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GCO - Q1 2017 Genesco Inc Earnings Call

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PRESENTATION

Operator

Good day, everyone, and welcome to the Genesco first-quarter FY17 conference call. Just a 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.

Due to the length of recent conference calls, participants will have the opportunity for one question and one follow up during the question-and-answer session. I will now turn the call over the 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'm joined today by our Chief Financial Officer, Mimi Vaughn.

Our bottom-line results for the first quarter improved from a year ago and exceeded our expectations, driven by a significantly better performance from the Lids Sports Group. Adjusted earnings per share were $0.62, up from $0.51 last year. Comparable sales increased 1%, at the lower end of expected range, but gross margin was considerably better than anticipated and was the major contributor to the better results for the quarter.

Comps in our US businesses were solid in the quarter first two months of the quarter, benefiting from the catch-up in income tax refunds and an earlier Easter. The comps for the full quarter, however, reflected a significant slowdown during the last two weeks of April that led to the 1% comp overall. Over in the UK, the retail environment remained challenging throughout the quarter, particularly at the end, resulting in negative comps for our business there.

A major contributor to the improvement in first-quarter profitability was the significant swing at Lids, as we began to gain traction, turning that business around following multiple initiatives we executed during FY16. This included reducing Lids' retail inventories 25% by year end through heightened promotional activity that we ramped up throughout the year and especially intensified in the fourth quarter. This allowed us to start FY17 in a much cleaner inventory position to drive full-price selling and higher margins.

In addition, while sales in Q1 were challenged by the offset to Ohio State winning the College Football Championship last year, we benefited from a favorable NBA playoff lineup and a strong start to the baseball season. Beyond the benefits coming from clean inventory and fresh receipts, Lids' shipping and warehousing costs, which is part of reported gross margin, improved due to recent technology investments, warehouse consolidation, and other initiatives that have driven supply chain efficiencies.

I'd like to give a shout out to the entire Lids Team. This Team has worked hard and persevered through a very difficult year and a half to get the business back on solid footing, including the past three months when everyone carried additional weight as we transitioned to new Leadership. Thank you, and congratulations on a fine first quarter.

And I also want to welcome David Baxter to the Genesco family. David officially joins us next week as Chief Executive Officer of the Lids Sports Group. David has spent the majority of his career in key senior executive roles in the licensed sports industry, much of it with Adidas, where he helped develop and lead their substantial licensed business. His deep experience in the industry complements the core retailing strength of the current Lids Team in a way that is potentially very important, given the current dynamics in the licensed space, especially with regard to the professional leagues.

Turning to Journeys, comps in Q1 were a little below expectations, and profitability was in line with expectations but down year over year as planned. This was due in part to some factors unique to both periods, which Mimi will describe in more detail.

Journeys comps for the greater part of the quarter, through the Easter offset, were solid, but weakened in the last few weeks of April and in the beginning of Q2 given the cooler weather in much of the US. Despite this tough post-Easter trend, Journeys ended the quarter with a positive comp. Moreover, we continue to believe the business is very well-positioned to capitalize on the important back-to-school and holiday seasons, when most of Journeys' volume is done.

In the UK, Schuh felt comp pressure throughout the quarter, which resulted in comps being down 5%. The business battled an exceptionally sluggish retail environment that also affected many other UK retailers. Consumer demand in general was very promotionally driven amid weak consumer confidence.

The trend became significantly worse in the weeks following Easter, as traffic was down double digits and demand for seasonal footwear was dampened by colder weather. Nonetheless, the Schuh Team did a great job managing expenses under difficult circumstances to deliver operating results that, while down year over year, met expectations in spite of the comp shortfall. And with the improvement in weather, comps in the first three weeks of Q2 have turned positive.

Finally, Johnston & Murphy had another outstanding quarter, led by the strength of its product offering, which contributed to a notable increase in profitability.

Looking at the three weeks in the second quarter to date, comps for Genesco overall through Saturday, May 21, are up 1%, which is roughly in line with our expectations. The first two weeks showed a stronger trend versus the first quarter, but last week reflected an offset to Memorial Day, which was a week earlier last year.

So these numbers are not yet representative of the trend for the quarter. And just a reminder, sales and profit in the second quarter are our lowest of the year, as volumes for our largest businesses typically do not pick up until back-to-school begins.

With respect to the rest of the year, we are reiterating our guidance of adjusted earnings per share to range to $4.80 and $4.90, and Mimi will give further color on guidance in her remarks. And with that, let me turn the call over to her to go over the financials and guidance in greater detail.

Mimi Vaughn - *Genesco Inc. - CFO*

Thank you, Bob. Good morning, everyone.

As a reminder, as usual, we have posted more detailed information online in our CFO commentary. For Q1, total sales decreased 2%, to $649 million. Excluding Lids Team Sports from last the year sales, total sales would have increased for the quarter. Q1 sales included a 1% increase in consolidated comp sales, an increase in non-comp sales of approximately $13 million, including 36 Little Burgundy stores we acquired, and a decrease of 2% in wholesale sales, not including Lids Team Sports.

As Bob mentioned, comps started the first quarter stronger than they finished. Sales weakened in the last weeks of April when the weather was unseasonably cold on both sides of the Atlantic, slowing sales of spring and summer footwear in particular.

By division, comps were up in all our US divisions, up 1% at Journeys, up 2% at Lids, and up 6% at Johnston & Murphy, but down 5% at Schuh. We had planned flat-to-negative comps for Lids, but clean inventory and the strength of NBA Basketball and MLB Baseball sales offset other team and promotional sales headwinds we had expected.

Consolidated store comps were up 1%, and consolidated direct comps were flat, out of step with the trend of double-digit increases we had been experiencing for the last several quarters, and putting direct as a percent of total retail sales at 8% for the quarter. Direct comps were negative in Lids and in Schuh for different reasons, offsetting gains in other divisions and causing the total Company average to be flat.

Last year in Q1, Lids had turned on its Locate system, which gave online access to an additional 50,000-plus SKUs from inventory located in stores, and coupled with promotional sales in connection with the inventory cleanup, helped drive a 62% direct comp. Last year's results also benefited from a surge of shipments from an order backlog created while the warehouse was closed for inventory at the end of Q4, an event we did not repeat this year.

Locate's sales were up this year in Q1, but not enough to comp positively against the promotional and order backlog sales from last year. Schuh's negative direct comps were due in part to a higher level of returns than usual after the January clearance period and weak website conversion following Easter.

Turning to the second quarter to date, for the total Company, comps through Saturday, May 21, were up 1%, with stores up 1% and direct up 2%. By division, total comps were down 1% at Journeys, down 1% at Lids, up 5% at Johnston & Murphy, and up 6% at Schuh. As Bob said, these three weeks of comps do not reflect the trend in the quarter since last week includes an offset to Memorial Day, which affected Journeys and Lids especially. The most dramatic swing, nonetheless, has been at Schuh, which is unaffected by Memorial Day, where comps have improved with the warmup in the weather.

Gross margin for Q1 improved 140 basis points, to 50.8%, and was better than expected due to better-than-expected results in several of our divisions, with Lids as the biggest contributor. Gross margin for Lids in total increased 560 basis points. The sale of Lids Team Sports, which was a lower-margin business, greatly aided this improvement, but the improvement in the remaining retail business was also strong, totaling 250 basis points.

This improvement exceeded our expectations due to three major reasons. First, selective price increases boosted initial margins. Second, since inventory entering the year was so clean, we did fewer promotions in the quarter. This, plus our strategy of taking markdowns earlier and more often, worked well and ended up requiring fewer markdown dollars.

Third, in Q1, Lids experienced a dramatic improvement over the prior-year in shipping the warehouse expense, which is included in our gross margin numbers, and which had been at an unusually high level last year. The biggest margin improvements were in businesses where the intensity of the promotional activity had been the greatest, in Lids e-commerce and in Locker Room.

Journeys gross margin, as we anticipated, was down 60 basis points in total. A Q1 last year, gross margin for Journeys was at record levels due to strong margins resulting from a favorable brand mix that we knew we would not repeat in Q1 this year. Additionally, due to the warmer winter, Journeys had higher markdowns on carryover product, which affected margins this year as well. Gross margin at Schuh and Licensed Brands was up in the quarter, despite top-line challenges for both.

Total adjusted SG&A expense increased 110 basis points, to 47.5% for the quarter. A major factor behind this increase was a sale of Lids Team Sports, since this business operated at a lower level of expense than our retail businesses. However, with the 1% comp, remaining operations deleverage due to rent expense from new stores and heavy renewals, bonus accruals, and higher selling salaries.

One other item that caused expense pressure, especially for Journeys and Lids, was increased credit card chargebacks in connection with the EMV liability shift from issuing banks to retailers. While we had expected some increase in chargebacks, the level was considerably greater than we had anticipated. We have instituted a number of new operational procedures in stores to combat fraud and are working to deploy the EMV technology at point of sale as quickly as possible, so we expect this be a negative factor for much of the year.

Finally, the stronger US dollar against the pound created foreign exchange headwinds to top line, but not the bottom line, since Schuh had losses in the quarter.

Even with lower sales, due to improved gross margin, adjusted operating income increased to $21.5 million, from a little under $20 million last year. Operating margin increased 30 basis points to 3.3%. First quarter adjusted EPS was $0.62, or an increase of 22% over last year's $0.51. We anticipated earnings would be down in the quarter when we began the year, so this was a good result.

Turning to the balance sheet, inventory was down 13% year over year on a sales decrease of 2%. Excluding Lids Team Sports, inventory was down 6%, with retail square footage up 3% and sales up 3%. Journeys inventory was extremely clean, and not including Little Burgundy, was down over last year's level. Including Little Burgundy, Journeys' inventory was up 3% on a square footage increase of 5% and a sales increase of 6%.

Schuh's inventory was up 1% on a square footage increase of 12% and sales decrease of 4%. Schuh's inventory was clean despite the sales shortfall in the quarter.

Lids' inventory was down 37% on a sales decrease of 13%. Part of the decrease was a result of the Lids Team Sports sale. Inventory for the remaining Lids business was down 24% on a square footage decrease of 2% and a sales increase of 1%.

Next, capital expenditures were $17 million, and depreciation and amortization was $19 million. We continued to be active repurchasers of our stock in the first quarter. In all, we repurchased approximately 1.1 million shares for roughly $73 million, at an average price of $66.75 per share.

Now, turning to guidance, while earnings in Q1 were better than expected and we bought back additional shares in, we are holding guidance of adjusted earnings per share for FY17 of a range of $4.80 to $4.90. This represents an increase of 12% to 14% over FY16. Our top line assumption is for sales to be down slightly for FY17, taking into account the Lids Team Sports sale, headwinds on sales from last year's Lids promotional activity, and the impact of a stronger dollar exchange rate.

We initially guided comps cautiously due to macroeconomic concerns that are currently playing out across our industry, and these concerns remain in play. Our assumption is for comps in the low single digits for most of our businesses, with consolidated comps of 1% to 2%.

We are planning on opening 132 new stores this year, heavily concentrated in the Journeys Group, especially during this Q. We expect gross margin to be up between 150 and 170 basis point in total. This is predicated on a sizable margin recovery at Lids of more than 500 basis points, some of which is a change in mix from the Lids Team Sports sale. The rest is a pickup from the lower level of promotions.

We anticipate SG&A expense will deleverage 125 to 150 basis points due to higher bonus expense and deleverage of rent, selling salaries, and other expenses with a lower cost, plus higher expenses from minimum wage increases and new overtime requirements and a continued elevated level of chargebacks. We came off a year in which no bonuses were paid in Lids and Corporate, and therefore, bonuses related to improved profitability will be part of this deleverage.

We expect 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 currently are. We expect positive impact from a legacy pension plan could offset much of this pressure. Lastly, the Schuh acquisition incentive payments are completed and are no longer a factor.

This all results in an operating margin that is up for the year, and our fiscal tax rate is expected be 36.9%. We are planning capital expenditures in the $125-million to $135-million range, which includes a planned expansion of the Journeys distribution center and is up over last year's level. Depreciation and amortization is estimated at $79 million.

We are assuming average outstanding of 20.6 million for the year. This includes buybacks made in the first quarter, and no additional stock buybacks are included in this guidance.

While we have largely achieved the goal of working through last year's cash flow and the proceeds from the sale of Lids Team Sports, our Board has recently approved a new repurchase authorization of $100 million, which we can use opportunistically going forward. This replaces the prior authorization, which had $11 million remaining.

Now, I will turn the call back over to Bob.

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

Thanks, Mimi.

I'm going to provide an update on some of the main drivers of growth in each of our businesses in FY17, starting with Journeys.

While traffic has been challenging post-Easter, as we said, we believe it's largely weather- and calendar-driven and expect that as temperatures become more seasonable and we move through the Memorial Day offset, sales trends will improve. In fact, traffic in our northern regions of the country where it has been colder have been more affected than those regions in the south.

We were pleased to see ASP increases for Journeys in Q1, due largely to mix changes with the sale of higher-priced products. This is encouraging trend that not only helps top line, but helps operationally, as fewer payers are handled the system. Looking further ahead, we believe Journeys is well-positioned for back to school and holiday, given early read from demand and sellthroughs for fall and winter product that we will be selling back.

At the same time, Journeys is making progress on a number of initiatives to drive growth in its direct business. That includes supply chain investments to increase the speed of deliveries to customers, adding more web-exclusive product offerings, and increasing catalog and direct marketing to drive higher digital and store traffic.

Another exciting growth vehicle is Journeys Kidz. As a reminder, this concept has had positive comps for the past 13 years. We are aiming to build on this momentum by expanding the brand's footprint, and plan to open 45 new stores in FY17.

And we are excited about the addition of Little Burgundy, which provides a new platform by serving a slightly older customer in Canada, with a heavier weighting of female customers compared with Journeys. The business is off to a very good start this year, and we believe there are opportunities to build both Little Burgundy and our Journeys business in Canada through a sharing of best practices between our teams.

At Schuh, as we mentioned, the weather has turned favorable in the second quarter, and sales have picked up. We'll have to see if this trend continues. But regardless, we believe it is prudent to remain cautious about Schuh's top-line opportunities in the near term, given the volatility we've experienced and then possible headwinds from the Brexit referendum in June, especially with respect to currency.

In the meantime, we are making progress working with vendors to deepen our relationships and capitalize the benefits of being part of the global Journeys brand to gain some more advantages, such as Journeys has achieved in the US. These actions, along with a more targeted promotional strategy, should accelerate growth and improve margins for Schuh is the year progresses. We are also moving ahead on our plan to open a handful of Schuh locations this year, including a third store in Germany.

Finally, I want to acknowledge the great job the Schuh Team has done in managing the business in a challenging operating environment. They were able to deliver roughly their planned bottom line in Q1 despite top-line challenges, and importantly, they did this while keeping inventories in line, which builds our confidence regarding the rest of the year.

Moving to Lids, it has been a solid start to the year. One call out is the Hat business, which delivered the strongest comp of all the Lids businesses in Q1, along with improved margins, fueled in part by a good start to the Major League Baseball season. That said, we will hit base headwinds in the Lids Sports Group overall in Q2 from the mix of unfavorable NHL teams in this year's playoffs compared with last year.

In the NBA, we surely prefer Golden State and Cleveland, but also believe we can do a fair amount of business in Toronto and Oklahoma if they make the finals. But make no mistake, Golden State and Cleveland are by far our preference.

Beyond the good start to the year, we are focused on the initiative we put in place to drive profitable growth. Lids will continue to benefit from the new merchandising practices and processes we have implemented to increase churns and better flow product into our stores and onto our websites.

The strategy of taking markdowns earlier and more frequently in the season has helped not only gross margin, but has also freed up open-to-buy dollars to better chase hot product and drive comps. This, coupled with new metrics to continuously monitor inventory freshness, will help ensure that we don't get into a position like last year that required extraordinary efforts to right size inventory levels.

In addition to the merchandising initiatives, we believe the business will soon get a boost from the recent launch of the hybrid software platform. This new front end for Lids.com, which has successfully been going live in stages over the past few weeks, will give us meaningful improvements in navigation, presentation, and customer interaction, and we expect it will drive much better conversion on our websites.

Next, at Johnston & Murphy, the year is off to an excellent start, and great product continues to drive the business following a strong year last year. The current performance is being led by J&M's expanded offering of casual and sports casual footwear, along with brand's growing apparel collection and women's line. We are seeing particular strength in our own J&M stores, especially full-line locations, which is a great sign of brand health given the current retail environment. But even in department stores, where traffic trends have been challenging, our wholesale customers have been seeing strong sellthroughs.

And finally, our Licensed Brands division had a tough first quarter, reflecting the recent performance of many of our key accounts in the department store and national chain channels. A bright spot we are excited about is the relaunch of Bass footwear through a newly acquired license.

While we delivered some new product in spring, we are using the great heritage of the brand and its iconic silhouette like The Weejun to do a major launch for fall. We are really pleased with the traction we have been making in the marketplace that served not only legacy Bass customers, but also those retailers that can introduce the brand to the millennial customer who may be less familiar with it.

So in closing, I would like to thank the entire Genesco Team for delivering a solid start to the year, especially in light of the challenges facing most of retail over the past few months. It was great to see Lids contribute meaningfully once again to the over results, and while our enthusiasm is being tempered by external factors, we feel good about the strong strategic positioning of each of our businesses and confident in our ability to capitalize on many long-term opportunities that lie ahead.

So Operator, we are now ready to take questions. So that this doesn't take until dinnertime, we're going to ask that you limit yourselves to one question, and then only if necessary, one follow up.

Thank you for doing that.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Jay Sole, Morgan Stanley.

Jay Sole - *Morgan Stanley - Analyst*

Hi, good morning. Bob, you mentioned this is a time of industry transition in the Lids business. Can you just talk more about that, explain what opportunities that might present for Lids?

And then my second question is just about balance sheet capacity for more buybacks if you do choose to opportunistically buy back some shares going forward. Thank you.

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

As we said, we think bringing in Dave Baxter is terrific for what we think is a landscape that continues to shift in licensed sports. Start with the fact that we think we have a very strong strategic position as the largest omni-channel retailer of licensed sports gear. We're making all the investments to continue to drive that as the leader in the category with Locate [hybrid's auto] store. And we've addressed the need to be faster as merchandisers, and so we think that leads to additional opportunities down the road.

Then if you look industry, the definition of retail channels is shifting a little bit. All the [leads] are taking a good look at that, as well as the vendors, and they seem to be more committed than ever to cleaning up retail, especially online retail, and that all plays to our advantage. And obviously, we would like to have a seat at the table to somehow influence a little bit of it of how that happens.

Increasingly, there are select vertical rights that might be available to us. That generally comes at a price, but we're surely going to consider it. We're doing a lot in customization, which again requires collaboration with the leagues. So as an example, you can get -- I forget how many players we now have, but you can now get the autograph of a player custom embroidered on a hat, and it's a great offer for the customers. It's a great margin for us. Obviously, that's something that we do in collaboration with the leagues and the player associations.

We're doing a similar thing with colleges now, Jay. We're taking some of the trademarks they have and setting up the ability to embroider that. So think of an Alabama had with Roll Tide. And so there's lots of things happening in the space, and we think the more that we are in constant conversation with all of our partners and really thinking through how we fit into that whole landscape, the better off we are.

On the balance sheet question, I'll start. I'll hand it to Mimi. As you know, we won't sit on cash. And so the last round of buybacks was related to the cash we generated last year, the sale of Lids Team Sports. The liquidation of a lot of the inventory at Lids also added cash. We consider a lot of uses for cash, but what we won't do is we won't sit on it for a long time.

And the acquisition environment, while we've looked at a lot of stuff, we just have been, we think, prudent and discriminating in what we would do, so that led us to buy our shares as the best alternative. So we're prepared on a go-forward to continue down that track. We're not going to lever up the Company dramatically in order to continue to that track, though.

So we're going to be examining what our cash flows look to be in the coming years. As you know, we generate all of our cash in fourth quarter, so the closer we get fourth quarter, the more we start thinking about the fact that we have another cash balance coming our way. With that, I'll pass it to Mimi.

Mimi Vaughn - *Genesco Inc. - CFO*

Jay, we've been very opportunistic about buying our stock, and we go in and buy when we think pricing levels are appropriate. And if that opportunity presents itself this year, we have a $400-million line, and we have no US borrowings currently. Of course, our peak working capital needs happen in the third quarter, and even with that, we would have availability to buy back in advance of generating this year's cash flow if we chose to do so. And so if the opportunity presents itself and we feel like it is the right thing to do, we would have the capacity to do that.

Operator

Pam Quintiliano, SunTrust.

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

Let's move on.

Operator

Chris Svezia, Susquehanna Financial Group.

Chris Svezia - *Susquehanna Financial Group / SIG - Analyst*

Hi, good morning. Thanks for taking my questions. Bob, just for you, just going back to Schuh for a second, I know in the past you made some comments about how there's some brand separation between what's going on in the US and in the UK.

How much of what you're seeing is just strictly really the weather, and how much is really better alignment of brands or better traction key brands? Just maybe talk about the sustainability of seeing comp improvement at Schuh.

And then just lastly, Mimi, for you, just on the gross margin, slight uptick in terms of the improvement relative to your previous guidance. Any color about the cadence and how we think about it through the year? Most of the improvement is probably Q4? Is that fair to say?

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

So on Schuh, it's a little bit of everything. Traffic, which we measure, was down, and then by the end of the quarter, down significantly. As you probably know, Chris, a lot of UK retailers released some pretty tough results, so we're not alone on the high street in terms of suffering from traffic.

There was some divergence in certain brands in terms of their demands profile here versus over there, and that hasn't changed a lot. Obviously, what the Schuh guys have done is adjusted the assortment to reflect the demand patterns. So that's less a factor now than it was because they've make those adjustments. Obviously, what they're hustling to do is to find the brands that will replace the ones that softened up, and they're having some success doing that.

But the traffic patterns have been not our friend, and obviously, when traffic and sales get soft, then the promotional environment that you are surrounded with also becomes a little bit challenging. So that's the best I can describe for you right now. We're cautious, as we said, both because of the volatility, but also the referendum in June is creating a lot of angst. And if nothing else, even if it doesn't ding consumer confidence, depending on the outcome, it could hit currency, and that would matter to us.

Mimi Vaughn - *Genesco Inc. - CFO*

So Chris, we were pleased with where we came out on gross margins, and gross margins for Lids in particular were stronger than we had anticipated in the first quarter. So we're going to wait to see.

Some of that was caused by some one-time of the things. We took some price increases. We're going to have to see if those hold throughout the year. We had some pretty high expenses in our warehouse last year, which improved significantly and gave us the upside for Q1.

As we think through the course of the rest of the year, the gross margin improvements won't be as strong in the second quarter, but then we expect that in the third, and in the fourth quarter in particular, that gross margin will pick up. And that really mirrors what happened last year where we promoted in Lids through most of the year, but the intensity increased pretty significantly in the third, and then very significantly the fourth quarter.

So a little less pickup next quarter. A lot more in the third quarter, and then more than that in the fourth.

Operator

Pam Quintiliano, SunTrust.

Unidentified Participant - - *Analyst*

Hi, this is Dave in for Pam. Sorry about the earlier. Thanks for taking the question. Looking domestically, can you talk about the health of your core Journeys and Lids consumers in terms of the macro factors impacting your comp guidance and the trends that are benefiting them?

Also, others have said that consumers are spending on experiences that are -- [instead of apparel]. What your thoughts, and how are you are addressing that?

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

Look, we are not thinking about the consumer much differently than most other people are. The data shows that the spending is decent from the consumer, but it's not in our categories. People are spending on eating out.

Mimi Vaughn - *Genesco Inc. - CFO*

Home.

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

Home is doing well. The mall is not doing well. And so we are building our comp assumptions around continuation of the same. Our guidance for the year is built off of 1% --

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Mimi Vaughn - *Genesco Inc. - CFO*

1% to 2%

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

1% to 2%, so that's pretty much says it.

Operator

Erinn Murphy, Piper Jaffray

Erinn Murphy - *Piper Jaffray & Co. - Analyst*

Maybe going back, Mimi, to you on the guidance. I think last time you spoke to us, you did speak about EPS growth in the half being down and then clearly picking up strongly in the second half. Obviously, gross margin much better.

You alluded to that and an earlier response, that it would be down -- or excuse me -- it's up to a lesser extent in Q2. So just maybe help us think about on a EPS basis, just the cadence that you feel comfortable with from a second-quarter perspective versus the second half, where it seems like gross margin picks back up to the level that we just saw on that first quarter.

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

Erinn, I'll start, and then I'll hand it to Mimi. Obviously, we had a really nice first quarter. And the natural question is, does that inform us that we can do the same throughout the rest of the year. Our guidance suggests that we are not there yet.

And what that relates to is additional things that we've seen on the expense side that we think are potential headwinds. And the two big categories for that are labor and then some of the battles we're having with fraud in our stores. And as you know, with the EMV conversion, many, many retailers have been challenged by that, and so we are not alone, But we are building in a little more cushion there into our guidance that is pretty much spread out over the year as a percent of sales

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Mimi Vaughn - *Genesco Inc. - CFO*

Yes, and just to build on what Bob just said, the percent of sales is largest in the back half of our year, and so the fourth quarter is impacted by those expenses to the largest extent. But Erinn, if you look at our earnings pattern last year, we had over 80% of our earnings in the third and fourth quarter last year, and we would expect the same from this year.

In fact, the second quarter is our lowest quarter from an earnings point of view, and so it's really important for us to be able to deliver on the third and the fourth quarter. So, we still remain cautious about our outlook on the second quarter, especially because it is such a low earnings quarter, and any additional expenses tend to add to the deleverage of that quarter; but then we are able to pick up ground in the third and fourth quarter. So I think that would be the way that we would think about it.

Erinn Murphy - *Piper Jaffray & Co. - Analyst*

Okay, so just if I'm hearing you right, clearly still some benefit on the gross margin side in Q2, maybe not to the same extent given some of the one-time or nuances in Q1, but the deleverage because it's a small quarter on the top line just in general, maybe offset that in the second quarter, and then you pick it back up.

Mimi Vaughn - *Genesco Inc. - CFO*

Yes, I think that would be the right way to think about it. We do expect SG&A to deleverage throughout the course of the quarter, in part because of the Lids Team Sports. It's not part of mix anymore. And so just naturally speaking, the level of expenses goes up, and then these additional expenses that we've discussed will impact the third and fourth quarters. So that's the offset, in part, to gross margin.

Operator

Jonathan Komp, Robert W. Baird.

Jonathan Komp - *Robert W. Baird & Company, Inc. - Analyst*

Hi. If I could ask -- I'm just focusing on Lids -- maybe a bigger picture question about margin opportunity, and I know a lot of noise last year for a number of different reasons. But when I look at the margin performance of that business relative to FY15, first quarter still down little bit, and I think expected down on that basis for the full year relative to that FY15 number, even though you've sold the Team Sports business, which was lower margin. So any way to just conceptually frame up that opportunity to get back towards the -- I think for the year end 2015, it was a 5.4% margin business, but how are you thinking about some of the puts and takes?

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

This is Bob. I'll start more qualitatively. Last year in particular, anybody who's been around retail knows that when it rains it pours, and you get a domino effect on bad things. So the inventory situation hit expenses as hard as it hit gross margin, as we had to handle that many more goods, et cetera, et cetera.

And where we are now is we have a merchant team operating with great discipline. They're flowing goods more thoughtfully against demand, and more of a key item focus. We have a better markdown cadence. We think that all plays in our favor.

In the stores, we're now using Shop Attract, and we've really proved that even in the headwear stores, they look like they're self-service oriented. We've proven that in fact product is sold, not bought, and that staffing to demand and selling skills really matter, so we're focused a lot on that.

In the warehouse, we're now running with AutoStore, which is robotic picking, and that has taken an enormous amount of labor which was already too high last year, because we had so many returns from stores to try and clear goods on the web. When we were clearing a lot of goods on the web, we ended up spending a lot of money on shipping because we had bulk buyers that came in, that were shipped out of multiple sites, so we were eating a lot of freight.

And so I'm just giving you the rundown on all the things that it's the opposite of the when it rains it pours, so when it finally stops raining, there's lots of things that can improve. And so that's part of what contributed to the improvement that we saw in the first quarter.

Mimi Vaughn - *Genesco Inc. - CFO*

And John, I think it's important to remember that our bonus program is pretty leveraged, and so last year didn't have any bonus expense. This year, we do have fairly significant bonus expense, not only from the sale of Lids Team Sports, but also from the improvement in operations.

And so when you look back to FY15, the way we thought about it, it's going to take more than a year. It's probably going to take a couple of years for us to be able to get back to those levels because of that bonus deleverage. The way that our bonus program works is that you actually to improve over the prior year's results in order to get additional bonus, and so unless the business improves, then that bonus amount flows back into operating earnings. And so, we can expect a couple years worth of pick-up in Lids bottom-line margins to be able to get back to 2015's level.

Jonathan Komp - *Robert W. Baird & Company, Inc. - Analyst*

Okay, very helpful. And maybe just sticking on Lids, a shorter-term question, any comments on what you're seeing throughout the industry for that business? And related to that, do you think there will be any short-term impacts from the Sports Authority? I know they have, it looks like maybe a little bit of a fan shop business, but any short-term impact you're expecting from some of that volatility?

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

We're not expecting a whole lot from Sports Authority. We think that what's going to continue to happen in this industry, which was our investment thesis when we went to Locker Room business, we expect further consolidation. We expect to be a participant in that over time, and we think that, that helps the industry.

Operator

Eddie Plank, Jefferies.

Eddie Plank - *Jefferies LLC - Analyst*

Hi, good morning, guys. Thanks for taking the question. Two quick ones. On the Lids gross margin, was the elimination of the wholesale business better than you expected? I think last quarter, you implied some pick-up, but it seems maybe the magnitude was little higher.

And then a quick follow up. How are you thinking -- you didn't comment on Macy's at all today, Bob. I'm just wondering how you guys are thinking about the profitability opportunity there? And any update on how you feel about shop locations within the Macy's boxes right now.

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

We will take those backwards. I'll do Macy's. At Macy's, right now, with our partner, we are focused on profit improvement. We are not currently focused on growth this year. We are both ambitious to continue to get back on a growth track when we've got full proof of concept.

So right now, we're acting what we've learned over the past two years -- what markets work, what locations within stores work, what's the merchandising mix that works? What are the promotional patterns? Obviously, Macy's has a unique promotional environment, so how do we play most effectively in that world? We are testing models with much more flexible labor, which was always the plan. And then operationally -- and there's just a lot of things operationally we need to get in sync along with our partner.

So this year, we might make a little, lose little. It's going to be in the neighborhood of breakeven probably. This is a business that will take some time to get right, and just like a lot of our successful businesses, you go through and investment period before you find the groove. And so that's where we are right now with Macy's.

Mimi Vaughn - *Genesco Inc. - CFO*

On gross margins -- so you have to think about the Lids Team Sports business. I wouldn't say it was a wholesale business, but it mirrored the economics of a wholesale business. So if you think about it, the gross margin was lower, and also, the level of expenses was lower.

When you take out the Lids Team Sports business, just naturally speaking because of the mix of businesses, the Lids margin will go up. So we anticipated that the Lids margin would go up in the quarter, but where we gained additional benefit was in the pickup in the remaining retail business.

If you look at the overall pickup of 560 basis points, about half of that came from removing the Team Sports business. The other part came from the pickup in the retail business' gross margin because of all of those factors that we've described. Some of those we think were unique to the first quarter. We're going to have to see whether or not those continue, but we will improve on gross margin as we anniversary the heavy promotional activity in the back part of the year.

Operator

Mitch Kummetz, B. Riley.

Mitch Kummetz - *Robert W. Baird & Company, Inc. - Analyst*

Thanks for taking my questions. Bob, I know you don't like talking about brands and trends, but clearly, there is brand that is trending very well right now that does have some pretty broad mall-based distribution. And I'm just curious if there's any way you can speak to the product availability that you're getting or any changes in the competitive landscape that you might be seeing as result of that?

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

With every brand that gains a lot of momentum, we chase it hard. And as is almost always the case, when a brand gets strong momentum, it's usually a chase environment. We feel like Journeys is always in a pretty strong position to chase because of their size and their relationships, so we feel pretty good about our ability to compete.

Mitch Kummetz - *Robert W. Baird & Company, Inc. - Analyst*

Okay. And then Mimi, just on the margins at Lids and the Team Sports sale, so you said it was 310 basis points of gross margin benefit in the quarter, and then I think in your CFO commentary, you talked about 50 basis points of SG&A deleverage in the quarter, and I think you attributed that primarily to the Team Sports sale.

So are those the numbers that we should be thinking about terms of the run rate of the impact on Team Sports, the sale, like in the 300-basis point range on gross margin and 50 basis points of deleverage? Is that how we should be thinking about that over the balance of the year?

Mimi Vaughn - *Genesco Inc. - CFO*

I think that, that wouldn't be a bad number to use for the balance of the year. The Team Sports business tended to be heavier weightings in a second and the third quarters, and so their level contribution ended up picking up somewhat in those quarters and then weren't much of a factor in the fourth quarter so I'd spread it out in that way.

Operator

Sam Poser, Sterne, Agee & Leach.

Sam Poser - *Sterne, Agee & Leach, Inc. - Analyst*

Thank you very much. Good morning. I just wanted to follow up. You commented that the Lids hat business was what did quite well in the quarter. Can you give us some idea of the variance between the hat comps in the Locker Room comps in the quarter to like --

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

No, were not going to break out comps --

Sam Poser - *Sterne, Agee & Leach, Inc. - Analyst*

No, just the difference between them. Like the Lids business comp was 20 basis points better than the other. Just to give us some idea, because you did mention the hat business being better, and I wondered to like to what degree was it better than the Locker Room business.

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

A little bit better.

Sam Poser - *Sterne, Agee & Leach, Inc. - Analyst*

And at what point -- you've made all the changes here to the Locker Room business now. You've cleaned up the inventory, which is great. Inventory is way down there. At what point -- how long is it going to take -- you used the word proof of concepts -- when you get a read and know -- okay, we feel good about this now that we've changed the way we are attacking and everything else, for the Locker Room concept by itself.

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

The proof of concept was a specifically made reference to Macy's. Sam, right now, we will -- as you know, we have a new CEO starting next week, so when David gets in the chair, one of the very important things to do is for him to get really engaged with the teams, to look at what the trends are, and to start to form his own opinions; bringing to the table his unique insights, being a career industry guide, on what we need to do in order to get this thing humming -- get the Locker Room business humming the way we want.

And so the work that he does in the first months that he is here will help inform that question. So Ill beg your patience, and let's give Dave a little time to get his feet underneath him in the Lids world, and then we'll come back to you.

Operator

Laurent Vasilescu, Macquarie Capital.

Laurent Vasilescu - *Macquarie Research - Analyst*

Good morning. Congrats on strong results in a challenging environment. I wanted to follow up on the Macy's question. It looks like you increased the Locker Room closures from 9 to 38 for the year. Can you talk about the decision to increase the store closures? What's the right store count going forward?

And then as a followup, I think you had mentioned in the prepared remarks that Schuh so double-digit declines in traffic at the end of 1Q. Can you talk about traffic variance at Lids and Journeys over the course of 1Q and then quarter to date?

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

Yes. Your first question, I think you are confusing things. We have a Locker Room business. A small percentage of our Locker Room business is done in Macy's. The bulk of it is done in the Locker Room stores and Clubhouse stores that we operate independently. The closures that we have made there, is some closures in Macy's, but the big impact of closures is and will be in the broader set of Locker Room stores.

So we have in the neighborhood, across the whole business, not including Macy's, somewhere around 60 stores in the next two years. And the first couple, the first group that we've dealt with this year, when we've gotten to the lease event, we've had actually a lot of success resetting rent. So it's a bigger story than just what stores we've closed. There are stores where we had them targeted to close possibly, but we've gotten nice rent reductions that allowed us to stay in business.

So I'm turning your question into a bigger one which says, where does the Locker Room business see profit improvement, and we think it is a combination of closing stores and resetting rents; and it's a little hard right now to tell you what the percentage between the two is going to be but both will contribute to performance improvement.

Operator

Jill Nelson, Johnson Rice.

Jill Nelson - *Johnson Rice & Company - Analyst*

Just a bit more clarification on the Team Sports impact to Lids gross margin. I think for the Lids overall division for the year, you're expecting about 500 basis points in gross margin improvement. If you could tell us maybe what percentage of that improvement is reflecting the sale of Team Sports?

Mimi Vaughn - *Genesco Inc. - CFO*

It is about half. I think that we had said that when we looked at the amount of gross margin that we gave up last year, let's just take Team Sports out all together from last year, we gave up about 400 basis points. So we expected that the pickup would be in the neighborhood of half of that. We'd get about half of that back this year. So 200 to 250 basis points would be what we expect for the core retail business, so the balance of that then is Lids Team Sports.

Jill Nelson - *Johnson Rice & Company - Analyst*

And then you commented I believe in Q&A that first quarter, you tested some price increases at Lids, if you could give us more info around that strategy. Thank you.

Mimi Vaughn - *Genesco Inc. - CFO*

Yes, I think that our price increases were just more generally to what we typically do. We're always changing prices. We're always attempting price increases. The real question is whether or not the price increases end up sticking relative to the amount of volume we ended up giving up.

In Canada, we increased prices in particular, because much of the product that we buy is denominated in US dollars and with the exchange rate rates, we were actually sitting in a position where our gross margins were being squeezed because of the higher cost of goods. And so, the reference to testing the price increases a lot was around the price increases we've taken in Canada to see whether or not those could stick to improve our margin situation there.

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

To be clear, in the US, we are largely MSRP retailers. So it's not as if we're taking prices above what the venders are recommending, what they're setting as MSRP price. So that's pretty much standard -- as they take up prices, we will take up prices with them, and obviously, there's a lot of back and forth about how well that's working.

Operator

Corinna Freedman, BB&T.

Corinna Freedman - *BB&T Capital Markets - Analyst*

Hi. Good morning, guys. Quick question on the kids business, just wondering if you could give us some color there, and with several of your competitors now getting bigger into that space, do you have any comments on differentiation or the increased competition that's coming up for that segment? Thank you.

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

And we love the competitive environment in the segment because we actually think it's consolidating. (Technical difficulty) Stride Rite has backed down on a lot of their store count, and I think a lot of the -- it's been a hard space for a lot of other bigger box guys to compete in. So obviously, Foot Locker has been calling it out as a success, as have we, and we think there's enough differentiation between what Foot Locker does and we do that if the world evolves so that there's two major outlets for the core brands, that's a good thing; and we can live very comfortably with two major kids footwear stores gaining share.

Corinna Freedman - *BB&T Capital Markets - Analyst*

My follow-up question is about e-commerce. Any thoughts there, anything you're working on for back-to-school that's differentiated versus last year? Thank you.

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

Obviously, we are investing -- it's a regular pattern of investing and getting better, so if there was ever an example of continuous improvement, that would be it. The biggest callout -- everybody's doing something. We called out what Journeys is doing. Schuh is always testing a new approaches.

The biggest change is probably over at Lids because we've changed the front end to [hybris] from, to be honest, a fairly antiquated home-grown front end, which we've been with for probably too long. So that is a front end that we rolled out in stages, taking pieces of traffic and redirecting it to the site to make sure that we did not have any glitches, and so far so good. And we will get some good reads on the traffic, the conversion off of that, which we expect to be better. We'll have a good read on that by the time we gather in three months.

Operator

It appears or no further questions at this time. Mr. Dennis, I'd like to turn the conference back to you for any additional remarks.

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

Well, we appreciate everybody joining us for this call, and we look forward to catching up again in three months. Cheers.

Operator

This concludes our call for today. Thank you for your participation. You may now disconnect.
