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PRESENTATION

Operator

Good day, everyone, and welcome to the Genesco Fourth Quarter Fiscal 2021 Conference Call. Just a reminder, today's call is being recorded. I will now turn the call over to Dave Slater, Vice President of FP&A and Investor Relations. Please go ahead, Sir.

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

Good morning, everyone, and thank you for joining us to discuss our fourth quarter and fiscal 2021 full year results and our key areas of focus for fiscal 2022. Participants on the call expect to make forward-looking statements. These statements reflect the participants' expectations as of today, but actual results could be different.

Genesco refers you to this morning's earnings release and the company's SEC filings, including the most recent 10-K and 10-Q filings for some of the factors, including the impact of COVID-19 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 in the quarterly earnings section. I want to remind everyone that we have posted a presentation summarizing our results that is accessible on our website.

With me on the call today is Mimi Vaughn, our Board Chair, President and Chief Executive Officer, who will begin our prepared remarks with highlights from the fourth quarter and year; and Tom George, our Chief Financial Officer, who will review Q4 results in more detail and provide direction for the first quarter of the upcoming year. Tom will then turn the call back over to Mimi, who will then discuss some of our key strategic initiatives. We hope that you are all staying safe and healthy.

Now I'd like to turn it over to Mimi.

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

Thanks, Dave. Good morning, everyone, and thank you for joining us today. I'd like to begin by welcoming Tom, who with almost 30-years of CFO Experience and deep roots in brands and retail has been a tremendous addition to our team as we drive the recovery in our business and a return to profitable growth.

We concluded an incredibly challenging year with a fourth quarter that exceeded our expectations across the board. Our performance was driven by record digital revenue and superb all-around results at Journeys, highlighted by stronger-than-anticipated store volume. As it did throughout fiscal '21, our organization successfully navigated difficult operating conditions to serve our customers this time during the all-important holiday selling season.

I could not be more proud of how well our teams have executed during the pandemic. They have faced each new challenge in a very dynamic environment with tenacity and ingenuity while operating under protocols to ensure our highest priority, the health and safety of each other and our customers. My sincere thanks goes out to every member of our team at Genesco for all your good work driving the results we achieved.

Before we get into a review of fourth quarter performance, I'd like to highlight some of the major accomplishments from fiscal '21. Starting with the significant and unfamiliar task of efficiently closing and swiftly reopening our entire fleet of nearly 1,500 retail locations, some of them multiple times. Capitalizing on the accelerated shift to online spending, achieving record digital revenue of $450 million, an increase of almost 75% year-over-year while also fueling record profitability for this channel, driving record conversion rates in stores, helping to partially offset the impact from lower traffic levels and store closures. Increasing market share in Journeys and Schuh, which represent a large majority of our revenue with their ability to retain sales in the face of the pandemic disruption. Conserving capital and reducing operating expenses by 15% compared with fiscal '20, generating cash flow of over $130 million to ensure healthy liquidity. And finally, delivering sequential improvement every quarter.

In particular, bottom line results reflect the strong foundation we built for the digital channel prior to the pandemic. Our online business generated double-digit operating margins before COVID-19 due to our focus on full price selling, disciplined marketing spend and shipping and return policies to reinforce profitability. Thanks to numerous digital investments we've made over the past several years, not only were we able to effectively handle the unprecedented volume from accelerated demand but e-commerce margins improved further as we leveraged these investments over a wider base of revenues.

Our overall performance under difficult circumstances also reflects the strong competitive positions of our retail concepts prior to COVID-19 and our success capitalizing on opportunities to further strengthen the leadership positions of our teen and young adult footwear businesses. In today's channel-less world, where the consumer can shop anywhere the consumer wants, Journeys and Schuh's results underscore the tremendous loyalty they've developed with their existing customers and compelling proposition they offer new customers.

So turning now to the fourth quarter. The work we did to have the right assortments and right holiday campaigns helped deliver Q4 results ahead of expectations in spite of some store closures not anticipated in the U.K. and Canada and supply chain delays and disruption. While we continue to face softer traffic levels than 1 year ago across our retail businesses, Journeys stores posted a nice improvement compared with the third quarter as more shoppers visited Journeys locations during the peak weeks leading up to Christmas. Our store teams once again drove very strong levels of customer conversion to help materially offset the headwinds from less traffic.

Meanwhile, our business online, especially mobile, experienced very strong gains in both traffic and conversion, with new customers, again, driving increased volumes. New website visitors were up 40%, contributing an almost 50% growth in new customer purchases, and we delivered another strong quarter of digital growth with comps up 55%. The combination of these factors led to a total revenue decrease of 6% versus last year, with stores open about 90% of the possible days in the quarter. This result was better than we expected due mainly to the stronger store sales at Journeys and represents a meaningful improvement from last quarter's 11% decline in Q2's 20% decline.

While gross margins were down compared to last year, the gap narrowed for the third consecutive quarter and the sequential improvement was driven by an increase at Journeys due to strong full price selling. As a result of decisive cost containment actions, along with onetime benefits, including substantial rent abatements recognized in the quarter, we drove total expenses down twice as much as revenue on a percentage basis. Inclusive of the rent abatements, operating income was up year-over-year.

By tightly managing inventory throughout the year, we had the flexibility and confidence to bring in new fresh product. However, much lower year-end numbers also reflect the disruption in the supply chain which caused delays, especially at Journeys and Schuh, where we would have liked to have received product earlier.

Turning now to discuss each business in more detail. Let's start with Journeys and begin by congratulating the team on its impressive results across the board. Journeys delivered record operating profit in the biggest quarter of the year in the midst of a pandemic. Fourth quarter top line results matched last year's levels as its merchant team skillfully interpreted trends making the right product calls and its store and digital teams delivered an exceptional customer experience.

When our stores were open this year, Journeys customers were enthusiastic to shop our physical locations and engage with our people. And over the holidays, we were pleased by the strong appetite to shop our stores. With replenishment orders for many key styles arriving post holiday, combined with the first wave of checks from the December stimulus program delivered early in the new year, the business accelerated as January progressed, leading to a strong finish to the quarter.

Comfort reigns as the fashion choice of the pandemic and Journeys' offering of casual product continued to resonate strongly with consumers. While teens always have a big complement of fashion athletic footwear in their closets when fashion swings toward non-athletic or what we call casual footwear, Journeys' is especially well positioned among its competition to deliver this assortment. This Fall and winter, our consumers' appetite for Boots began early and our boot business was good. And our casual business was even better, especially in women's and kids. Congratulations Journeys' team.

Following a good back-to-school season, Schuh came into the fourth quarter with positive momentum and a strong assortment of high demand brands and styles. Unfortunately, the holiday season was severely disrupted by store closures across the U.K. with Schuh stores closed for about 2/3 of the possible days in the quarter. Fortunately, with best-in-class digital abilities, Schuh was able to capture a significant portion of lost store volume through its digital channel, and total sales were down only 13%, capping off a year in which Schuh, like Journeys, gained market share.

As with Journeys, Schuh's casual assortment gained ground over its fashion-athletic assortment with boots and casual strong throughout the quarter and women's leading the way. Meanwhile, Johnston & Murphy's casual footwear offering and apparel categories were, again, the bright spots for the brand in what remained a very tough environment due to the work-from-home trend and significantly fewer social gatherings during the pandemic. The plan going forward is to accelerate the work started years ago to evolve J&M into a footwear first lifestyle brand, with a range of footwear and apparel from dressier to more casual.

Despite the challenging year, there were some solid proof points that this strategy continues to gain traction including the success in the innovative XC4 collection through the relaunch of golf. For the upcoming year, J&M has focused 90% of new product development on the expansion of its casual offering to include casual athletic, leisure, rugged, outdoor and performance.

We brought in a new Head of Product Development, who brings a successful track record developing casual brands to aid in these efforts. As the customer returns to work and socializing, which we hope will be sooner than later, J&M's assortment will be ready for the post-pandemic lifestyle and further void by J&M core customers increased level of savings during the pandemic.

So turning now to the current quarter. Early February extended January's positive momentum until we hit the offset of income tax refunds, which were delayed by a few weeks this year. Nevertheless, February sales came in, in line with our expectations, and in March, we have seen an uptick as refunds began to catch up. Looking ahead, while great progress is being made on this front, we expect the environment to remain fluid in the near-term until the vaccine is more fully rolled out.

In terms of how this shapes our results, it means the first half will show an improvement to last year, given the easier comparisons due to the COVID shutdowns, but we will still be under pressure from store closures especially in the U.K., which is expected to be shut down until shortly after Easter. We anticipate store traffic will also continue to be affected across all geographies this spring. These dynamics will further pressure our results in these low volume months, when in normal times, fixed operating expenses makes it challenging to breakeven. Stimulus will help, we will see how much, and we are optimistic about a greater recovery in the back half. But what we're most excited about is we see opportunities to solidify the digital gains we've made and capitalize on the ongoing industry consolidation to further expand our market share. As many challenges as COVID-19 has created for our company, it has also provided us the real opportunity to transform our business at a faster pace. We've learned a lot and will work hard to accelerate the initiatives and investments we plan to achieve these goals and exceed the expectations of the consumer whose needs have advanced.

So I'll now turn the call over to Tom, who will review our fourth quarter results and future outlook in more detail.

Thomas A. George - *Genesco Inc. - Senior VP of Finance & Interim CFO*

Thank you, Mimi. We were pleased with our performance in Q4 as we handily exceeded our expectations in all facets of operating results. Building upon our strong return to profitability in Q3, sequential improvements compared to the prior quarters in revenue, gross margin and SG&A due to some help from rent abatements, drove higher operating income than last year. A higher tax rate offset the higher operating income, resulting in adjusted earnings per share of $2.76 compared to $3.09 last year.

Turning to the specifics for the quarter. While comps were up 1%, consolidated revenue was $637 million, down 6% compared to last year, driven by continued pressure at J&M and the impact from store closures during the quarter. A robust e-commerce comp of 55% was offset by a decline in-store revenue of 19%, driven by a comp decline of 10%.

While our stores were closed for 10% of the possible operating days during the quarter. Digital sales increased to 27% of our retail business from 17% last year. Consolidated gross margin was 45.8%, down 110 basis points from last year. As we have experienced all year, increased shipping to fulfill direct sales pressured the gross margin rate in all our businesses totaling 80 basis points of the overall decline. Notably, Journeys' gross margin increased 210 basis points driven by lower markdowns. Schuh's gross margin decreased 410 basis points due to the increased e-comm shipping expense. J&M's gross margin decrease of 1,690 basis points was due to more closeouts at wholesale, higher markdowns at retail and incremental inventory reserves.

Finally, the combination of lower revenue at J&M, typically the highest gross margin rate of our businesses and the revenue growth of licensed brands typically our lowest gross margin rate negatively impacted the overall mix by 50 basis points. Adjusted SG&A expenses were down 12% and as a percentage of sales leveraged 240 basis points to 35.7% as we benefited from ongoing actions around expense management, savings associated with rent abatements as well as relief from government programs in the U.K. and Canada. The largest year-over-year savings came from occupancy costs, driven in large part by the execution of about $18 million of rent abatements with our landlord partners who provided support for the time stores were closed and savings from the U.K. government program, which provides property tax relief.

The next largest areas of savings came from the reduction in-store salaries -- store selling salaries, driven by effective use of workforce management tools and from lower bonus expense. These savings were partially offset by increased marketing expenses needed to drive traffic in both stores and online. We took the most significant cost actions at J&M evident by the 29% reduction in SG&A in Q4 and a 25% reduction for the full year.

In addition to the rent abatement savings, our organization has been intently focused on a multiyear effort centered around occupancy cost, and we have achieved even greater traction with the pandemic. We negotiated 123 renewals this year and achieved a 23% reduction in cash rent or 22% on a straight-line basis in North America. This was on top of an 11% cash rent reduction or 8% on a straight-line basis for 160 renewals last year.

These renewals are for an even shorter-term averaging approximately 1.5 years compared to the 3-year average we saw last year, with almost 1/3 of our fleet coming up for renewal in the next 24 months, this will remain a key priority for us going forward. In summary, the fourth quarter's adjusted operating income was $64.7 million versus last year's $59.3 million. Our adjusted non-GAAP tax rate for the fourth quarter was 37.5%. Tax initiatives under the CARES Act and other provisions generated a onetime $65 million permanent income tax benefit for Fiscal year-end '21. This permanent benefit is excluded for non GAAP reporting.

Turning now to the balance sheet. Q4 total inventory was down 20% on sales that were down 6%. The levels of Journeys and Schuh are lower than we would like given the delays in the supply chain. For the fourth quarter, our ending net cash position was $182 million, $100 million higher than the third quarter's level, driven by strong cash generation from operations. The year-end cash balance benefited from both the lower inventory levels as well as rent payables that will be trued up once remaining COVID related deals are fully completed and executed. Capital expenditures were $6 million as our spend remains focused on digital and omnichannel and depreciation and amortization was $11 million. We closed 16 stores and opened none during the fourth quarter, capping off the full year in which we closed 33 stores and opened 13.

Now looking forward to fiscal '22, given the uncertainty remaining with the pandemic, we are not providing specific guidance for Q1 or the full fiscal year. That said, I do want to share some high-level thoughts on how we are thinking about our business. To do this, we think it's best to use the pre-pandemic fiscal '20 as the reference point as there is simply too much noise in fiscal '21 results, for drawing informative comparisons for future expectations. Thinking about Q1 revenue, although we expect a nice recovery compared to fiscal '21, we will be below fiscal '20 levels. This is mainly due to Schuh with major store closures expected through most of Q1 and continued pressure on J&M. Directionally, the overall sales decline for Q1 compared to fiscal-year end '20 could be in the neighborhood of the 11% decline we experienced in the past third quarter.

We will have more stores closed than in the fourth quarter. Our view does not contemplate additional store closures or restrictions beyond what we know today. In addition, we have not included any stimulus from the most recent bill in our forward-thinking, which historically is a tailwind. Gross margin rates for Q1 will be below fiscal '20 levels, more than the 210 basis point decline we experienced this past third quarter. The increase in closed stores will drive higher e-commerce penetration and the higher shipping costs that come with it.

Additionally, we anticipate the negative headwind from J&M to continue into Q1. We expect SG&A dollars in Q1 to be below FY '20 Q1 levels, inclusive of some onetime benefits. However, there will be some deleveraging due to the sales volume likely in the neighborhood of 100 basis points. This is driven by closed stores and lower store volumes as the fixed store occupancy expense causes deleverage.

In summary, it will be difficult to turn a profit in Q1 as is typical during our lower volume quarters of the year. Combined with the seasonality of our business, we are expecting more than 100% of our full year earnings to come from the third and fourth quarters. Even though we are expecting an overall loss in Q1 since that loss is generated in foreign jurisdictions for which there is no-tax benefit, we expect a tax expense related to a small amount of U.S. earnings in Q1. The annual tax rate is expected to be approximately 32%. For fiscal '22, capital expenditures will be between $35 million and $40 million and centered on digital and omnichannel investments, which comprised about 75% of this amount.

Mimi will talk further about the initiatives for the coming year. This does not include another $16 million net of tenant allowance related to the move to a new headquarters location, which we delayed because of the pandemic. But which was precipitated by the landlord's plan to demolish our current building. We estimate depreciation and amortization at $48 million. We currently plan to open up to 15 new stores, mainly at Journeys. New store leases will be designed to minimize our risk by including landlord support on build out costs variable rent and kick out opportunities. We currently plan on closing about 35 stores, but discount could go up or down based on our ability to obtain short-term lease deals at attractive rents.

Our strong year-end cash position enables us to invest in our business. We had moderated capital expenditures with the onset of the pandemic and expect to catch up with some of our initiatives. In addition we plan to increase our inventory levels to drive increased back half sales. These investments will be funded by earnings and a net inflow of cash from our tax planning initiatives. Also, we anticipate this year's numbers will include bonus expense. As a reminder, our EVA program pays for year-over-year improvement and we paid no bonus in the year we just finished. For the year, we are assuming an average of 14.6 million shares outstanding this assumes no stock buybacks under our current $100 million Board authorization, of which $90 million is remaining.

Now turning to discuss in general, our cost structure. Given the accelerated shift of our business from stores to digital and impact from the pandemic, we must reshape our cost structure. Initially, we believe we can reduce operating expenses by as much as $25 million to $30 million, approximately 3% on an annualized basis. This is a good start to a multiyear profit improvement plan to rebound from the pandemic and to enable investments in growth, while at the same time, improving operating margins and return on invested capital. We will provide more detail as the year progresses. In conclusion, I would like to thank all our employees for taking such an active role in managing the organization through such a dynamic year. I have been extremely impressed with the talent and drive of the team since I arrived. I'm confident that we have the right people who are focused on the right priorities to drive the organization forward as we move into the next fiscal year.

At this time I would like to turn the call back over to Mimi, so she can cover some of our strategic priorities and other areas of focus.

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

Thanks, Tom. As I said, COVID-19, and has provided us the opportunity to transform our business at a faster pace as we emerge from the pandemic and to build our company into an even stronger position. With online behavior advancing by several years, we need to accelerate many of the digital and omnichannel initiatives in our pipeline. The investments we have made paid huge dividends this year, importantly, as a footwear-focused company, digital provides the platform to drive profitable growth across all our concepts.

The pandemic also drove or hastened a number of consumer trends that play into the sweet spots of our 2 largest businesses, Journeys and Schuh, such as an increased emphasis on comfort and greater casualization. While this was already the direction Johnston & Murphy was headed, we're accelerating progress here as well. A year ago, I described the outcome of our 5-year planning process and the 6 strategic growth pillars around which we aligned our business. While the past year only reinforce that we are focused on the right areas, we reevaluated our initiatives to take further advantage of the significant changes underway in our industry.

I'll walk you through the pillars and briefly highlight select initiatives for fiscal '22. The first pillar is build deeper consumer insights to strengthen customer relationships and brand equity. Data-driven consumer insights and more robust CRM capabilities are key to driving our next big wave of growth. Not only do we have robust information for our online customers. But in North America, 70-plus percent of store customers trust us enough to give us their data as well, providing a very strong foundation on which we continue to build. We implemented a completely new CRM system in fiscal '21 at Schuh, aimed at increasing frequency of shopping and average order value. Schuh's CRM welcome campaigns initially launched in summer were designed with personalized content to drive additional purchases and further build engagement with Schuh.

These new campaigns delivered results that exceeded our expectations. This new CRM system will create the basis for the launch in fiscal '22 of a loyalty program that incentivizes customers to consolidate their purchases across brands at Schuh, through recognition and rewards. Likewise, over at Journeys, we just finished an evaluation of how to take Journeys' CRM capabilities to the next level and enable us to introduce a loyalty program for Journeys in the future.

The second pillar is intensify product innovation and trend insight efforts. I've talked about J&M's product innovation, which uses proprietary technology to differentiate the brand from competitors as it fast tracks development of a broader casual offering. Additionally, we're excited to reap the benefits of last year's Togast acquisition, which advanced our strategy of growing the branded side of Genesco. Beyond acquiring new talent and additional sourcing capabilities, we secured the rights to the Levi's footwear license for men's, women's and kids in the U.S. We are leaning in not only to the gender, but also the category opportunities in areas like slippers, flip flops and slides.

Levi's is one of the most recognized consumer brands with a heritage dating back almost 170 years. The Levi's brand halo and casual aesthetic are a perfect fit with pandemic fashion preferences and we are very optimistic about the growth prospects here as demand in the channels for this product returns.

Next, I'll discuss the third and fourth pillars together. Accelerate digital to grow direct-to-consumer and maximize the relationship between physical and digital, with a series of initiatives we have underway. While we doubled e-commerce in the 5 years leading up to the pandemic, we aim to double the business again in a much shorter period by leveraging the 75% comp increase we achieved last year. To do this, in North American stores, we're launching the initial rollout of BOPUS, an offering we've had in the U.K. that drives around 20% of Schuh's online purchases and steers customer traffic to its stores. As the lines between physical and digital further blur, we're tackling last mile innovation by rolling out this capability, along with buy online, ship to store and ultimately, offerings important to our customers like curbside pickup.

The foundational project for this effort was last fall's upgrade of our inventory, locating and order brokering system which provides the requisite improved inventory accuracy. Building on this, we will install new store point-of-sale software and hardware to accelerate the digitization of our stores and provide a platform for new capabilities, including mobile checkout, line busting and features to make non selling tasks more efficient. These projects plus the completion of another bespoke e-commerce picking module at the Journeys distribution center comprise the greater part of our capital spend in fiscal '22 and which Tom highlighted as being significantly more concentrated in digital and supply chain.

The fifth pillar is reshape the cost base to reinvest for future growth. As our business transforms, we require a cost structure that supports an omnichannel business, while our stores remain a critical strategic asset in this omnichannel world, we've been working to evolve the historical rent and selling salary models. Tom just took you through our cost initiatives, and I want to reinforce that working with our landlord partners to find a solution that rightsizes rent to match traffic levels is a big part of this endeavor.

And finally, the sixth pillar pursue synergistic acquisitions that add growth and create shareholder value, we are pursuing reactively rather than proactively until we recover further from the pandemic.

So now to conclude, as I reflect on my first year as CEO, I have been truly amazed by the executional excellence and resilience of our entire organization as we navigated a year like none other. I want to again thank our remarkable people for their extraordinary efforts. Genesco's success can be traced directly back to you who have stepped up in so many ways right from the beginning of the pandemic.

My thanks to you all. This concludes our prepared remarks, and I'll now turn the call back over to the operator for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from the line of Steve Marotta with CL King & Associates.

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

Mimi, Dave and Tom, terrific fourth quarter. Way to manage your sell-through and unprecedented pandemic. Can you talk a little bit about the supply chain issue that's currently going on? How it's affecting each of the domestic businesses as well as if there's geographic variability within some of the segments particularly Journeys? And if that's giving you any additional reads perhaps on potential future fashion trends?

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

Sure. So I think that's 2 questions. So let's talk first about just the availability of inventory across banners. So as you know, there have been supply chain disruptions since stores opened back up, really following the initial store closures back last spring. But there's also been disruption on the consumer side. Patterns have been shifting as far as purchasing. And this disruption can be traced directly back to just congestion in the ports, not enough containers and all the other variables that you've heard about we factored this into our forecast, of course. And I think overall, the supply chain is probably running about 4 to 6 weeks behind. But it's a bit of a domino effect that we wish we had some more product over the holidays, that product then arrived in January that helped fuel some more sales in January. We wish we had more product delivered then, but that's coming now in time for tax returns.

So it's a bit of a domino effect, I think, we think, until sometime this summer and is affecting really all of our businesses. But we feel like we will manage through that. This is a much lower volume time for our company. When we get to the high-volume part of the year with back-to-school and with holiday, the supply chain ought to be in much better shape. As far as any geographic differences with Journeys and insight into future fashion trends.

So the last major fashion trend that we came through that we described to was the retro athletic trend. And we had a nice long run several years in that trend because there was just a great choice of options from all the athletic brands. What we've seen really throughout this year is we have seen that the consumer shifted into what we call casual. We just described, we differentiate between fashion athletic and the casual side of our businesses. And in the summer, we -- in spring and the summer, we saw a move into sandal product. Sandals did really well over spring. And then through the third quarter, we saw a further acceleration of everything that is our non-athletic product. And boots, of course, are always strong in the fourth quarter, but we have just seen an appetite for a number of brands that are more in the casual side of the world. And of course, comfort was very important. The comfort has always been important to kids. I think that as we look into the future, Journeys is just extraordinarily well positioned among its competition were known as the place to go for fashion footwear and casual and fashion really go together. So we've seen many of the same trends across the country, no specific geographic differences, but a number of brands performing quite nicely.

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

That's very helpful. And I have one other follow-up question, given the target of $25 million to $30 million in annual SG&A savings. Can you talk a little bit about time frame on when you would expect to realize that magnitude? And if you think there will be any offsets to that? In other words, would you use a portion of that for demand creation activities or some other growth opportunity?

Thomas A. George - *Genesco Inc. - Senior VP of Finance & Interim CFO*

Yes, Steve, this is Tom. I think the best way to answer that is it will take some time to get up to that $25 million to $30 million. It's more of an annualized rate, sort of exiting the year with an additional $25 million to $30 million. It may come sooner in the form of some additional rent abatements and whatnot. But for the most part, we're looking at permanent savings in the cost structure and exit the year with savings of $25 million to $30 million. And on the other side, just -- we also believe we'll continue to have some increased digital penetration. And as a result of that, there's going to be some additional variable cost associated with increasing the digital penetration. So there obviously, will be some offsets to that $25 million to $30 million.

But we feel good about the ability to be able to do that. That should be able to mitigate a lot of the increase in the variable cost associated with the increased digital penetration. And in net-net, put us in a much better position as we move into the following years to earn good -- better operating margins, better returns on capital. And I think one other thing to point out is with J&M. We feel good our opportunity there still. Most of the headwind in the quarter was really all about the retail stores for J&M in the wholesale business because the digital business was actually roughly flat for the quarter.

So there's still a lot of people out there that want the J&M brand. But it's going to take a good 2-years to be able to recover -- for J&M to recover to some of the historical profitability rates. So I think, hopefully, that gives you some color, too, in terms of longer term, where we see our cost structure and our improved returns on capital.

Operator

Our next question comes from the line of Jonathan Komp with Baird.

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

If I could start on Journeys. I know the math is a little rough here. So just is there any more color on what you saw in January? I mean, the math would suggest it could have been a pretty healthy double digits for total sales. So any more color there? And then I don't think you commented on Journeys in the first quarter when you were discussing the comparison to 2020. So any more color on what you're expecting there?

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

Yes. So I'll start and just talk a little bit about January, and January was a terrific month. I think that we spoke to you at ICR when we released our results as of the end of December. And I think our sales were down 8% at that time, and we closed the year with sales down 6% of January, which is typically a low volume -- lower volume month, was strong enough to be able to drive that improvement. And much of that came from Journeys. What we see with the Journeys consumer is that they are very -- when they've got money in their pocket, they want to come spend it and they want to come spend it at Journeys stores. And we've seen that benefit with tax returns, our folks in the Journeys business, call it, tax miss because it's such a great time for selling. We need to come up with a term for the stimulus effect because the stimulus that was passed in late December got out in the market really quickly. And we a rush into our business and an immediate impact across the entire month of January. That continued into February. And as I said, our business is quite impacted by tax refunds. And if you're following the tax refunds, there was about a $50 billion gap due to the delay of 2 weeks in refunds this year. So we, again, saw that affect our business.

So lots of different things going on. But what we do know is that this upcoming stimulus package is even better than ones we've seen before as far as both the dollar amount and the number of programs that will be beneficial for our consumer. It's not only the direct payment to families, but also the increase in the child tax credit, the payment of some of the tax credit dollars sooner rather than later. In terms of the back half of the year is going to be great for us because it's going to going to relate to back-to-school and holiday. And I think that families want to spend the dollars on our kids. So that's going to be a low tailwind in the back part of the year. And I think that folks who thought they were going to have to pay taxes on their unemployment dollars, you're not going to have to do that either. And so there ought to be some dollars in the consumer's pocket.

We don't give specific expectations around each one of our businesses. And so you can understand just in terms of Journeys that we had a great January, followed by a great first half of February and then the offset from some of the tax refunds. Journeys has performed -- had a record quarter. Much better revenue was matched to last year, much better gross margins. We expect some of that to continue and really excellent cost containment across the board, which was a recipe for a record quarter. Tom, would you add anything to that?

Thomas A. George - *Genesco Inc. - Senior VP of Finance & Interim CFO*

No. I think just to add a little bit of color on the first quarter guide. Really, the pressure there relative to fiscal-year end '20 is in the Schuh business because of all the store closures. That are still there relative to FY '20 and still some pressure from J&M again, primarily the retail business and the wholesale business. and some lift, actually, we expect in the first quarter relative to our licensed brand business because we're starting to get some traction there, and we're really pleased with how that's panning out so far. But -- so net-net, it's really the pressures about the Schuh business in the U.K. with all those store closures.

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

And then just to clarify, I know you mentioned not including incremental benefit from stimulus that looks likely here. Are you baking in the catch-up in the tax refunds, which have started to catch up, but still are behind, are you taking that in? And given that scenario that the refund catch up and the stimulus. Do you have enough of the right inventory to take advantage of that?

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

Yes. So we definitely -- taxes are a bit of a roll of the dice this year. I mean, on balance, it could be actually bigger than last year just because some of the folks who are eligible for stimulus can file through tax refunds. So a lot is in motion for this year, but we did assume that we would have a tax refund season, not dissimilar from last year. And in terms of do we have enough of the right inventory, I think that, as I just described, the slowdown in the supply chain. Over the last several weeks, we've gotten some replenishment of the Journeys' inventory. So I think it's going to be that what we expected 3 or 4 weeks ago, we get now and so on and so on until we get further on along in the year.

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

Okay. Great. And just last one for me. In the markets that you're open, maybe this is across your brands, but are you seeing any signs of changing consumer behavior as we get closer and further along with some of the vaccinations that are starting to happen or just curious if you're noticing any changes?

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

Yes. So for sure, if January was an indication, store traffic was still down, but we had positive store comps because traffic was much better. And we have been driving increased conversions and in Journeys increased transaction size. And so interestingly, our Journeys consumer has had more of an appetite to be out and about, but we saw a pickup in traffic certainly in January. We're about to hit a very bumpy stretch where our stores were closed, I think, this time last year. Next week, we had closed our stores.

So it will be a bit up and down. What we are waiting to see is really the Johnston & Murphy customer return. We did see an improved amount of traffic and people did want to shop in stores over the holidays, so we did see some pickup in traffic. What we know is that our J&M customer is in an incredibly good position to spend after they've been dormant for much of the past year. Their jobs have not been affected. Their assets have appreciated their homes and their 401(K)s and they have not been spending on vacations and on services and the like.

And so we have been very busy adjusting what we think will happen post pandemic or as we come out of the pandemic for Johnston and Murphy, which is a real -- a greater casual offering and we're really pleased with the progress that our product team has made there. And we think that, coupled with a very loyal Johnston & Murphy customer will give us a great foundation to get that business to achieve a higher level of sales.

The Johnston & Murphy customer, I think 40% of the Johnston & Murphy customers have purchased at least 4 times from us. And so that's just an incredible legacy to have to build back the foundation of sales for the brand. And then some of the new product and the new marketing that we've got in the pipeline ought to really help us to continue to attract some new customers to the brand. So I think what we're waiting for is for the change in Johnston & Murphy, and offices have not started to open again. The last we track one of the barometers of people returning to work. And the last release still showed that only about 15% and of workers that return to the -- to offices in the 10 major metropolitan areas. So I think, certainly, we've got a lot of optimism for what's going to happen, but it hasn't quite happened yet.

Operator

Our next question comes from the line of Janine Stichter with Jefferies.

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

I want to ask a bit about the 6% operating margin target that I think you gave exactly a year ago, just as the world was kind of coming to a hault. As you reflect back on that, is there anything that stops you from getting there? And then maybe on the flip side, is there anything that you feel can put you above that level just given some of the progress you've made on expenses and rent?

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

Yes. So 1 year ago, feels like a lifetime ago, Janine. So just to think a little bit about a 6% operating margin. So in terms of -- has anything structurally changed in our business, the thing that has structurally changed is the greater degree of digital penetration.

And as I discussed in the prepared remarks, our e-commerce channel is profitable. In fact, it's highly profitable we celebrate every additional e-commerce sale that we get because we start from a profitable base, and then we become even more profitable because we can amortize and so digital in and of itself is a great part of our business, and more growth in digital will mean more profit and more dollars to the bottom line. And so that's a real positive. What we have been working on is we've been working on the store economics. And what we saw, certainly, with lower traffic, and with people more compel to shop online is lower store volumes. And in a fixed expense world, that's very challenging to the economics.

So the remedy for that is both to work on expenses, which we've made a lot of progress with our landlords. Tom talked about the 20-plus percent reduction in rent expense. But there's also an opportunity to drive top line. So top line in stores will be driven by the consolidation that has happened within retail. There has been a lot of fallout, as you know, on both sides of the Atlantic, but particularly in the U.K. a lot of brands and retailers that we would count as competitors. And so we've seen some regional competitors closed department stores close, anywhere that there are footwear points of distribution that close, we have an opportunity to pick up that market share. We saw that when we came out of the Great Recession. And that allows us the opportunity to really drive the economics within our 4 walls as well. And so the combination of both the really profit-rich nature of our digital channel plus some opportunity to rightsize the economics of our store channel should put us in good shape going forward. It's going to take a bit to get the store economics right, but I think some help on the top line will accelerate that progress.

Thomas A. George - *Genesco Inc. - Senior VP of Finance & Interim CFO*

I think I'd just add, we also see some opportunities with a more formalized procurement process to be able to work on our overheads as well and take some costs out of the cost structure.

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

Okay. Great. And then maybe just along those same lines, if you could talk a little bit about any thoughts you have about rolling out BOPUS in the U.S., how that might offset some of the digital shipping headwinds and what you've seen with that in the U.K.?

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

Sure. So we're really excited about it. It takes a lot of work to get this type of effort rolled out, and I talked about the projects that we had, the projects that we've had in our lineup and that we will continue from this year. And so we are do the initial pilots of BOPUS a bit later in this year. What we have seen in the U.K. is that it drives about 20% of the online business for Schuh. So we think there's an opportunity to drive an increase in our online business, which will be great. And then to be able to -- I mean, one of the great benefits of having the store network that we have particularly at Journeys, is that it's really convenient for the consumer. I think that 80-plus percent of the population lives within a few miles of Journeys stores that it's really convenient to just drive by and pick up your package.

We've got a nice size store where you don't have to walk through a maze of aisles to find where you should pick up your package. And we think that our store associates, and we know our store associates will seize the opportunity to sell additional things to those customers who walk through the door. So we are really excited about a chance to be able to drive people who would be shopping online into our stores where we know that our people will take it from there.

Operator

Our next question comes from the line of Mitch Kummetz with Pivotal Research.

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

I've got a few. So Tom, I think in Q1, you covered the sales side of it pretty well. I'm just curious on the gross margin. I think you said that Q3 gross margin was down 210 bps and that Q1, I think, relative to 2-years ago should be down more than that, if I heard you correctly. And I'm just curious because it sounds like there were some benefits in the fourth quarter in terms of full price selling that you think will carry forward. So is the pressure point really the higher digital penetration? Is it freight? Can you maybe kind of walk through some of those puts and takes on Q3 -- Q1 gross margin?

Thomas A. George - *Genesco Inc. - Senior VP of Finance & Interim CFO*

You're right, right, Mitch. It's a combination of things. Some of it is the higher digital penetration. Some of it is the difference in full price selling relative to 2 years ago. And a big part of it is the more digital business that's going to drive that reduction for this quarter versus 2-years ago.

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

And I think that just to underscore that. So our Schuh stores at the end of the day, they're going to be open for. I mean they closed basically, Mitch, right? All of them closed right after Christmas, and they're not going to open up until the middle to the end of April. So we're talking about almost essentially no store revenue from Schuh. And that creates a lot of pressure because all of that volume is going through online.

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

Okay. And then, Mimi, you talked about some opportunities in the back half. I would guess, one of the biggest pieces would be back-to-school. Is there any way as you sort of reflect back on last year's back-to-school season kind of how that came in versus normal? Like was it 10% shortfall than normal? Just to kind of -- so we kind of frame what the opportunity might be if we have a normal back-to-school season versus obviously a disruptive one last year?

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

All right. So we're pretty looking forward to a more normal back-to-school for this year. If you remember, we typically see a huge bump up in back-to-school volume at the end of July. That builds into August, and August is really much of our back-to-school volume, and then we pick up some of it in September. Well, it was crickets in July and August this year. But then we saw a nice pickup in September and October. And part of it was the phasing in of schools, but we really decided that more than 2/3 of the country's children were learning remotely. And that doesn't really create the catalyst for going and doing some shopping.

So when it comes to this year, there is an opportunity. And I would say it was hard to tell precisely, but I think we probably got 60% -- in the neighborhood of about 60% of what we normally would have gotten it back-to-school last year. So there is an opportunity for perhaps some pent-up demand for back-to-school this year. And a more normalized cycle of kids being in person plus that child tax credit that I was talking about, that is something that should put some money in the consumer's pocket around the same time that kids go back to school. So there's a good combination of some factors for BTS this year.

Operator

Thank you. Ladies and gentlemen, this concludes our time allowed for questions. I'll turn the floor back to Ms. Vaughn for any final comments.

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

Thank you for joining us today, and we look forward to talking to you in another 3 months.

Operator

Thank you. This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.
