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

It is dependent on whether the vendors have got stuff in transit or sitting and ready to roll and that varies. They obviously are chasing hardest the stuff that has got the biggest demand or where we feel like we have an inventory opportunity. I am not going to tell you what that is. Journeys, as you know, because of their size, can get vendors to be very reactive to their needs and so they are doing what they can.

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

So Pam, I think a good example is to look at the comp from the fourth quarter that Journeys' ability to deliver that 16% and meet that demand just gives you some insight into how thoughtful our vendors are about managing inventory. And so if they can get the product, they do pull it forward and they jump on trends as fast as they see it.

Pam Quintiliano - *SunTrust Robinson Humphrey - Analyst*

Great. And yes, given the make of the product, it is a little bit easier in the summer. I would assume that also helps the situation. So -- and then lastly, Dennis, you mentioned in your comments about some mall traffic challenges. Any updated thoughts that you have regarding the health of your consumers as we think about Journeys and Lids? Obviously we are abundantly aware of the differences in how they are shopping with online versus mall, but just how you think they are feeling -- gas prices, macro, all of that stuff and if you are seeing any shift in just their spending habits.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Pam, the numbers speak for it. We've had positive comps in all four of our businesses and in the Lids case, we are buying a little bit of that. Our general view is kind of what you read in the papers. What you read is what we are seeing, which is there is still maybe a disconnect between the level of consumer spending and what people are citing as stronger employment and other macro trends. And then, obviously, there's the continuing shift to online from stores. And when we are up this quarter, I think it's like 27% online and 3% in the stores, that speaks volumes for what is going on.

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

It's interesting because all that is being done on down traffic. Pam, our belief is that consumers are doing their investigation and they are doing their research online, which may reduce one or two trips to the mall. So there's no question that call traffic is down, but interestingly with the traffic counters that we have put into the Journeys stores, we are able to see that traffic is declining on a year-over-year basis, yet our conversion rates are improving and importantly our dollars per transaction are improving as well as we are focusing on selling skills and making sure that we optimize all the traffic that walks in the door. So while there may be fewer trips to the mall, the intent here is to maximize every customer who comes across our door.

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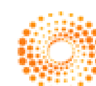

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Pam Quintiliano - *SunTrust Robinson Humphrey - Analyst*

Excellent. Best of luck, guys.

Operator

Jill Nelson, Johnston Rice.

Jill Nelson - *Johnson Rice & Company - Analyst*

Just two quick ones. I believe last call you talked about you were going to be working with some vendors in efforts to ease some pricing pressure at the Lids. Could you just address that, how those conversations are going and if you're getting any traction there?

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Sorry, Jill. You'll have to help me a little more on that.

Jill Nelson - *Johnson Rice & Company - Analyst*

You had referred to the online pricing pressure last quarter, but you did say that in an effort -- one way to mitigate that pressure, you are going talk, be in discussions with vendors to try to put some more controls out on the pricing across the market and what have you.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Yes, simply put, it's a never-ending battle. We need to get -- now I remember what you are talking about. This is online. We need to get our vendors to be as attentive to distribution online as they have been historically in the stores and there are certain vendors who do that -- are as good online as elsewhere. I think we have been raising the conversation, the volume on the conversation and I think we can see it is having a little bit of impact. But as we say in sports, it is sort of 3 yards and a cloud of dust.

Jill Nelson - *Johnson Rice & Company - Analyst*

All right. And then just trying to parse through the difference between the big variance between the Lids store growth, as well -- and the e-commerce growth. I know a big part of that is just the promotional activity you are doing online, but if you could maybe -- are you seeing a different customer, or maybe a different product selling better online versus store? Just trying to parse through that variance. Appreciate it.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Well, two things going on. One, we have discovered that e-commerce is an excellent clearance vehicle, especially for the most distressed goods that are taking the highest marks. And so we are operating it that way and we get a lot of people coming in buying multiples. The big theme in sports is that what happens in the stores is you get mostly the local customer and we are merchandised for that with local teams and then online tilts very heavily towards the displaced fan who is the person who is not living in a ZIP Code where that team plays. And so their only alternative in most instances is to go online and buy the product and that is probably the biggest distinction.

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Jill Nelson - *Johnson Rice & Company - Analyst*

Okay, thank you.

Operator

Samuel Poser, Sterne, Agee & Leach.

Ben Shamsian - *Sterne, Agee & Leach - Analyst*

Hi, it is Ben Shamsian for Sam. Thanks for taking my questions. Bob, for you, help us understand the competency or value add that Genesco could give to Lids and alternatively why wouldn't shareholder capital be better served in a footwear business, which you have proven to be successful?

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Well, as you know, we have run the businesses fairly independently and so I am not sure that capital from shareholders in Lids is not a good investment. We wouldn't be doing it if it wasn't. We've already articulated the strategic thesis of why we think that is true. And so we don't think of it as a trade-off between footwear or Lids. We take each opportunity individually and we believe what we are building at Lids has great long-term return potential for shareholders.

Ben Shamsian - *Sterne, Agee & Leach - Analyst*

Got it. Okay. And then just on Schuh, without mentioning specific brands, I just want to understand the decoupling on the category side, if there's any -- if there are categories that are performing well in Journeys, but not at Schuh or vice versa and how can we think about that. I don't need to know the brands specifically.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Well, Ben, it's actually brand-specific, so it isn't as much categories as it is brands. So I'm afraid I can't be very helpful to you. Sorry.

Operator

Okay. And then for you, Mimi, the labor tests you talk about with Journeys, what is the timing of those results and can you quantify the magnitude that if you do need to raise wages how much would that be and the timing of that? That would be helpful.

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

Yes, so what we are doing is in Journeys are specifically testing to see whether or not increasing wages would reduce turnover at the assistant manager level and the idea there is that, in the short term, we would face some wage pressure as we increase wages, but that over the longer term that that should pay off by reducing turnover. We are in the middle of testing. If we roll something out, it will be in the back half of the year and our quantification of what that is will be based on the outcome of those tests, so we will keep you posted as to how those go, but we just wanted to make you all aware of the fact that that was going on and that that might be a decision that we make for the back half of the year.

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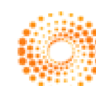

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Ben Shamsian - *Sterne, Agee & Leach - Analyst*

But just so I understand, if the test does prove right and you do make the decision, it is likely going to have a negative effect at least in the back half of this year?

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

If we make the decision then to increase wages, then that is something that takes place right away. We are able to better leverage our store wages with the volumes in the third and fourth quarter, so as we get the results of these tests, we will roll it into what our outlook is, but we wanted you all to be aware of it so that you didn't have a surprise as we announced it.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

But to be clear, the test is not just whether we lower turnover; it's whether lower turnover drives more conversion. What you're trying to do is set up a situation where you have more experienced people who are going to have -- provide better service, get better close rates and that translates into top line. We're not just trying to add expense.

Ben Shamsian - *Sterne, Agee & Leach - Analyst*

No, I understand. I am just looking from a -- just from a modeling and how can we think about earnings standpoint in the next two three quarters that could possibly be an unforeseen hit to the bottom line. Okay. That was it. I appreciate it. Thank you.

Operator

Chris Svezia, Susquehanna Financial Group.

Chris Svezia - *Susquehanna Financial Group - Analyst*

I guess, Mimi, for you, just to clarify an earlier question regarding second quarter, did you indicate that potentially second-quarter earnings in terms of the decline could be worse than the first quarter, down 36% or did you not say that specifically?

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

No, no, the first quarter was down 37%. We expect the second quarter to be down significantly, not as much as 37%.

Chris Svezia - *Susquehanna Financial Group - Analyst*

Okay, that is helpful. Journeys, given the investments you are making, labor, etc., the leverage point for that division from a comp perspective is now what? Is it 6%? I'm just trying to gauge what you need to do in order to get to that leverage point for the Journeys division.

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

No, I think that how you have to think about that is that we are making investments in the e-commerce channel and we are making investment in -- and then we continue to operate our store network and the store network has a high fixed cost base. And we continue to believe that we can leverage given no other pressures in Journeys at about that 3% level of comp. And we have been doing some more investment recently in our shopper track and sending catalogs to drive traffic to the store, but those are productive investments that will drive top line. And so I don't know

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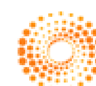

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that the profile within the stores of a comp we need to be able to leverage the stores has changed that much aside from the timing of the individual investments that we are making.

Chris Svezia - *Susquehanna Financial Group - Analyst*

Okay. But it's fair to say this year it grinds a little bit higher into that 5%-ish level I guess is what I'm trying to get at?

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

This year, what we have been facing is we have been facing some minimum wage pressure across the board that -- every retailer these days are talking about wage pressure and increasing wages and even McDonald's is talking about increasing wages. And so that is some of the pressure that we are seeing that will add to the pressure for store comps. That is just a phenomenon of late.

Chris Svezia - *Susquehanna Financial Group - Analyst*

Okay. Bob, for you. When you step back and look at the guidance that you gave -- the revised guidance -- and we kind of know where the trend line has been going in terms of the revisions that we've seen multiple quarters in a row, when you look at it at this point when you went back to everyone from a divisional perspective, do you feel like the level that you've given is appropriate? I know it's difficult to gauge how everything is going to play out, but have you kind of set the parameters by that -- really has to get nasty in order for you guys to have to revise again. I'm just trying to understand what can make it much worse, what could make it maybe better and just your thought process around that?

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

It's a very fair question. We have done a ton of analysis in making sure that operation by operation that we have tried to weave in what we think is conservative scenarios and protecting against the things that can happen. We are trying to be conservative, and I will fully admit that that is the speech we gave you three months ago. So in some way, the Emperor has no clothes, but I think I got dressed today. So we are hoping we are there. We are hoping we have found the bottom. I will tell you we tilt it to be conservative because of that.

If you asked the question what could change, obviously the big thing is macro. So if the industry gets more challenged and we ride that wave down, that would probably be the thing that I would -- if you said three months from now you are questioning your guidance again what happened and I had to guess right now what happened, what happened I think would be macro.

Chris Svezia - *Susquehanna Financial Group - Analyst*

So it would be more macro than business brand (multiple speakers).

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

I can't think of anything in our business that we haven't sort of taken into account that would be a factor that would be a bust over the next three months. But, again, we have been trying to do that and we've been getting surprised, so hopefully we have found the bottom.

Chris Svezia - *Susquehanna Financial Group - Analyst*

Okay. Last thing, not to beat this to death, but on the license business, when you parcel between the different categories, NFL, NBA, NHL, MLB, where, if anything, is either the biggest pressure, need to resize the inventory, whatever? I understand that, yes, some other players have indicated

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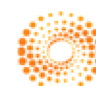

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across the board that the category has been difficult. It is to a degree because it is not a fashion business, but where is the biggest pressure point? Where do you feel like you have made the most progress? Just kind of maybe walk through that if you could.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Well, look, the biggest issues are in the biggest categories, so our biggest categories are MLB by far, particularly because of the hat business and then the NFL. So everything is scaled proportionate to the size of the business that we do. I think we probably have a little less exposure in MLB because for us MLB functions the closest to a 12-month business because you've got the MLB season that kicks in in April. World Series is in October and then you are a month away from Black Friday. And so you get another opportunity to do MLB business. So I would say that is probably the least exposed and then the rest is proportionate to the size of the business.

The other thing, just to be clear, is it is heavily on the fashion -- we've got a lot of basics in our business and our basics is fine and we are feeling like as soon as we get the fashion side cleaned up, we are in good shape and we've just maintained a faster cadence on fashion.

Chris Svezia - *Susquehanna Financial Group - Analyst*

Okay. All right, all the best. Appreciate it. Thanks.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Thank you, everybody, for joining us and we look forward to having a chat in roughly 3 months. See you all.

Operator

Ladies and gentlemen, that does conclude our conference for today. We thank you for your participation.

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