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GCO - Q3 2017 Genesco Inc Earnings Call

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PRESENTATION

Operator

Good day, everyone, and welcome to the Genesco third-quarter FY17 conference call. Just as a reminder this 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-Q 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 homepage under Investor Relations.

I'll now turn the call over to Bob Dennis, Genesco's Chairman, President, and Chief Executive Officer. Please go ahead, sir.

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

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

We have a number of topics to cover. I'm going to start with a brief review of our Q3 results including the key drivers of our performance against expectations. And then next I'm going to discuss November sales, including the Black Friday weekend and how our current sales trends are shaping our outlook for the remainder of the year. Then Mimi will walk you through the numbers in more detail as well as the specifics on our guidance. And then I'll return to provide additional forward-looking commentary on each of our businesses and after that we will take questions.

Our third-quarter results, while down from last year, exceeded our expectations. We delivered adjusted EPS of $1.28 compared to $1.40 a year ago. Consolidated comp sales decline 3%, with challenging comps at Journeys partially offset by comp gains in our other retail divisions. But in total comps were better than we expected.

The improvement in our bottom line versus expectations was driven by the stronger-than-anticipated comps at Lids and Schuh, better gross margins at Lids, and very effective selling salary and expense management at Journeys. EPS also benefited from share repurchases made during the quarter.

Lids comp sales were up 2%, fueled by the favorable MLB playoff and World Series lineups, despite the tough 12% comparison from last year when we increased our promotional activity to right-size inventory. Gross margin on the Lids retail businesses was up a significant 400 basis points as we anniversaried promotional activity and benefited from more full-price selling. The third quarter in a row we reaped the benefit of the numerous initiatives we executed to improve the Lids business during FY16.

At Journeys, comps continued to be challenged by the ongoing fashion rotation we described last quarter. As we said then, about every two to four years through the history of the concept Journeys teem customers advise they're ready for something different and embraces a new fashion direction. While Journeys has adeptly managed this shift through several rotations, including grunge and skate, the current shift has been exaggerated since Journeys has been narrow and deep in its merchandise assortment for some time. A fashion rotation out of a more concentrated position clearly has more negative impact.

So, following a very challenging August, Journeys comps improved a little in September with the later back-to-school, but then deteriorated quite a bit in October as unseasonably warm weather across the US hurt mall traffic and food sales. Journeys comps for Q3 were down 8% against a solid 6% increase last year.

We continue to see strong consumer interest and rapid growth in brands that are not yet at a size in the assortment to fully offset the decline elsewhere. Our confidence in the spring assortment continues to be strong as the Journeys team has committed to much larger positions and styles the consumer is looking for.

In the last two fiscal years Journeys has delivered record sales and earnings as the preeminent provider of fashion footwear to teens. And with the change in assortment we feel we should be back on track to be doing so once again.

On the other side of the Atlantic, following a tough August, Schuh's comps in September rebounded with a later back-to-school in the UK compared with last year. And in October Schuh adjusted its promotional cadence to better address market conditions and was able to drive higher sales and gain gross margin dollars. Positive comps in September and October offset August's decline, and Schuh's comps ended flat for Q3. In spite of these improvements, our reported profitability was once again pressured by foreign exchange headwinds from the stronger US dollar versus the falling pound.

Finally, Johnston & Murphy sales of apparel and more casual footwear fueled a 1% increase on top of a 5% increase last year. It was a solid performance by J&M, in a challenging retail environment for non-athletic footwear.

Turning to our Q4 comp, through this past Tuesday, November 29, including the Thanksgiving weekend, quarter-to-date consolidated comps were down 2%, with stores down 4% and direct sales up 9%. Underlying these fourth-quarter numbers, however, is a tale of very two different trends, with very strong Lids results offsetting weaker results in the rest of our businesses.

The Chicago Cubs dramatic win over the Cleveland Indians in game seven and the end of the plus-100-year World Series drought provided Lids with an unusually strong start to the quarter. Lids comps are up 15% Q4 to date. I'd like to salute the entire Lids Team for the tremendous effort and superb execution that capitalized on the Cubs victory. That took a lot of work.

Lids achieved record-breaking sales in many stores serving fans in the local Chicago market, which was augmented by online sales to displaced Cub fans throughout the country. Congratulations and well done, Lids.

On the other hand, as many retailers have reported the persistent warm weather in November hurt all of our US businesses, and, as a result, the effects of the ongoing fashion rotation at Journeys were compounded by soft demand for boots. Johnston & Murphy's comp for the period was flat as sales of boots and other cold weather products were affected. And even sales of knit hats in Lids were hurt, as well.

For the Black Friday weekend, comp sales improved slightly from the quarter-to-date trend for all our footwear business, except the two, but were disappointing overall. Fashion footwear on both sides of the Atlantic was incredibly promotional as competitors moved to clear excess fall and winter inventory. And while Schuh adjusted its promotional cadence, competitors were much more aggressive. Overall it looks like it will be a very promotional season for the category if these trends continue through the holiday.

Looking ahead at Lids, the Cubs victory should be a nice tailwind through Q4 and into next year but at more moderate levels than in November. We achieved the biggest impact of the anticipated pickup in the first weeks immediately after the World Series win, and later in the month over Black Friday weekend. We originally expected Lids Q4 comps to be negative as we continue to anniversary strong comps from the inventory right-sizing last year, and we now anticipate Lids Q4 comps will be positive.

And on the flip side, given recent results, we have become more cautious about Journeys and the rest of our footwear businesses. On a consolidated basis based on our concern that the upside from Q3 and the game from the Cubs may be offset by difficult trends at Journeys and Schuh in Q4. So, we are holding EPS guidance at $3.80 to $4 for FY17.

Mimi will walk through the guidance in more detail, so, with that, let me turn the call over to her to go over the financials.

Mimi Vaughn - *Genesco Inc. - CFO*

Thanks, Bob. Good morning, everyone. As a reminder, as usual we have posted more detailed information online in our CFO commentary.

For Q3 total sales decreased 8% to $711 million. Excluding Lids Team Sports from last year, total sales were down 3% for the quarter, which includes a 3% decrease in consolidated comps sales and a 4% increase in wholesale sales.

As Bob pointed out, in Q3 comps were flat to moderately positive for all our businesses other than Journeys. By division, comps were down 8% at Journeys, flat at Schuh, up 2% at Lids and up 1% at Johnston & Murphy. We had planned negative comps for Lids and Schuh. Consequently, with the MLB playoffs and World Series help, and the turnaround in Schuh comps, overall comp results were better than we expected.

Consolidated store comps were down 4%, and consolidated direct comps were up 7%. Direct as a percent of total retail sales remained at 8% for the quarter. Comps for all our direct businesses except for Lids were positive. And for Journeys and Schuh they were positive at double-digit level.

Last year in Q3 Lids' new locate system, which gave online access to an additional 50,000-plus SKUs from inventory located in stores, coupled with promotional sales from the inventory cleanup, drove a very noteworthy 52% direct comp. Lifted by online MLB sales, Lids' direct comps were almost flat for the quarter against this very challenging comparison.

Turning to the fourth quarter to date, consolidated comps through Tuesday, November 29, including the Black Friday weekend, were down 2%, with stores down 4% and direct up 9%. By division, total comps were down 12% at Journeys, down 6% at Schuh, up 15% at Lids, and flat at Johnston & Murphy.

We would like to call out that this is the last time we will be reporting quarter-to-date comps. Given calendar shifts, payday, and other offsets, among other things, this snapshot is often not indicative of what the quarterly trend will be, and therefore not helpful, we feel, for understanding our business. We will, however, continue to give quarterly comp guidance in the CFO commentary posted online.

Gross margin for Q3 improved 170 basis points to 50%, driven by Lids and Johnston & Murphy where better results offset declines in other businesses. Gross margin for Lids improved 790 basis points, partly reflecting the sale of Lids Team Sports which was a lower margin business. But the improvement in the retail business alone was very robust, 410 basis points in total, due to a lower level of promotions this year and much stronger full-price sales. Gross margin was up 100 basis points for Johnston and Murphy due to lower markdowns and lower expense to deliver product.

Journeys gross margin decreased 120 basis points. Initial margins were a little lower but most of this decrease came from additional markdown as Journeys worked diligently and successfully to keep inventory clean.

Schuh's gross margin was 110 basis points lower, driven by both mix, with athletic as a higher percentage of the overall assortment, and higher markdowns reflecting Schuh's more aggressive promotional stance. Finally, gross margins on licensed brands was lower due to lower IMOs.

Total SG&A expense increased 270 basis points to 44.3% for Q3. A significant factor driving this increase was the sale of Lids Team Sports which operated at a lower expense level than our retail businesses. However, with the negative comp remaining operations, particularly Journeys, deleveraged, due mostly to rent expense from new stores and renewals, higher depreciation, higher credit card charges, and higher advertising expense to stimulate sales. Bonus expense at Lids contributed to the deleverage, as well.

One bright spot for us continues to be how effectively we manage selling salaries, holding them flat in Q3 in spite of the minimum wage pressure we have been battling and the top-line weakness. Journeys managed selling salaries very aggressively in the quarter and expenses came in better than last year, even with the negative comp.

Throughout this year we have been flagging increased credit card chargebacks in connection with the credit card shift and signature liability shift from issuing banks to retailers. In Q3, chargeback expense increased from Q2 levels, and we expect this to be a negative factor until we finalize implementation of new technology early next year.

Lastly, the stronger US dollar against the UK pound created foreign exchange headwinds for Schuh as the pound declined 17% year over year in Q3. Foreign currency was responsible for three-quarters of the decline in Schuh's operating income.

Consolidated operating income came in better than anticipated as higher sales contributed higher gross margin dollars and leveraged expenses more than we expected, but was worse than last year as better results in Lids and J&M were not enough to offset declines in Journeys and Schuh. Adjusted operating income decreased to $40.9 million from $52.2 million, and adjusted operating margin decreased 90 basis points to 5.8%. We delivered third-quarter adjusted EPS of $1.28, which benefited from share repurchases we made in the last year but was under last year's level of $1.40.

Turning to the balance sheet, excluding Lids Team Sports total inventory was down 1% with a 3% decline in sales and 2% increase in retail square footage. Journeys inventory was clean. Without Little Burgundy, Journeys inventory was down 5%. Including Little Burgundy, Journeys inventory was down 1% on a square footage increase of 6% and a sales decrease of 2%.

Schuh's inventory was clean even with the flat comp. On a constant currency basis, Schuh's inventory was down 3% on a square footage increase of 10% and sales increase of 4%. Inventory for the Lids retail business was down 2% on a square footage decrease of 6% and a 1% decline in sales.

Capital expenditures were $25 million and depreciation and amortization was $19 million for Q3. Finally, we repurchased 747,000 shares for roughly $40 million at an average price of $53.34 per share.

Turning now to guidance, given the challenges at Journeys and Schuh we have taken down expectations for sales for the remainder of the year. We now expect gross margins in Q4 to be more pressured with higher markdowns in these businesses, as well. But this will be offset a little by better gross margins at Lids. SG&A expense will delever further with a lower comp.

Taking into account the upside from Q3 and from the Cubs, offset by these challenges, we are reiterating our expectation for adjusted earnings per share for FY17 of a range of $3.80 to $4. Our top-line assumption is for sales to be down 5% to 6% for the year, reflecting the Lids Team Sports sale, the impact of a stronger dollar on exchange rates, and a consolidated comp at a negative 2% to 3% for the year. Our comp assumption for Lids is now positive for the year, along with J&M, offset by negative comps for Journeys and Schuh.

Excluding Macy's, by the end of the year we plan to have opened 88 new stores concentrated in Journeys Kidz, and to have closed 91 stores for a net 3 fewer stores. We expect gross margin to be up between 140 and 160 basis points in total for the Company. This is predicated on a sizable margin recovery at Lids of more than 550 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.

With the negative comp, we anticipate SG&A expense will deleverage 220 to 250 basis points, which is more than our last guidance estimate, including higher bonus expense in the better-performing businesses plus a continued elevated level of chargeback. We expect the strong dollar will weigh down earnings by $0.17 per share for the year assuming exchange rates stay where they currently are. But we expect positive impact from a legacy pension plan to offset some of this pressure.

This all results in an operating margin that is down for the year, and our FY17 tax rate is expected to be 35.9%. We anticipate capital expenditures will be in the $110 million to $120 million range, including some investment in the planned expansion of the Journeys distribution center. Depreciation and amortization is estimated at $76 million.

Lastly, we are assuming average shares outstanding of 20.2 million for FY17. This includes buybacks made in the last three quarters and assumes no additional stock buybacks for the year.

$40 million remains outstanding under the recently approved repurchase authorization of $100 million, which we can use opportunistically going forward. For reference, given that we have repurchased 2.2 million shares, or almost 10% of our share base in FY17, if we complete no additional buybacks this year we estimate our average share count for next year FY18 would be 19.6 million shares.

Now I will turn the call back over to Bob.

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

Thanks, Mimi. I'm going to provide additional thoughts on the outlook for each of the business, starting with Journeys. While Journeys comps got off to a very challenging start in Q4, we are optimistic and expect the trend will get better in the balance of the quarter for two reasons.

First, the unusually warm weather has hurt boot sales thus far in the quarter. And, second, we're planning on deliveries of new product late in the quarter that reflect the fashion shift, and that should give us a pop.

The weather will get colder. And then, as we saw over Black Friday weekend, selective promotions on products not achieving the desired sell-throughs will move significant volume. We will take action as required in one way or the other. We plan to end the year in a clean inventory position, as we did in Q2 and Q3.

In addition to the weather, our outlook for boots has also been altered by the consumer wearing fashion athletic styles more year round into the fall and winter months. The newness in our fashion athletic assortment continues to perform well. However, it just isn't enough to offset the softness in boots as this athletic product represents a much smaller percentages of the mix right now in Q4. But this trend does bode well for spring and the new fiscal year.

We said on our last call that the customer has signaled the direction of this fashion shift more clearly than in some prior ones, making our primary challenge to get enough of the new product into the assortment to satisfy the demand. So, drawing on the strength of our vendor relationships, our spring order book has filled up nicely with product that we believe will have strong appeal to the Journeys' customer, some of which will actually be arriving in late Q4. In the meantime, the Journeys Team is taking actions to drive sales over the remainder of the quarter, and this includes things like increasing the frequency of email marketing campaigns, upping the online marketing spend, and doubling down on social media efforts to engage with our customer.

And there are several bright spots within the Journeys group worth noting. First, Journeys' direct business remains robust, increasing by strong double digits in each month of the third quarter.

And, second, Journeys Kidz has been less affected by the fashion shift than its older counterpart. We remain on track to open 38 new Kidz stores in FY17 and we believe we're well positioned to solidify Journeys Kidz as the go-to place for branded children's footwear in the mall.

And then, finally, as we approach the one-year anniversary of our acquisition of Little Burgundy, I want to congratulate the team in Canada for consistently exceeding our expectations from what we originally had in our mind when we purchased the business. They have delivered a double-digit comp in this fiscal year. So, congratulations to the LB team.

As Schuh, we entered the fourth quarter with good momentum and resilience in overall retail sales in the UK post Brexit referendum. Last year in Q4, comps were down 2% and gross margin decreased 200 basis points. So, with these easier comparisons we believe the business was set up well for an improved holiday season until we hit a very promotional Black Friday weekend.

Our learnings from the promotional activity in the back half of the year has given Schuh the direction it needs to take in the weeks leading up to Christmas. And while we expect improvement in the recent sales trends for the rest of the quarter, our outlook for the business has become more conservative.

We have several reasons to be optimistic about Schuh's prospects for improving the current trend in Q4. First, boot sales picked up with the arrival of colder weather in the UK. And at the same time Schuh has been able to capitalize on the strength in fashion athletic as they are a little ahead of Journeys in the current fashion rotation.

And then, finally, Schuh has made good progress leveraging vendor relationships in order to receive better terms. This has helped offset the pressure from a higher penetration in athletic product which carries a lower gross margin than the rest of the mix.

Moving to Lids again, we expect demand for Cubs product to remain strong through the holiday season and into next year. And beyond the Cubs effect we continue to see the benefit of the work we did last year to turn the business around. We've been in a much better position to chase top product now that we are taking more markdowns in season and freeing up open-to-buy dollars to flow of new goods into Lids stores and onto lids.com.

This has been true not only in locker room but also in the headwear business where several micro trends, led by branded hats, are driving positive comps and gross margin expansion. In addition, Lids has benefited from closing or renegotiating rents for the 50 underperforming stores we earmarked to address this year and next.

And then, finally, we are pleased with the progress we're making in our partnership with Macy's. We closed 37 shops this year to reduce our footprint down to a more profitable core, relocated shops to improve adjacencies, worked with the merchandising mix to better serve the Macy's customer, and tweaked the staffing model to better align with current traffic trends in several stores.

Marcy's stores in the Chicago market profited greatly from the Cubs victory, with strong comp sales. And an area of upside for us is macys.com, which is one of the top-10 sites for retail traffic. That said, there's more work ahead to develop a sustainable operating model that generates the return targets we established for the business at the outset of this relationship.

Next, Johnston & Murphy posted its 8th consecutive quarterly comp increase. J&M's performance once again underscores the team's success pivoting the brand from a [dressed] resource to a lifestyle brand through expanded casual and sports casual footwear collections and growing apparel offering. We believe J&M is well-positioned to continue to take market share, but based on what looks to be a promotional holiday season for the category, we have moderated our outlook for Q4.

And, lastly, our Licensed Brands Division had another challenging quarter, reflecting the weak performance of many of our key accounts in the department store and national chain channels. We continue to be excited about the recent launch of Vasque footwear, which is helping offset some of the current softness in Dockers and Chaps.

In closing, in the midst of all the short-term focus here, it would be easy to lose sight of the longer term competitive advantages that we as a Company enjoy. Lids is the leading omnichannel retailer of licensed sports merchandise in North America. The month since the Cubs' World Series victory illustrates that compelling position. Our Chicagoland stores reaped a windfall in sales generated in the excitement of the victory, the victory parade, and the ongoing celebration in the local market; while the e-commerce business has served the nationwide fan base with speed and efficiency.

Likewise, Journeys occupies the same leadership position in the teen fashion footwear market. We own the mall where the research shows that our customers still like to buy even as they increasingly research their purchases online. And the strong vendor relationships that Journeys' scale and experience provides are invaluable in managing through the fashion cycles that are a fact of life in this market. These relationships help us to not only work out a product that is losing its luster in an orderly way, but also get favorable access to the shoes that our customers really want to buy.

And Johnston & Murphy's leadership position in its segment of the market is founded on a brand equity that has taken more than 165 years and 30 presidents to create. This heritage, plus an ability to understand its customers ever-evolving fashion needs and translate that into a product offering that resonates season after season, is the inherent advantage that keeps J&M at the top of the leader board.

And then, finally, of course the commitment and talent of our extraordinary teams across all of our businesses remain our greatest strength, as they meet the challenges and opportunities that present themselves every day. My thanks to all of you for all that you do, and especially during the demanding stretch we just finished through the Black Friday weekend. And with that said, operator, we're ready for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Jay Sole, Morgan Stanley.

Jay Sole - *Morgan Stanley - Analyst*

Thank you. Bob, my question is about the World Series. Can you just give us an idea of the dollars that a regular baseball season generates from the World Series and how that compares to this year?

Because obviously the Cubs, but Cleveland's a story, too. And last year Kansas city was a story. So, can you just tell us a little bit how the differences changed?

And then, at the same time, can you tell us about how the NFL business is doing, because usually November and December are big NFL months, it seems like the ratings are down for the NFL this year. So, Bob, has that been an offset? If you can just gives us some numbers around, that would be helpful.

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

Sure. I'm going to give you some color on it and I'll ask Mimi to talk more specifically. Obviously in Q3 we had a good line up of playoff teams. But then especially in the beginning of Q4, when the Cubs won the series, that was a one-time event.

It's a little tricky because the team at Lids believes that the demand within the hot categories, and especially the Cubs, may have pulled dollars away from other categories. The best example of that is the Blackhawks are off to -- for us, pretty slow start on sales despite having a very strong early win/loss record. So, there is a lot of mixed stuff that goes on in terms of how the customer behaves, what we are presenting at the front of the store.

So, as we go forward we're expecting to continue to have tail winds from Cubs in Q4, all the way into next year, including the beginning of the next baseball season, because we will have World Series related products available then. Obviously we've reflected all of that in our guidance. So, we will get a little bump the rest of the way but the big bump is pretty much over.

And with that I'll pass it to Mimi if she wants to give any more color on it.

Mimi Vaughn - *Genesco Inc. - CFO*

I think the Cubs' win, and particularly the national fan base is what is so notable about this World Series. Jay, as we looked at it, it wasn't just the Cubs in the third quarter but it was really the strength of the lineup among the Blue Jays, the Dodgers, the Cubs and the Indians. So, we think that we perhaps picked up about 4 points of comp for Lids in the third quarter, and about half of that was Cubs and about half of that was the rest of the strength of that lineup.

As Bob said, there are some offsets in other teams that attention was drawn away from. The Cubs in the fourth quarter, we believe, will provide us about 5 to 6 points of comps. So, if you'll recall, we promoted significantly during the fourth quarter last year in order to right-size our inventories.

And going against those numbers we felt like we would have negative comps within Lids. The strength of the Cubs really carries us to a favorable comp position for the fourth quarter, we think, in the mid-single digits range. So, the Cubs were quite strong for us both in the third and the fourth quarter.

Operator

Pam Quintiliano, SunTrust.

Pam Quintiliano - *SunTrust Robinson Humphrey - Analyst*

Thanks for taking my question. I wanted to talk a little bit about Journeys. It's really exciting.

It sounds like you're getting some of the product earlier than anticipated. I was hoping you could remind us when you had hoped to get in that product versus now getting it in potentially for 4Q, and if this includes any exclusive product to Journeys.

And then just one other one on Journeys, a quick one, historically when the weather turns do you think you make up with that pent-up demand on sales or is it then lost because your consumer has gone and spent on something else instead? Thanks so much.

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

Thanks, Pam. Let me talk first about Q4, then we will talk about going forward. We noted in our Q3 call the team saw the emerging demand for product from several brands with really new fashion statements, and we bought into those trends.

Indeed, those brands are up significantly for us. What we didn't foresee was the extent to which the demand within this trend would explode and surpass what we anticipated. In fact, this trend has expanded in a rate we had never seen before.

And when we look back there wasn't any strong indicator. At the time we placed the bulk of our Q4 orders, and even back to school, and that even up to Q4, there was no evidence that demand would expand at this pace. We've looked at Google trends and a lot of the social media items that hopefully would be a predictor and we didn't see that.

What we believe is our spring assortment, which will begin to drop in late January, and that's why we're calling out a little help in Q4, that will put us in a very strong position. So, we've done a very major rotation in terms of what the assortment will look like, and that's why we're confident we will get off to a good start next year. Specifically in next year we're bought for a low single-digit comp in Q1.

We believe the shift in the assortment will take us where we need to be. Obviously we will see once we get to Q4 if that holds together. And then the compounding factor has been that we're disappointed with sales of seasonal product at Journeys.

And we noted even back on the Q3 call that our early read on boots was a little, not encouraging, but we said that our read then was naturally hard to put too much faith in because it was in the summer. And since then the weather has not been our friend. But nor do customers seem to have a pure fashion drive into boots as they've had in the past years.

And as we called out, there are a lot of teams that are wearing athletic until they can't wear athletic anymore. I was talking to one of our board members who said when she walks around New York, she sees the women shift into boots given a seasonal move, and that's probably true. The teenagers are acting a little differently and they're sticking with athletic a little longer into this time of year than perhaps they had in the past.

So, we are going to be subject to both the timing of winter. And then it's not as much whether we can catch up on the sales. That's not our main focus.

Our main focus is on how other retailers react to the slow start in terms of promotion because in the branded category, if some of the other retailers who carry the brands that we carry, if they break ranks, that might change the dynamic in the marketplace. So, we're paying more attention to that.

If we got a major snowstorm tomorrow -- which is not going to happen -- we would probably move a lot of boots at a good price. But we probably need that to happen pretty soon before the retailers out there start to make a move on the product.

Anything you would add Mimi?

Mimi Vaughn - *Genesco Inc. - CFO*

I just to reiterate our commitment to the new spring product are quite substantial. We have great relationships with the vendors that we believe that needs to supply this product, and that has allowed us to make substantial progress.

To elaborate a bit on the winter product, our number one goal right now is to make sure that we don't end the year with a lot of excess inventory. So, we've been very mindful of that and have been doing all that we can to make sure that we end in a good inventory position.

So, we've been taking actions and our Journey's merchants have been working hard to make that happen. We may give up some upside in sales as a result of working our inventory down but we think that, that is of primary importance in this fourth quarter.

Operator

Erinn Murphy, Piper Jaffray.

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

Great, thanks. Good morning. Just following up on Journeys, is it possible for you guys to break out what you saw in terms of traffic versus ticket for that down 8% comp in the quarter? And then what were the contributors that decelerated during the month of November when you saw that down 12%?

And then the second piece of that, Q4 for boots, what typically has been the mix of boots at Journeys for Q4? And then just given the last two warm winters, or last year and what seems to be warm so far, what should that mix look like over time? Thanks.

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

Just qualitatively, what happened in November is that's where boots become a significant part of our business. So, in addition to having the challenges with the rotation of fashion athletics that we described, you can layer on top of that a very slow start up to the boot season.

Other retailers, as you probably know, have called that out, so that's an industry-wide event. We're subject to two things, one of which hopefully gets cured with cold weather, and if not we will then start to promote our way to make sure that our inventories are right-sized at the end of the quarter, as we always have. And that scenario in particular affects our conservatism in terms of how we're thinking about that.

Mimi Vaughn - *Genesco Inc. - CFO*

Right. And then just to talk specifically about traffic, traffic in August and September, we spoke about the fact that late in the summer and in July that traffic had fallen off and that we expected that it would pick back up when we hit back to school. And it did, in fact, tick back up from the levels where it was in August and September.

But then as we moved into October and November, traffic was down pretty significantly in our stores. And the fact of the matter was, customers just weren't looking for cold-weather product and weren't coming into our stores. Conversion, interestingly, was up in October and was mostly flat in November, but it really was the decline in traffic that ended up getting us.

As far as average ticket, average selling price has been increasing for us because we've been trading into a higher-priced product. We've been trading out of product that is in the $50 to $60 range and trading up into product that is a higher average price. So, our average ticket size has, interestingly, the add-on purchases have come down a bit.

The way we think about it, Erinn, is that our customers tend to have a certain amount of money in their pockets that they're going to spend. So, when they were buying lower-priced footwear, they'd buy something plus an add on, be it a backpack or a pair socks or some accessories within our stores. So, our average ticket has actually remained relatively flat despite that increase in average price of our footwear.

I think your last question was boot mix, and our boot mix is certainly down year over year versus where it was last year

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Operator

Mitch Kummetz, B. Riley.

Mitch Kummetz - *B. Riley & Company - Analyst*

Yes, thanks. Maybe just quick on the boots. Bob, you mentioned that if it snowed next week that would be a big help.

But then, Mimi, you talked about being mindful not to end the year with too much inventory, and you're willing to give up on some sales in order to focus more on the inventory side. It seems like I'm doing a lot of weather watching these days, and we're actually supposed to get some pretty cold weather.

Mimi Vaughn - *Genesco Inc. - CFO*

We are, too. (laughter)

Mitch Kummetz - *B. Riley & Company - Analyst*

I'm not surprised. So, the weather is supposed to turn next week. How do you view channel inventory?

You're obviously watching your competitors out there. What are you assuming in terms of the weather over the balance of the quarter? And if we do get the weather how much does that really help?

How much can you chase versus just watching the inventory, just trying to manage through and maybe not being as promotional as maybe what's anticipated? I'm just trying to understand those dynamics.

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

Mitch, you're asking if we have perfect information that connects the unknown of weather to the unknown of how well weather might help us. And obviously what I'm saying is we don't. The merchants at Journeys are going to have to use their judgment to watch the development of sales, keep an eye on the weather and the calendar, and keep their eye on the competitors, and with all that input make a good judgment call, accordingly.

In general, the feeling is that retail in general is operating with a better inventory position than past years, so hopefully that will help a little bit. So, I just can't give you an answer to that, other than to point out the fact that Journeys' track record is one where they always manage through the inventory in effective way, and the buying team is the same buying team. So, we have a lot of faith that they are on it., that they will make the right call.

They will likely be making some conservative calls the deeper we get into the season and not let the highest traffic days go past without being in the right position to get our inventories aligned.

Operator

Jonathan Komp, Robert W. Baird.

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

Yes, hi, thanks. I'd like to follow up on the topic of traffic and conversion for Journeys. I think a few months ago you talked about the initial comps for lots at Journeys in August really not being a traffic issue, it was entirely lower conversion. Now it sounds like traffic's fallen off a little bit more.

Understanding the boot headwinds, but are there any signs that, as you don't have the current mix of the fashion athletic product that you're talking about, that customers are staying away from the stores and heading elsewhere? And then as you look forward to spring and the ability to shift the merchandise assortment, Bob, maybe is there any historical context you can provide historically on that type of shift towards fashion athletic for Journeys and if it's been successful in the past?

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

In general, the shift that Journeys makes when we have a fashion rotation of any sort is that we go through a negative comp period, as we are seeing now, and we come back strong. Before we get into the details of traffic and conversion, let's just look at the Journeys customer. We have started doing a lot of research, and we did another round after back-to-school, and it really just points to the behavior of the kids and Journeys' role within it.

First, the teenagers tell us they still like to go to stores. And that is confirmed by the independent research and it's confirmed by our mix of sales between stores and online. They will do -- no surprise -- a lot more research online.

So, when you see a decline in traffic, we have always assumed over the last several years a lot of that is the window shopping aspect, the first step of shopping. And the fact that we have been comping up on lower traffic with better conversion is a good fit with that.

Right now we're in a spot where we are not converting because when they come into our store we don't necessarily have exactly what they want. And then the driver on traffic is the fact that the weather doesn't compel them relative to other years to get out there and start looking for winter goods.

Second, the research tells us that the teams are very brand oriented, much more so than in apparel. And this was very consistent with syndicated research which confirms that. But, as I said, you have to have the brand the teams want, and we have been a little off course on that, but we're correcting it.

And then, finally, just while I'm going through this teenager, the other bit of the research shows that Journeys continues to be the number one store brand for our segment of enthusiast teams, both in terms of their awareness of the store and then their intent to purchase from us.

What I'm saying is that we got traffic, we got conversion, but what we don't see is any indication of a fundamental change in our business model rather than a fashion rotation that we have seen several times in the past history of Journeys. And when we go through these fashion rotations in the past, we come out strong on the next trend.

So, while this dip's been a little more severe because of our concentrated position going in, and then it's been a little further exacerbated by weather, we think the team has done a great job of pivoting and we believe we are headed back to where we need to be in terms of assortment and performance.

Mimi Vaughn - *Genesco Inc. - CFO*

John, I think you've got the cadence of the traffic right. I think we would attribute the drop off in October and November largely to the weather. As Bob says, we have no evidence that our teen is going in and shopping online.

We are viewed as the destination for fashion athletic footwear within the mall. We believe that positioning will serve us well when we've got the product that the customer really wants to buy.

Operator

Laurent Vasilescu, Macquarie.

Dan Isaacson - *Macquarie Research Equities - Analyst*

Hi, good morning. This is Dan Isaacson on for Laurent. Do you guys have any thoughts on a high-level plan on store openings and closures for next year? And which banners are you looking on to either open or close stores on?

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

We continue to be cautious on square footage expansion overall. We would expect that teen Journeys and the Lids patch stores, which are pretty close to being built out in the US, will see little to no new growth, may even reduce square footage in the next few years in the C malls. We've got Macy's and other big box guys that are closing stores.

As the C malls start to waver, that could be closures. So, what we're doing for those chains, the marginal stores in the marginal malls are on very short lease lives. They stay open essentially on a year-to-year basis as long as the landlord will allow us to stay nicely profitable; otherwise we close them.

What store growth we will achieve will likely come, as Mimi had noted, from Journeys Kidz where we see some very nice white space, and it's a category were mom does go because of the fit issues. And then we're just completing our buildout of Schuh in the UK, but that is largely there.

And then Lids Locker Room is the wild card. It's another potential area of future growth. But right now we're focused on closing the unprofitable stores, or at least restructuring their rents, the ones we opened a few years back, and then we're maximizing the performance in the remaining stores.

And then, finally, we're right-sizing, as we noted, Macy's down to its profitable core, from which we get that thing positioned correctly and get to our return target, that's another potential area of growth. If you add it all up, our square footage growth on a percentage basis is going to be a lot, lot less in the next five years than it was in the past five years.

Mimi Vaughn - *Genesco Inc. - CFO*

Dan, I think that if you look at where we were this year, we are projected to open 88 stores and we are closing 91 stores. So, on a net basis we are going to be flat because the stores we're opening are a little bit bigger than the stores we are closing. But, importantly, we're not trading off productivity for productivity within those numbers.

We're opening what we believe will be stronger stores, and closing what we believe will be weaker stores. Those stores that we are closing operate at a lower level of sales and profitability, and oftentimes are in a low to negative profitability situation. So, we think that, that is a healthy pruning of our overall fleet.

For next year specifically, we anticipate that we would be opening stores at a rate that's similar to this year. So, it be something like 40 Kidz stores. We have been opening stores in Canada for Journeys.

Lids right now have over 100 stores in Canada. Journeys doesn't quite yet have 40. So, we think there's an opportunity among all of our various banners in Canada to open about 10 stores.

Between Journeys and Lids, there would be another 10 stores that we would fill in. Johnston and Murphy and Schuh each would have a little bit fewer than 10 stores. So, altogether that adds up to be about 70 to 80 stores we would open for next year.

And then, of course, the wild card will be how many stores we close. Often when we go to close a store the landlord often finds that they are able to give us great rent concessions. We've gone to close several of the Lids Locker Room stores that have been underperforming, and, in fact, we've been able to get 40% rent concessions on 23 stores that we had otherwise planned on closing.

So, I think the closing is the wild card and is dependent on how good the rent concessions will be. But, at the end of the day, if a store is so low volume that it isn't worth the time to continue to operate no matter how good the rent release is, then we will close the store.

Operator

Scott Krasik, Buckingham Research Group.

Scott Krasik - *Buckingham Research Group - Analyst*

Yes, hello. Thanks for fitting me in here. I wanted to talk about gross margins. There's a lot of moving parts here.

For Lids, obviously you have this big recovery from the excess inventory issues last year. And then the warehouse costs popped up this quarter. So, just wondering, how much that is.

But then do you view this as a one-time thing on the recovery, especially just given how much you must be selling full price for Cubs? And then on Journeys, last year you were able, I think in the fourth quarter it was promotional but your gross margins weren't even down, or maybe down a little bit because you got concessions from vendors.

So, I'm just wondering, to your point you may have to be promotional this fourth quarter, do you expect to get the same level of support? And then how do you view Journeys' gross margin as you shift into some of these new trends? Thanks.

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

On Lids, it probably is -- certainly this order of magnitude, it's a one-time event. What's interesting is if you look at the profile of the way the team is running Lids right now, they still are taking a lot of markdown on product on a number of units that were identifying and flowing through with markdown product. The gap is not as big as we ever would have imagined.

And the reason is, what they are doing is they are taking marks much earlier, which means their marks are much less deep. The two benefits of that, the one obvious one is it allows us to have a better result in terms of what the final gross margin is for the markdown product, and then on a blended basis over all. But maybe as important or more important is it's clearing up open to buy to create chase dollars.

Scott, as you can imagine, in a category like licensed sport, the more dollars you have available to chase, the more you can get after that prized team to the extent that there's product available. You can get out ahead of it, hopefully, and invest in the teams that have the potential to make the playoffs. So, that's the story there.

On Journeys, when a retailer runs into the kind of sales challenges that we've had at Journeys, it naturally weighs on gross margin. The Journeys' team's ability to work with vendors to get assistance in all sorts of different forms historically has been good. That can come in all sorts of forms in terms of getting relief.

We truly partner with our vendors to try and do the thing that is best for them and best for us given the circumstance. But I think it's fair to say that in the near term, given the sales pressure, there will be some pressure on gross margin. In the longer term, the product shift does probably weight us a little in the direction of slightly lower initials because of the athletic emphasis.

The flip of that is we get better ASPs. The kind of fashion trend we're talking about is a swing from a lower ASP to a higher SP. So, the wild card will be units.

We have to be careful about assuming that a higher ASP translates into sales on a one-to-one basis. Our kid only has so much money to spend. If we actually got that we would feel very fortunate.

More likely they buy a little less of other stuff in our store and we've already seen a little bit of evidence of that. So, that's the general dynamic. Mimi, anything you want to add?

Mimi Vaughn - *Genesco Inc. - CFO*

Scott, I think that this year's fourth quarter will not be like last year's fourth quarter. We gave up about 120 basis points in Journeys gross margin in the third quarter. And that was due to the markdowns just to ensure that our inventories would be really clean at the end of the quarter.

We think that it's likely going to take the same action in the fourth quarter this year. So, we are giving up a little bit of initial due to the stronger athletic mix but we think that this year it is actually going to take some markdowns on our part. Our vendors have absolutely been working with us.

But the magnitude of the correction that we had to make between the product we were going to receive and the product that we needed to mark down this year has been such that it will impact our bottom line. And going forward, when we anniversary this, clearly we won't have the level of markdowns next year but our gross margins will be at a lower level because of that athletic mix.

Operator

That concludes today's question-and-answer session. Mr. Dennis, at this time I will turn the conference back to you for any additional or closing remarks.

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

Thank you. We will, as we always have done in the past, be attending ICR in January down in sunny Florida. I assume it won't snow there, but that would be good.

So, we look forward to seeing all of you there. And we wish you all a happy holiday. And thank you for being with us today.

Operator

And, again, that does conclude today's call. We would like to thank everyone for their participation. You may now disconnect.
