Company Name: Genesco Inc. (GCO)
Event: Baird’s 2018 Global Consumer, Technology & Services Conference
Date: June 6, 2018

<<Jonathan R. Komp, Analyst, Robert W. Baird & Co>>

Okay, great. Thank you. Let’s get started today. I’m Jon Komp, Baird, Senior Analyst, covering the Active Lifestyle Space. Very pleased today to have Bob Dennis and Mimi Vaughn from Genesco. With me today, which I’m sure many of you know Genesco is a leading portfolio – really leading specialty retail brands covering the team footwear, apparel and license sporting good markets pretty broadly.

And, yup, some of the matters you may know Journeys, Lids, shoe in the UK, Johnston & Murphy is very iconic retailer. So, very pleased to have them with us today to tell the story. I’m going to let them kick off with some opening remarks, and then we’ll kick into the Q&A session.

<<Robert J. Dennis, Chairman, President and Chief Executive Officer>>

Great. Thanks. So it’s a timely conference for us, some of you probably are aware that we released our earnings yesterday for the first quarter. I’ll give a quick overview and ask Mimi to give a few more details behind it. So, we basically, on an EPS basis, lost $0.06, which was pretty much our expectations, and if you look at the shape of the business, we had a nice performance in our U.S. based businesses. We had some acceleration in our sales comps in all three major retail businesses in the U.S. and then we just called out that may got even a little better off of that.

I’d caution you all about May, I know a lot of retailers have come out and said May was strong, but in our experience when you have an extended winter, which we had here. So that was a bit of a headwind in the first quarter that you have some pent-up demand. So, the surge in sales that we saw in May, I think might be just a seasonal effect. So, I’d give you that heads up.

Our challenges were in the UK with our shoe business. Over there, they had an even more extended winter, they had a snow storm. In April, which is very unusual for them and that’s really impeded the sales of seasonal goods. And in addition to that, if you’ve been following UK retailing, it’s just been very difficult in the footwear and apparel space over there, the breadth foot is in the headlines every day and as you probably know they don’t have a real good resolution to that yet. And so what we’re seeing is, is people tightening their belts a little bit, there is healthy spending on basics, but in the fashion category, it’s been a little tougher.

And then finally, in the UK, we’ve had some vendors that are really pursuing the scarcity model in terms of supply, and that’s a model to be clear we like, because that drives demand, but usually connects to narrow distribution, which works for us, but every once in awhile you run into a couple of styles that are so hot that the customer is willing to wait for the supply chain to catch up with demand. And so we’ve had a little bit of that situation going on as well and we’re expecting some relief on that as we move into the second quarter of the back half of the year.

So, with that said, Mimi, anything you want to add to the quarterly highlights?

<<Mimi E. Vaughn, Senior Vice President, Finance and Chief Financial Officer>>

No. I think that's right. We reaffirmed our guidance for the year at $3.05 to $3.45, and really on the strength of our U.S. retail footwear businesses, both Journeys and Johnston & Murphy are coming off of a really good fourth quarter as a strong start to the year. We're anticipating that moderates a little bit in the back half of the year, but our feeling like our guidance number can be reaffirmed even with the experiences that we've had with shoe.

<<Jonathan R. Komp, Analyst, Robert W. Baird & Co>>

Great. I'm launching the Q&A here in just for everyone in the room at session3@rwbaird, if you want to chime in with questions, I'll get them up here and work them in. But I want to start with the U.S. businesses both in the quarter and into early Q2 here, I think clearly an area of strength in your business. So, I'd love to maybe just start high level of kind of your assessment since it's been broad based for your businesses in the U.S., what you see in terms of the environment kind of the state where we are today, and kind of the broader assessment of the U.S. today?

<<Robert J. Dennis, Chairman, President and Chief Executive Officer>>

Yeah. So, when we look at the business, it's hard for us to be general, because so much of our performance ends up being category specific. So, overall, the trends that have been out there are continued to be out there, which are negative traffic trends in the malls, seems to have moderated a little bit versus last year, but again, you've got weather and Easter offsets and everything. So, I wouldn't read too much into that yet.

The pattern for us is, when we're right with our assortment, and we've got what people want. We see our traffic relative to the mall increase and that's the case with Journeys right now. So, for those of you that follow us know that Journeys came through a fashion cycle as they exited from a campus focused fashion trend, and getting into retro athletic and fashion athletic, which continues to be very strong for us. So, we are seeing great traffic into the stores, positive traffic, which we hadn't seen in a while and good conversion, and so we're translating that into a very positive comps.

So, our expectations, everybody has how longer than fashion trend last, historically they've lasted two, three, four years. There is some concern that we hear from investors that social media in particular might accelerate the cycle. We're feeling pretty good for sure about this year. If you were buying for one of the things about retail is, you don't have it, you can't sell it. And so the buying team has gotten the confidence to extend into the back half with buys that will allow us to sustain some nice positive comps. And so we're excited about where we stand in that business.

In the Lids business, we're seeing improvement over the fourth quarter, but it's the reverse story in the sense to that, we're at a fashion law within the headwear world, and about two thirds of our business has concentrated in the licensed headwear space. And that's another, if you look historically over 20 years, you'll see that it ebbs and flows, and so we're in a period, where there isn't anything that really is providing new excitement.

Our vendors and our teams are working and experimenting, and testing, and running programs that hopefully can excite the consumer, but we've seen this before. And so we're going to keep on slugging it out, but the result of that is the traffic into our stores in the headwear stores is trailing the mall. And so when you're hot, you're hot; when you're not, you're not, and that's a little bit of where we are right now, but we're working that very hard to try and turn the corner on that business.

And then finally, in the U.S. Johnston & Murphy is a terrific brand, that's been running nine years of positive sales growth, and what the team there has done, which is terrific, is reoriented the brand to be more lifestyle and away from its legacy dress shoe positioning, still do a lot of dress shoe business, but the number one seller in the month after month after month always turns out to be something on the casual side of the store, which is consistent with trends in fashion we're seeing right now. And we're also having great success in our stores with apparel and accessories. And so our customers recognizing the brand as standing for a lot more than just the dress shoe, which is its legacy. So, that's the U.S. history, anything maybe you'd add?

<<Mimi E. Vaughn, Senior Vice President, Finance and Chief Financial Officer>>

Yeah. I think, other thing I would say is that we are fortunate and that we are a legacy catalog business, and we actually built our e-commerce businesses within our store networks, and have seen nice double-digit growth also over the last decade within our e-commerce businesses, and our well penetrated.

So, a lot of the work that we are doing is around driving our e-commerce business, in addition to all of the omni-commerce initiatives. And so we can see inventory across our entire network and access that for our customers, who are working hard on some customer facing initiatives to make those interactions across both e-commerce and the store network quite seamless to our customers.

One of the advantages of having a store network is that we are a place, where our customers can come in and return their product, which in the world of having a lot of deliveries to your house has been something that not just our customers, the customers in general have called out as being a feature that they like a lot. And so we really have gravitated the retail model into thinking about how do we best serve our customers in whichever way they would like to be served.

And one thing that's interesting is that our Journeys' customers are a bit counterintuitive, is a very young digitally native customers, there are our age groups that we serve there is the 13 to 22 year old. And you'd think they'd be the ones, who would be shopping online all the time, and in fact, that's not the case.

They do all their homework, on their devices, because they are living with their mobile devices attached to them at all times of day and night, and do a lot of homework, and then decide that they want to come into the store to actually complete their transaction. They like the tactile experience of touching the product of getting the validation from our sales people that what they are buying is right, their shoes size changes. And so for us, it really has been a lot of initiatives around thinking about how do we best serve our customer taking aspects of the digital and physical world, and being able to unite them.

<<Jonathan R. Komp, Analyst, Robert W. Baird & Co>>

And maybe I want to stick on the fashion element for Journeys for a little bit. Yeah. I think it was early 2017 when you brought really an infusion of the fashion and retro lifestyle athletic. And now, you're cycling positive same-store sale months in sustaining positive same-store sales. So, maybe just give a little more color you've talked about the number of brands and the trend broadening, and in terms of how you're thinking about the balance of this year, and even beyond, how you'd stay on top of the fashion and kind of your degree of visibility in the pipeline there?

<<Robert J. Dennis, Chairman, President and Chief Executive Officer>>

Yeah. So, the first thing was notable is there's a lot of brands playing in this space. And so just about every brand that has great legacy retro product is showing up on the doorstep, and not all of it, but much of it is working. And so that gives us the opportunity to be diversified, which we really like. The other thing that they're doing is which I think was an issue with the last fashion cycle is, they are very attentive to freshness. And so we are probably having less product of that is carryover and more product that is being seasonally driven and new to the market.

And for us that's we love – sometimes when you have carryover product, because it helped your margins, you're not – you're doing less closing out. But if you're going to commit to keeping it fresh, which is what these brands are doing in partnership with us, then I think the life of the cycle can be extended, because the customer could come in and see something new. So, we're feeling pretty good about being able to go to continue to ride this trend. The other thing that everybody asks about is, when you get into our fourth quarter, and then first quarter next year there is a boot business that's also important and last year's boot business was terrific.

We were helped more by weather than by fashion to be honest. But the way the weather set up in the U.S. in particular, allowed us to really drive a lot of boot sales throughout the entire season. And so we're being pretty cautious knowing that it lined up so well last year in contrast to the year before that. So, we're planning a modest gain in boots. We're not being overly aggressive there, but again, hoping to repeat – just repeat last year.

<<Mimi E. Vaughn, Senior Vice President, Finance and Chief Financial Officer>>

Yeah. The biggest change that we have seen in fashion cycles is that used to be that fashion would start out on the coast either the East Coast or the West Coast, and then gravitate inland. So that I think the change we've seen is that information is so ubiquitously available that people in the middle of the country in the heartland actually pick up on fashion trends faster.

And so that's one thing we've adjusted into our model is that a fashion rather than moving slowly and migrating inward actually all happens at the same time. And so that's something that we can adjust for and we can accommodate. The life cycle of teens tends to gravitate around their back to school events, and so we tend to see that they are looking for a newness and freshness, but in their comfort zone, so they can be just like their other friends.

<<Jonathan R. Komp, Analyst, Robert W. Baird & Co>>

When you look at Journeys specifically the guidance for the year, you assumed comps moderate, we have the discussion about what you're at really a three-year comp, because maybe, the one-year comparison isn't as tough as it really looks. So just how are you thinking about comparisons and the ability to keep some of the momentum that you have?

<<Robert J. Dennis, Chairman, President and Chief Executive Officer>>

Yeah. What Jon referred to, we call this out on the – on our call yesterday. We are moderating our comp expectations as the year progresses.

<<Mimi E. Vaughn, Senior Vice President, Finance and Chief Financial Officer>>

Yeah. We had a plus 11% in the fourth quarter just as referenced against a negative number the year before as we were rotating to a fashion cycle.

<<Robert J. Dennis, Chairman, President and Chief Executive Officer>>

So, people will look at a plus 11% and saying, how can you assume plus on top of that. We've got to go back one more year, and realize that plus 11% was going through a major negative number. And so it's just the simple way that the comps work, it's tricky stuff when the business has been volatile. And so we think we are properly planned out for the year ahead and therefore as Mimi mentioned, we reaffirmed our guidance.

<<Jonathan R. Komp, Analyst, Robert W. Baird & Co>>

Okay, great. Maybe switching banners a little bit talking about Lids for a while, also a business that's coming back, but from a much more negative and lower same-store sales base. Can you just frame up what the progression has been there? Two quarters ago, you saw same-store sales really bottom out, and now you've seen the gains, the loss is moderate, and you're translating to a more of a flat to positive number as you get to the latter part of the year. So, maybe talk about what needs to happen for that business to continue to stabilize and just what you see for Lids overall?

<<Robert J. Dennis, Chairman, President and Chief Executive Officer>>

Well, math is just pretty simple. We're going to lap the tough fashion cycle when we get to fourth quarter.

<<Jonathan R. Komp, Analyst, Robert W. Baird & Co>>

Late summer.

<<Robert J. Dennis, Chairman, President and Chief Executive Officer>>

Late summer. And so again, the math kicks in. What we really need is, what we talked about before is, we need some fashion trends in the headwear space to kick in, and I come from that business. So, I've been connected to it for a very long time, maybe before Genesco bought it. And so we've lived through the cycles and the trucker hat was hot, and the hip-hop hat was hot and then bucket hats were hot, and something will get hot it always has. So we're just having to work the store to – and work the customer to find what hooks, I mean the hook is usually driven by celebrity and fashion driven events just like a lot of other fashion, but – so our vendors are generally out their seeding products and trying to generate some interest on the headwear side. We are always watching this. With great interest, the NBA All-Star Game not for the basketball, but for who is sitting on the front row.

<<Mimi E. Vaughn, Senior Vice President, Finance and Chief Financial Officer>>

Yes. And I think the benefit of each of our business is our leaders and the categories that we represent. So we are by far the largest destination for fashion footwear for teenagers and our Journeys concept. We are by far the destination for headwear and our Lids concept. And part of the benefit of being the category leader is that when fashion does take a whole we can blow-up the fashion to a very large degree as Bob talked about. Some of you all may have been familiar with our snap back story back in fiscal 2011, where we took snapbacks from being really – didn't at all register in our business to $100 million business over the course of a couple of years.

Similarly, in the last cycle through the whole dad hat trend, we now have dad shoes, but the dad had trend that really lasted from fiscal 2016 to fiscal 2018. We were able to take a category that was in the $20 million range and blow that up to the $70 million range over a couple year period of time. And so by owning the category by really being the go to play when those fashion trends come into play, we are able to take those trends and make them into really comp driving events.

And so as we go through those malls, we are able to continue to have more mini fashion events like bucket hats or a mini fashion event, some of the work we're doing in the color ways with the new era products are mini fashion events and when those new very large drivers come along that is incremental with the underlying business that we have.

<<Jonathan R. Komp, Analyst, Robert W. Baird & Co>>

And as a follow-up since I've been asked more lately, when you look at their competitive landscape for the Lids business, and you see some of the licensing deals of your main competitor side, how do you think about the landscape overall and your ability to continue to compete?

<<Robert J. Dennis, Chairman, President and Chief Executive Officer>>

So the main competitor is Fanatics and they are primarily an online player. The customer dynamic, which we've demonstrated over and over, is that they will buy online, but they really are customers preferred to go to stores. It is a game day event, were driven a lot by the volumes and our stores go up and down with whether the team is home or away. And so we're driven by a lot of that need it now kind of behavior.

So, I don't think a store base retail gets displaced. It is going to consolidate and so there are some people who buy online. The biggest chunk of the online business goes to – has been online for a long time. And it's just gaining some share, because it's the displaced thing, and if you live in New York City and you're a Nashville Predators stand with the team, you'll have to go online. No one will carry a single piece of national product here.

And so – but for that home fan, we're still the destination for that. We feel very confident as Fanatics has gotten rights that are both retail and wholesale that comes with a huge minimum annual guarantee in terms of the royalty. And so we spent a lot of time with them. We're already doing business with them in the NHL, their service is very well and they have to, because to hit that minimal annual guarantee, they're going to have to do a ton of business in the wholesale channel.

The other thing that's happening in the channel is, there is a consolidation going on in the mom and pop space. So this is a space that in the headwear space, we consolidated the entire industry, which had a mom and pop component, does not really anymore. The more broadly licensed stores that carry jerseys and T-shirts and the hard goods, has still a big mom and pop element and that's become very difficult to compete in, because of the scale elements of being digital, the scale elements of dealing with the vendors. And so we're still very confident that we're in a good spot.

<<Mimi E. Vaughn, Senior Vice President, Finance and Chief Financial Officer>>

And just to underscore that point, I think that just with the challenges in retail, it has been very hard for most of our smaller competition, because lots of people sell shoes and sell hats. It's difficult for them to really withstand some of the forces that are taking place in retail today. So, with the fallout of smaller players with a lot of the bankruptcies that we've been seeing that will then ultimately benefit our business.

<<Jonathan R. Komp, Analyst, Robert W. Baird & Co>>

And then switching gears to the shoe business in the UK and Europe, you're clearly surprised negatively yesterday to have negative double-digit comps, it is less than 15% of the sales base, but still certainly some attention around that. But I thought yesterday, you certainly talked about the business with more of a finite view that between the weather events and some of the assortment allocations, do you expect to see a rebound pretty quickly. So maybe just highlight your expectations for that business.

<<Robert J. Dennis, Chairman, President and Chief Executive Officer>>

Well, you've summarized it well. We do expect improvement there and indeed we did see improvement in May and again, I'll caution you they had an even more extended winter than did the United States, and so there was a pent-up demand. And so we've seen some improvement. We would love to see more product. We have in certain categories and we have more orders on the book. So, if we get those deliveries, then we think we should be able to emerge from this, but it was a very, very tough quarter for all those reasons.

<<Mimi E. Vaughn, Senior Vice President, Finance and Chief Financial Officer>>

Yeah. And shoe was actually up against pretty strong comparisons last year. We had a plus 10% comp in the first quarter just due to some of the fashion drivers of the retro athletic product that were really strong and dominant in the UK in the first quarter last year. And so we were lapping against those pretty challenging comparisons in addition to some of the weather and supply events that we experienced. And so we expect that to moderate out through the course of the second quarter and shoes business was quite positive through all four quarters last year.

The UK market is more advanced digitally. And so the digital component of shoes business is in the high teens. And so that is a driver of our business. They are really advanced in terms of buy online, pick up and store, you can reserve product and pick it up in the store. We've experimented with the same day shuttle delivery within the UK market. We've got many warehouse centers that we can push the cut-off time for next day delivery to much later. And so we've got a really nice robust set of omnicommerce capabilities within shoe.

<<Jonathan R. Komp, Analyst, Robert W. Baird & Co>>

Great. And then maybe, moving over to the cost side of equation, you've publicly identified $35 million to $40 million of fixed cost to take out of the business. Maybe, just give an update when you look at some of the rents or reductions that you're getting versus the broader fixed costs adjustments, kind of a picture of what you're seeing there, plus maybe, any comments on eventually how low – is the goal ultimately to get the leverage point for comps, significantly lower it is today. And could you get it to a flat comp, or you would be able to leverage the business?

<<Mimi E. Vaughn, Senior Vice President, Finance and Chief Financial Officer>>

Sure.

<<Robert J. Dennis, Chairman, President and Chief Executive Officer>>

So, I'll talk about rent and, I'll hand it to you for the rest.

<<Mimi E. Vaughn, Senior Vice President, Finance and Chief Financial Officer>>

Okay.

<<Robert J. Dennis, Chairman, President and Chief Executive Officer>>

On the rent side, we've been talking about this for a while, as traffic has been a challenge in the malls, our position with the landlords has been, we can only afford to pay so much, we need to make our cost of capital. And so what we've been doing is getting some pretty hefty rent reductions. And at the same time, we've been closing stores. So, our net store count has been going down. When we can't get to a deal. And what we're finding is much more and more flexibility from the landlords and it's creeping its way up from the C malls to the B malls to the A minus malls. And so we're feeling very confident.

Now that said, there are – what we'd love to do is just get a variablized rent, because then we can both feel comfortable that we're matched up to the traffic, which landlords are generally unwilling to do. We do have a few deals that look like that. So what we're doing instead is, we're getting as close to that as we can by shortening up the lease life. So, for example in this year, we have done 114 renewals and on those, we've gotten accounting based rent reduction of about 12%, and we've shortened the lease life for that whole group of stores to a little over two years.

So, we're going to set ourselves, we have to come back and get another bite at the apple if the traffic trends continue to go down. And if you look at the C malls that we've renewed, those were renewed for just a little over a year. And so we're just going to keep going back and what you'll see is, we will continue to aggregate how many leases we are able to address and in theory, if you get down to a one-year term on all in theory if you got down to a one-year term on all of your leases, well then you're going to have every store running its cost of capital, because if you don't, you're going to close it. And so that's the path we're on and every year, we should get a bigger opportunity to make sure that all the rents are rightsized.

<<Mimi E. Vaughn, Senior Vice President, Finance and Chief Financial Officer>>

All right. So, those decreases that Bob described were on top of 300 leases that really renewed last year for a straight line rent increases of 9%. So, we've gone from 9% decreases on that cohort of stores to 12% this year today. And that's a very important part of our overall reduction program, because rent is the largest expense items outside of cost of goods in our economics, a lot of other retailers have store labor as their largest expense items outside of cost of goods, but we are small box and therefore rent rises on the leaderboard.

In addition to some of the rent savings that we are pursuing this holistic program that really is across all of our divisions and looking from the bottom up on several line items encompasses not just rent, but also we've re-negotiated our freighter carrier contract. We are working hard at reducing any IT expense within the stores like store network expense and have 25 plus items that we are pursuing and with the objective that used to be that we would have to have a 3% store comp to leverage.

We're under 2% at this point with the set of cost reductions rolled in. We'll keep working that. The rents reduction will compound themselves overtime and we'll be at a point, where we can leverage in the neighborhood of a flat comp with a couple of years of work here. But that resetting the cost base is an important part of our overall set of initiatives, because as much as we delever when – in a fixed expense environment, when you've got a positive comps and cost reductions, that's a formula for profitable growth.

<<Jonathan R. Komp, Analyst, Robert W. Baird & Co>>

Great. Maybe, one last topic, I want to be very sensitive around the obvious desire not to talk about the Lids process that you're in, but maybe if you could just give an overview of what's happened over the last few months in terms of the board structure and the review that's been going on year-to-date, and just to highlight what's changing.

<<Robert J. Dennis, Chairman, President and Chief Executive Officer>>

So as you know, we have a process to explore the potential sale of Lids, no guarantee that we will actually do something. So, it is really exploration. The background on that is this was a decision that was made at the end of last year, whereof the belief that Genesco has always traded either at a peer – at best at a peer level and more often at a discount to the peer group and we think the reason for that is where a small cap that's pretty confusing.

So, we're in the footwear space. We're in the licensed sports space, and we think it would be better off to focus on just the footwear space and reallocate assets accordingly. And so for that reason, we're exploring the potential sale of Lids. After that decision was made, but not yet announced, we had an activist take a position in the stock and long story short, we have agreed with the activist to bring on two independent board members not part of the activist organization. We have done that they haven't been to their first board meeting. We've had very good conversations, being very thoughtful. They have joined our strategic alternatives committee and that's where things sit today.

<<Jonathan R. Komp, Analyst, Robert W. Baird & Co>>

Great. And now, we are out of time here. Management team will be available for a short period for a break-out session. After this, next in this room will be Tyler Technologies. So, everyone can join me and thanking the team for being with us today.