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PRESENTATION

Operator

Good day, everyone, and welcome to the Genesco Second Quarter Fiscal 2020 Conference Call. Just a reminder, today's call is being recorded.

I would now like turn the call over to Dave Slater, Vice President of FP&A and Investor Relations. Please go ahead.

David Slater

Good morning, everyone, and thank you for joining us to discuss our second quarter 2020 results and our full year fiscal 2020 outlook. With me on the call today are Bob Dennis, Genesco's Chairman, President and Chief Executive Officer; Mimi Vaughn, our Chief Operating Officer; and Mel Tucker, our Chief Financial Officer.

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 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 attachment to this morning's press release and in schedules available on the company's homepage under Investor Relations in the Quarterly Earnings section.

I want to remind everyone that we have posted a presentation summarizing our results and guidance that is accessible on our website. As another reminder, we filed an 8-K in connection with our late -- with our last release in Q1 that contains adjusted non-GAAP fiscal '19 results by quarter for the last year we stated to reflect the sale of Lids Sports Group as if we never owned the business per GAAP requirements. You can find that on our website as well.

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

Robert J. Dennis - *Genesco Inc. - Chairman, President & CEO*

Thanks, Dave. We have 2 new people in the room with us today. Just heard from Dave Slater. Dave joins us with over 20 years of retail experience with leadership roles at Chico's FAS, Dollar Tree and Walmart. Dave will be leading our Investor Relations function as well as our Financial Planning & Analysis team. We are excited to have someone with his relative retail background join our team. As Dave mentioned, we are also joined today by our Chief Operating Officer, Mimi Vaughn and, for the first time, Mel Tucker, our new Chief Financial Officer. Mel joined Genesco in June from Century 21, the New York-based department store, where he was CFO since 2014. Mel also has extensive retail experience having served in senior financial role with leading companies such as (inaudible), PetSmart and Home Depot during his 25-year career. And we are thrilled to have someone of his caliber on our team, and so welcome to you both.

In a moment, Mel will review our recent performance and updated outlook in detail and Mimi will cover some specific topics that could have potential impact on our business and the progress we were making on the Schuh 20-point plan. But first, let me walk through the highlights from the second quarter.

From a high level, our consolidated results exceeded expectations across the board. The performance of our U.S. footwear businesses, Journeys in particular, fueled a 3% increase in consolidated comps, our 9th consecutive quarter of positive consolidated comparable sales for our footwear businesses. We were particularly pleased with this result given the more challenging step comp comparisons we faced as we moved from the first into the second quarter. Importantly, our overall brick-and-mortar performance remained in positive territory and e-commerce comp sales accelerated to 20% continuing its strong multiyear run.

Total sales for the company would have been up but for the impact of lower U.K. and Canadian exchange rates. The solid comp, coupled with higher gross margins across all divisions, resulted in a significant improvement in profitability. Excluding bonus expense, SG&A was up only 1% as we continue to benefit from the numerous cost savings initiatives we implemented through fiscal '19 and in this fiscal year.

On an adjusted basis, earnings per share was $0.15 compared with a loss of $0.01 in the second quarter last year. This solid performance, combined with our strong first quarter results, represent a great start to our first fiscal year as a footwear-focused company following the sale of Lids in early February. We completed the balance of the significant work of transitioning Lids off our infrastructure and systems during the quarter, and we continued the important work of eliminating the stranded costs associated with the sale.

Looking now at the performance of each of our footwear businesses in Q2. For Journeys, it was another outstanding quarter as the strength of its product assortment fueled continued top line momentum even as the business was up against a more challenging comp comparison. Strong full-price selling of seasonal footwear, including sandals, contributed to Journey's Q2 sales and margin gains, as did the ongoing success of fashion athletic styles. As usual, the retro and casual product that were bestsellers this year were different from a year ago as the Journeys merchants continue to showcase their ability to adeptly manage the fashion rotation that is an inherent part of the business.

Both store and e-commerce comps at Journeys were nicely positive, which led to a 4% comp increase on top of last year's double-digit gain and a significant improvement in year-over-year profitability. Similar to great -- recent quarters, great expense control along the strong sales allowed for expense leverage with rent leverage as the highlight.

Moving over to the U.K. The operating environment remains difficult due to the continued soft consumer demand for apparel and footwear, challenging retail traffic overall and then overall economic weakness related to even greater Brexit uncertainty. Given all that, we were pleased that Schuh achieved a flat comp driven by improved e-commerce results. The Schuh team did a good job navigating the current headwinds to deliver higher gross margins than a year ago through careful inventory management and lower markdowns on sale product. Unfortunately, this effort wasn't enough to offset lower overall sales from changes in foreign exchange, coupled with the deleverage from negative store comps in the quarter.

Some of you might have seen a recent article in the U.K.'s Sunday Times that reported Schuh had engaged an outside adviser to help explore potential restructuring opportunities. Important to understand the meaning of the word restructuring in this situation. We are largely looking at ways to renegotiate rents for Schuh's store fleet in order to improve profitability, following the ongoing declines in High Street and mall foot traffic making these rents uneconomical. Let me be clear as I think the article might have been misinterpreted. We are not exploring a potential sale of this business. Schuh remains firmly in our future plans, and we are encouraged by the results of our 20-point plan, and we are committed to working closely with the teams to improve upon recent results.

So now back to the U.S. Johnston & Murphy retail comps improved from first quarter levels, despite being up against stronger comparisons in the second quarter. While the shift to the sale catalog to later in the quarter versus last year was less effective than we had hoped, resulting in J&M's 1% comp gain, we did gain benefit from strong apparel sales. The business also achieved better gross margins and benefited from lower expense dollars to deliver an operating profit above last year's levels and ahead of expectations. Nine of the top 10 shoes for the season in our retail business were casual sport or hybrid styles with athletic-inspired bottoms underscoring the progress J&M has made diversifying its product offering beyond the dress shoes that the brand was originally known for.

Finally, Licensed Brands also delivered a better bottom line performance with meaningfully higher gross margins on lower sales.

With a sizable cash flow generated from operations last year and the sale of the Lids business, we have been actively buying back stock opportunistically and returning capital to shareholders. Across 2 authorizations, totaling $225 million, we began buybacks in late December and as of last Friday have repurchased close to 5.2 million shares, almost exhausting the second authorization. This represents a 27% reduction to average shares outstanding last year. While the most recent repurchase activity will aid earnings for this year, the impact will be in the back half. The improvement in earnings per share above our expectations in Q2 was driven by better operating performance and not by share buybacks. Even after finishing these 2 authorizations, we still have excess cash flow from last year we can put to work, and we anticipate generating additional cash flow in this fiscal year to add to that.

We are pleased to share that the top line momentum that we experienced in the second quarter continued nicely in August on both sides of the Atlantic for Journeys and for Schuh through the heart of the Back-to-School selling season. J&M's August comp results slowed during this low-volume month for this business as all goods begin to land and before a shift in the season begins.

Based on our strong first half results and positive start to the third quarter, combined with the repurchase of more shares than we initially expected, we are raising our full year guidance. We now expect earnings per share for fiscal '20 to be between $3.80 and $4.20, up from our previous range of $3.35 to $3.75. And as always, we do regard this guidance as a range with some upside and some potential downside. We are now more optimistic about Journeys' results offset by foreign exchange headwinds at Schuh and some comp headwinds at J&M. Later in the call, Mimi will review some of the other headwinds we potentially faced in the back half, which have not been built into our guidance, namely tariffs and Brexit, and our plans to lessen their possible impact. With respect to our guidance, something close to the middle reflects our best current belief of where we might turn out for the year, which represents an increase in the neighborhood of 20% over fiscal '19 earnings from continuing operations of $3.28.

And with that said, let me turn the call over to Mel to give more specifics of the financials and the guidance. Over to you, Mel.

Melvin G. Tucker - *Genesco Inc. - Senior VP of Finance & CFO*

Thanks, Bob. Good morning, everyone. As Bob said, we were very pleased with our second quarter performance. Our year-over-year profit improvement was led by Journeys with Johnston & Murphy and Licensed Brands each contributing to the improved results. Adjusted EPS grew considerably to $0.15 from negative $0.01 in the prior year, driven by solid comps, improved gross margins, both of which contributed to it versus expectations. This was partially offset by some SG&A deleverage in this lowest volume quarter, which small increases in expenses can have an outsized impact. Q2 consolidated revenue was flat with last year at $487 million. Excluding the effect of lower exchange rates, revenue was up 1%. Consolidated comps were up 3% with store comps up 1% and direct comps up 20%. Positive comps were offset to some extent by lower wholesale sales and closed stores. Direct as a percent of total retail sales was 10% in Q2, up 150 basis points, accelerating the good progress we continue to make driving e-commerce. As a reminder, we run our e-commerce business to be a profit center. We could grow e-comm more rapidly with higher marketing expense and more free shipping and return offers, we choose instead to keep an emphasis on profitable growth.

Journeys posted a solid comp increase of 4% on top of a robust 10% gain last year, marking the ninth consecutive quarter of increases highlighted by both positive store comps and strong double-digit e-commerce growth. Comp sales on a 2-year stack basis improved from Q1 to Q2. Highlights of Q2 store performance included mid-single-digit increases in conversion and a low single-digit increase in transaction size, which drove a strong comp in spite of less store traffic.

Schuh posted flat comp sales for the quarter in spite of a challenging macroeconomic environment in the U.K. versus a negative 7% a year ago. Not including the impact of foreign exchange, Schuh total sales were down only 1% for Q2. E-commerce posted a strong double-digit growth in comps but is offset by negative store comps. Store traffic declines and lower conversion rates were partially offset by higher ASPs.

Comp on a 2-year stack basis improved sequentially from the prior quarter, from double-digit negative to single-digit negative. Consumer brand choices continue to be polarized with strong preferences for certain athletic and casual brands, increase in kids and accessory sales were highlights for the quarter.

J&M posted a 1% comp for the quarter on top of a challenging 8% comp comparison from the prior year. A decline in store traffic was offset to some extent by an increase in conversion and higher transaction size. E-commerce comps drove the positive overall comp for the quarter.

Q2 consolidated gross margin increased 110 basis points to 48.6%. Journeys gross margin increased 70 basis points due to freight claims credits, lower shifting and warehouse cost and lower markdowns. Schuh's gross margin improved 50 basis points due to more efficient sell-through of sale product with lower markdowns. At J&M, gross margin was up 150 basis points, due largely to a favorable comparison in the wholesale business that we made the decision to clear merchandise last year in our women's category. Licensed Brands gross margin improved 470 basis points due to more direct consumer shipments, fewer markdowns and less closeout product.

Total adjusted SG&A expenses increased 30 basis points to 47.6%, driven primarily by increased marketing expense. As overall more mall traffic has declined, we have been growing our direct channel. We have invested in additional paid search and catalogs to drive traffic to our stores and to our websites. This increase in marketing expense was partially offset by lower bonus expense and rent savings. In this low-volume sales quarter, at a 1% store comp, we deleveraged store expenses just a little bit, thanks to the cost savings initiatives we began last year. We have continued cost reduction and profit-enhancement activities into the current fiscal year. Included in these activities is an effort to eliminate shared and stranded cost as a result of Lids divestiture. In total, we had between $12 million and $15 million of expenses that were allocated or shared with Lids, primarily in areas like Finance, IT, HR and the Call Center. We believe over time we can eliminate much of this stranded cost and are working diligently towards that end. As a part of the larger cost reduction efforts, we continue to have, in partnership with our landlords, very good success on -- with renewals and rent reductions. We've negotiated 92 renewals year-to-date and achieved a 15% reduction in cash rent or 11% on a straight-line basis in the U.S. This was on top of a 15% cash rent reduction or 8% on a straight-line basis for almost 170 renewals last year. An important aspect of these renewals is the short term, which for this year averaged approximately 3 years. This allows us to think about rent increasingly as more variables than fixed, providing flexibility in our cost structure. Other areas of savings identified this year include store labor hours, warehouse expenses and credit card fees. In total, between stranded cost elimination and these other opportunities, we aim to identify this year another $20 million of cost to take out of the business.

In summary, the second quarter's adjusted operating income was $4.7 million versus $1 million a year ago. Adjusted operating margin increased 80 basis points to 1%. Operating income dollars increased for every U.S. footwear division, offset to some extent by Schuh and higher bonuses at corporate.

Turning to the balance sheet. Inventory is in good shape. Q2 inventory was up 2% on flat quarterly sales. We intentionally added inventory at Journeys to be better positioned to supply our business during the Back-to-School period. Journeys' inventory was up 6% on a sales increase of 3%. J&M's inventory was down 4% on sales that were down 2%.

Schuh's inventory was up 2% on a sales decrease of 1% on a constant-currency basis as Schuh successfully managed inventory in a tough retail environment. Capital expenditures were $7 million and depreciation and amortization was $12 million. We continue to aggressively return capital to shareholders using almost all of the $100 million repurchase authorization that our Board approved in Q1. As of last Friday, August 30, we have repurchased close to 2.5 million shares for a total of $99 million. Altogether, including the initial repurchase authorization of $125 million, we have repurchased 5.2 million shares since December for $224 million. We ended the quarter with $58 million in cash versus $50 million a year ago and no U.S. dollar borrowings.

Moving on to guidance for fiscal '20. With a better-than-expected Q2 performance and a solid start to Q3 and the important high-volume Back-to-School season, coupled with the repurchase of additional shares, we are taking our EPS guidance range up to $3.80 to $4.20, compared to our previous guidance range of $3.35 to $3.75. Something close to the middle of this new range reflects our best current belief of where we might come out for the year. We continue to assume low single-digit overall comps for the year's remaining quarters due to more difficult stacked comparisons in the back half, for Journeys in particular. While we have increased Journeys' Q3 comp assumption, given the positive Back-to-School results thus far, we've reduced our Q3 comp assumption for J&M, given the slow start to the current quarter.

In addition, since the last time we discussed guidance, we faced further headwinds from the weakness of the British crown, which could affect sales and profits for the year. Another variable is the exact timing of eliminating stranded costs from the Lids divestiture. While we are pleased that Lids is completely off our shared services and systems and are confident we will ultimately eliminate much of this cost, Lids unplugged even faster than we expected. We have a detailed plan to eliminate the stranded costs that remain, but have more potential exposure for this year, in Q3 especially, due to this timing.

In the high end of our guidance range, we eliminate more cost. In the low-end, less. The guidance also does not anticipate repurchases of shares beyond the buybacks we've already completed. As Bob said, Mimi will discuss the possible impact of tariffs and a hard Brexit in the U.K., both of which could affect our results, but we have not built anything implicit -- explicitly into our guidance related to either of these factors.

For the year, we still expect consolidated sales will range from down 1% to up 1% with the high end of the range becoming more challenging with the pound weakness, but now expect higher consolidated comps ranging from up 2% to up 3%. Store comps underlying guidance now range from up 1% to up 2%. We still plan to open around 30 new stores, mostly Journeys and Journeys Kidz. We plan to close around 40 stores, if we can't get the right rent deals, or square footage decrease for the third year in a row. We now expect gross margin to be up 30 to 50 basis points in total, up from our initial estimate of 10 to 20 basis points, which -- with much of the improvement coming from the branded businesses, namely J&M and Licensed Brands. With a low store comp and the timing of eliminating stranded costs, we now expect SG&A expense will delever in the 30 to 50 basis point range. This all results in an operating margin within a few tenths of last year's levels and EPS that ranges from up mid-teens to up in the high 20% range due to the net impact of share buybacks. We now estimate that fiscal '20 tax rate at approximately 28%.

An important callout for modeling for the remainder of the year is that we expect much of the year-over-year improvement in EPS in the back half to come in the fourth quarter. Capital expenditures will be around $45 million as we plan to spend more on digital and omnichannel investments, while still investing to refresh our store fleet. We estimate depreciation and amortization at $50 million.

Lastly, we are assuming an average of approximately 15.7 million shares outstanding, assuming no stock buybacks beyond what we have made to date.

Now I'll turn the call over to Mimi, who will cover how the company is positioned to deal with 2 external headwinds, tariffs and Brexit, and provide an update on our Schuh 20-point improvement plan.

Mimi Eckel Vaughn - *Genesco Inc. - Senior VP & COO*

Thank you, Mel. Good morning, everybody. As we've discussed, it's been a strong first 6 months of fiscal '20, and we're heading into our busiest selling season with nice momentum. While we feel good about our prospects for the year, evidenced by our heightened outlook, both tariffs and Brexit present possible headwinds, and we're taking specific actions to mitigate their potential effect. Most importantly, we continue to root for a successful resolution of trade negotiations with China. As far as the fourth tranche of tariffs effective on September 1 and December 15, we don't believe the impact will be significant in this fiscal year and haven't yet included anything in our annual guidance as it remains a very fluid and dynamic situation. On an annual basis, currently about 1/3 of our merchandise is imported from China with approximately 10% from direct imports and the remaining amount imported by our third-party vendors.

So to give the details in terms of direct exposure, we develop and directly source merchandise for Johnston & Murphy and Licensed Brands, which together were a little less than 20% of our total sales in fiscal '19. Of those goods, approximately 50% currently comes from China, with a more heavy weighting to Licensed Brands, resulting in direct sourcing from China for merchandise representing a little less than 10% of our sales in total.

Since most of this product is leather shoes, the tariffs unfortunately went into effect at the start of September versus in mid-December. We will -- we pulled forward as much inventory as we could for receipt ahead of September 1 and have been working with our vendors to share the now higher cost.

The devaluation of the Chinese yuan is also helping lessen the near-term impact. We currently estimate the potential impact to our bottom line in this fiscal year, if nothing changes under the current circumstances, to be in the neighborhood of $1 million relating to this product that we source directly, given how late it is in the year.

Looking further out, our intent is to diversify sourcing as much as we can outside of China and these efforts are well underway for fiscal '21. The balance of our merchandise is imported by our third-party vendors. For Journeys, which accounted for 65% of total sales last year, we estimate that 30% to 40% of the product we buy from third-party vendors is currently sourced from China. The remainder of our business, which is based in the U.K. and the Republic of Ireland, of course, does not affect us.

For this indirectly sourced product, we expect that our third-party vendors would undertake similar actions to what we're taking. However, we have less visibility into their specific plans. We do know that many of our vendors, especially the bigger ones, which represent the majority of our purchases, have some time ago diversified their sourcing to include countries in addition to China. Therefore, we anticipate they will ship as much product sourced from factories and places like Vietnam to the U.S. as they can to mitigate any impact. The good news is that, to date, we have not heard from any of our footwear vendors that they intend to pass on price increases for this year.

Shifting gears now to Brexit. While we hope a hard Brexit, which entails the U.K. leaving the European Union without a trade agreement in place, does not become a reality, our Schuh team has been diligent about understanding the potential impact and has spent several months crafting a detailed contingency plan to minimize disruption, if it does. While there will be some additional cost to operate in this new environment, they would expect only a small amount of Schuh's product in operations. The Brexit situation evolves daily, but we believe we will be well prepared for whatever comes our way.

To give some color, we have to think about this situation both from the standpoint of what we sourced and where we operate. Like our situation in the U.S., Schuh has both indirect and direct sourcing. The indirect piece, the product brought in by third-party vendors, represents almost all of what Schuh currently sells. Today, much of this product lands on the continent before coming over to the U.K. duty free and with no customs border. It's our current understanding that the U.K. government plans, in the event of a hard Brexit, that goods landed in the U.K. can be cleared immediately and duties paid retrospectively. And if so, the vast majority of the product we sell would be able to flow freely into the U.K. For the remaining product that Schuh directly sources, which is largely our private-label product, a little over half of this comes from the EU. These goods could potentially be subject to additional tariffs, which would represent a small amount of additional costs, if we can't find alternative sourcing outside of the region.

Then in terms of where Schuh operates. Of its 132 stores, 10 are in the Republic of Ireland, which would remain in the EU. All product flows back and forth freely between these markets with no customs or duties today. We have options for the future, including setting up a mini distribution center in Ireland to land a product directly and supply these 10 stores and the e-commerce demand rather than continuing supplying from the U.K. This change would drive some additional costs, which would be partially offset by savings from the removal of other costs we incur in today's supply chain. The Schuh team has successfully set up mini distribution centers in the past and stands ready to implement this plan in a matter of weeks, if necessary.

So in summary, the incremental costs from Brexit would be potentially some duty on a small amount of a product we sell plus the additional expense of operating a mini distribution center in the Republic of Ireland, which should be manageable. Most importantly, goods will continue to flow into the U.K.

Touching now on our Schuh 20-point program. Consumer spending in the U.K. has held up relatively well, thanks to the strongest labor market in decades. However, for some time now, purchases have been concentrated in basics, like groceries and housing, while purchases in discretionary categories, particularly footwear and apparel have been under significant pressure. There continues to be a clear divergence not only across categories but also across channels as growth on online spending far outpaces growth on the High Street. The incessant Brexit back and forth and prolonged uncertainty has weighed on consumer confidence, which has been declining for some time now.

Against this challenging retail and consumer backdrop and Schuh's performance, as we discussed it on our last call, we implemented an aggressive set of actions aimed at immediately addressing near-term profitability. At the same time, we're executing initiatives to enhance Schuh's standing with the consumer and with the brands itself to better position Schuh over the more medium-term. The Schuh team is working hard with great urgency to impact the business. These initiatives include, among many others: testing new categories, like socks and apparels, and fuel add-on sales; launching new digital marketing campaigns; implementing new selling techniques and incentives to drive in-store conversion; continuing cost-reduction initiatives; and rapidly adding to the database of consumer names to bolster its marketing program.

As one of our most critical initiatives, as Bob mentioned earlier, we're attacking Schuh's fixed cost structure with a strong focus on rent reduction. In this environment, where traffic into stores has declined and rents are well above what the market warrants today, we must make progress on this front and achieve not only reductions but more flexible rent structures to weather the current retail volatility.

So now I'll hand the call back to Bob for closing.

Robert J. Dennis - *Genesco Inc. - Chairman, President & CEO*

Thanks, Mimi. The strong start to the year, including our ninth consecutive quarter of positive comp sales as a footwear company, is a testament to the dedication, commitment and hard work we glorify our employees on a daily basis. There are not many who can boast of this track record of successive positive comps. And with the solid start to the third quarter, the current trend continues, knock on wood, we are on our way to adding a 10th. We want to recognize the contributions of all of our employees and tell you how much we appreciate you.

In addition to our team's ability to execute, there are several reasons we are optimistic about our future. Our company is anchored by well-known brands with strong consumer connections and loyalty, positioning us well in today's volatile retail world. Bolstering our confidence is the fact that we were early to invest in digital and omnichannel infrastructures and today enjoy advanced capabilities allowing us to connect with and serve our customers whenever and however they choose. The combination of our digital offerings and fleet of stores and important strategic assets represents a powerful platforms to win with today's empowered consumer and emerge as a clear winner in the ongoing consolidation of retail. We are working hard to reposition all our stores with shorter, more favorable lease terms, which gives us ultimate flexibility. And now, as a footwear-focused company, the synergies among our businesses provide us with even more opportunities to drive enhanced profitability and greater shareholder value over the long term. We are truly stronger together.

And with that said, operator, we are now ready to take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we will take our first person from Janine Stichter with Jefferies.

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

Congrats on the strong quarter. I was just hoping if you could give a little bit perspective on Journeys. It seems like the strength you're seeing there is pretty broad based. If you can just give us some perspective on what the concentration looks like, whether it's by brand our by style that you're seeing right now. And then maybe some thoughts on how you're thinking about boots for the holiday season. And then kind of along those lines, also the e-commerce business really strong this quarter. So just any thoughts on what you're doing there that's maybe driving that growth.

Mimi Eckel Vaughn - *Genesco Inc. - Senior VP & COO*

Sure. So Janine, just to start with the perspective on the brands, and we've talked about this retro athletic trend that started with certain brands and it really has morphed into demand for other brands. And so this trend had a lot of legs because many of those athletics brands that we carry have retro styles in their libraries really spanning back. And so the brands and the styles driving the business today aren't the ones that were driving the business 2 years ago. So we've seen nice rotation within our business. And we are very pleased with the breadth of the comp drivers lately. Casual has been adding to the mix, while at the same time we have seen athletic continue to be strong. We had a very nice sandal season, a strong sandal season over the course of the summer. And we had a strong boot season last year. So we'll see about the coming boot season. It's a little too early to tell the temperatures across the country, at least Nashville this week is in excess of 90 degrees. So it's hard to get a clear reading on the boot season as yet, but we feel like we are well diversified across brands and across franchises. There's a lot of newness in what we've been seeing. We are particularly pleased with the progress, as I said, that we are making in casual.

On e-commerce growth, for the upcoming holiday season, look, we continue to make great progress within e-commerce. Some of the things that we're doing is we're just investing, and I think Mel said it on the call, he said that we run our e-commerce business to make profit. So we measure carefully some of the investments that we're making and ensure that we're getting positive returns for that but we have been spending more on paid search, we have been spending more on catalogs. It's been a really effective tool to drive traffic not only to our websites but also to our stores. And we have a really nice set of investments that we've made in systems like order management that have given us some robust capabilities.

Operator

And we will take our next question from Jonathan Komp with Baird.

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

Maybe just a follow-up on Journeys. I know the business is performing well against tough comparisons. The comparisons stay fairly tough. So if you could give any more color on how you're thinking about the sustainability there? I know you're embedding lower comps, but you've exceeded the plan recently, some I'm curious, the potential for that trend to continue as you look forward in the business as a seasonal mix changes.

Robert J. Dennis - *Genesco Inc. - Chairman, President & CEO*

Yes. There's not a whole lot more to say, this is Bob. The second quarter -- the notable thing about the second quarter was we were comping against 2 years for the first time of positive comps, and we continue to run up. So we believe we're gaining share. And we think the trends that were driving the business in the second quarter, they obviously, as we disclosed, persisted through Back-to-School. And so we feel like we've got a good assortment for holidays. So we're feeling good. The only thing that modifies a little bit our outlook relative to how Journeys did in the first half is the comparison. They got tougher especially in the fourth quarter. So we're being a little -- in our guidance, a little more muted in our comp expectations. But it's not because we don't think the business is strong, we just think the compares are up there. So it's about all we can say about Journeys.

Mimi Eckel Vaughn - *Genesco Inc. - Senior VP & COO*

Yes. And the only thing that I would point out is that we move from a 2-year stack of plus 1% in Journeys to plus 11% in the second quarter, and we performed really well against that. So in spite of the fact that there are equally tough compares in the back part of the year, if we put that performance up in the second quarter, it does bode well for the back half.

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

Okay. And then maybe just a similar question for Schuh. I know you outperformed in the quarter but didn't change the comp outlook. So is that embedding in conservatism, given all the factors we talked about, Mimi? Or how should we read the second half outlook there?

Mimi Eckel Vaughn - *Genesco Inc. - Senior VP & COO*

Yes. I think I'd start by saying that we feel like we have a really good underlying business at Schuh. We've got advanced technology there. We've got a strong customer service orientation, and we've got a really good experienced management team. It's been a very challenging environment. We feel like our 20-point plan focusing on near-term profitability is good. And as you said, our comps were better for the quarter than we expected. The thing and really just a highlight for the back part of the year is that there's just a lot of uncertainty in the U.K. It's like watching a ping-pong match where every few hours, there's this new information out there around Brexit. And so just being cognizant of that, I think, that's what has caused us to continue to be conservative in the back half. We'll see how things develop from here.

Robert J. Dennis - *Genesco Inc. - Chairman, President & CEO*

And with Schuh, what's worth keeping in mind is in the U.K., as we noted in the opening remarks, there's been an even more pronounced shift towards e-commerce and away from stores. Traffic on the High Street has been even tougher. The good news for us is long ago, I'm even predating our acquisition of Schuh, they were out ahead of digital and omnichannel in a big way. They regularly get rated as the best, if not one of the best, and sometimes the best omnichannel all-in retailer in the U.K. And those capabilities are becoming our friend in a big way. So with that -- as that shift -- and that's what happened in the quarter. They were negative in the stores, but very strongly positive online, and they just got a terrific machine for serving the customer in a way that, that customer now wants to be served. So that helps build some confidence.

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

Okay. Great. Then last one for me just on the profit outlook. Maybe first, if you could remind us, the $12 million to $15 million of stranded cost, is that an annualized number? And how should we think about kind of the impact you're embedding by quarter on a rough basis? And then might be early for this, Mel, but I'm curious kind of coming in with a fresh look, if there's any areas that you see bringing in your perspective that might be able to go further in terms of some of the cost savings opportunities that the company has been pursuing or if you think it will be pursuing kind of the status quo in terms of the areas that have already been looked at?

Mimi Eckel Vaughn - *Genesco Inc. - Senior VP & COO*

So I'm going to take the stranded cost question and then hand it to Mel just to talk about some of the profit improvement initiatives that we continue to pursue for this year. But we've said $12 million to $15 million of stranded cost and that is over the course of a fiscal year. I would just remind you that we shared expenses in areas like IT and HR and Finance with Lids. And in the first half of this year, if you think about it, we were providing these -- we continued to provide these services to Lids. And so while we have the cost, we also were getting some revenue to cover those costs. We've talked about Lids unplugging even faster than we expected. By the end of next year, we think we can eliminate most of these costs out. That would all be about perhaps $2 million to $3 million of that expense. So it's just going to take a little time because we need to renegotiate contracts and reorganize some of the work and reinvent how we go at some of this work. We've got to sell those building, and we have a path but it will take some time. So that really is what is weighing the SG&A expense in the back half of the year is just our -- anticipating that we're going to carry these costs. We've got really good plans in place. We've got people who are working to eliminate these costs and to the extent that we can make progress faster than we've got planned out. Then that will be good for the bottom line for the business. And I'll turn it to Mel just to talk a little bit about the profit improvement and cost savings.

Melvin G. Tucker - *Genesco Inc. - Senior VP of Finance & CFO*

Yes. So I would just echo kind of what Mimi has said. And I think that the important thing is, we've got a line of sight to eliminating these costs. It's just a matter of taking action to get it out. So while we have a line of sight, really the question in my mind is just the timing of when we're going to take it out. We're kind of at a starting stop but we're now moving forward and taking action or removing the cost. I think the divisions have done a very nice job of identifying opportunities on their P&L to pull costs. So the $12 million to $15 million in stranded costs, we think most of that's going to go away. We have also challenged him to go out and get some more program, total of roughly $20 million in cost takeout. I expect a good piece of that to be out on an annualized basis as we end the year, but the rest of it coming in the first half of next year, and we don't have full line of sight to the entire $20 million now, but the piece, this $12 million to $15 million, we do.

Operator

And our next question will come from Steve Marotta with CL King & Associates.

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

Mimi, just to reiterate, I want to clarify, you mentioned that this year, based on the timing of the tariffs and the mitigating factors that you've implemented so far basically, bringing items in a little bit earlier, that there's $1 million of direct COGS exposure in the current fiscal year to the incremental tariffs. Is that accurate?

Mimi Eckel Vaughn - *Genesco Inc. - Senior VP & COO*

Yes. That's right. And that's mostly associated with the products that we bring in directly. I think that I just want to give a shout out to our Johnston & Murphy and our Licensed Brands team. They -- we've been having tariff talks I think going on since much earlier this year, since the spring, but they got on the issue right away. They've done a great job of pulling product forward as much as possible. We originally thought tariffs might go into place in August. And so they went out and they pulled this product forward. And ever since we've heard about the September tariffs, our teams went back to work, renegotiating with factories to contribute and have had lots of success in getting factories to say, okay, we'll help absorb some of this cost. A small amount of the product is expected by this year because you can imagine we landed much of the product that we're going to sell in the early fall and so the exposure that we had is really in the very back part of the year. And so we're hopeful for some resolution of trade overall but considering everything that we have right now, the $1 million is associated with the goods that we import. We really have got nothing from any of our third-party footwear vendors about price increases. So that, from our view right now, should not have an impact.

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

Very helpful. And Bob, roughly 3 years ago, there was a switch from a trend standpoint to retro, and it caught everybody by surprise as related to the swiftness of that change. So it's kind of a two-part question. One is, are you seeing anything new that might be different than the retro trends, say, a year from now? And layered on to that is what kind of processes are in place now that may not have been 3 years ago so that even a swift change in trend might not mean such a headwind to comps and current merchandise?

Robert J. Dennis - *Genesco Inc. - Chairman, President & CEO*

Steve, great question. I'll frustrate you in several ways. First off, if we did see a forward trend that was going to change the landscape of the merchandise, we wouldn't tell you as we consider that competitive advantage. What we said previously is absolutely the case, which is having seen a good Back-to-School with the assortment that is currently working in having good visibility on what the assortment is going to look like for holiday. We obviously feel good about where we're headed, hence the guidance. I'm never going to promise you that a overnight rotation in fashion from the teenage crowd is never going to happen. And so it's a little hard to be predictive of that. What we are doing is trying to stay as diversified as we can with respect to vendors and franchises. And so we continue to track what's selling well. Our guys, obviously, are really good at moving out what's not moving well. And right now, we're on a very, very good trend. The one that happened 3 years ago -- 3 or 4 years ago was in our history pretty much a one-off in terms of how sudden and how severe it was. And so history would say that, that was a one-off, but as you know, black swan events are black swan events. So I would never say never.

Operator

And our next question will come from Sam Poser with Susquehanna.

Samuel Marc Poser - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

Welcome to everybody new as well. I have a whole bunch. Number one, you talked about the impact of Brexit on the Schuh business with a potential impact and so on from sort of an operational perspective. But what about, like, on an ongoing sales perspective? You guys couldn't get goods into the country. But what's it going to do to demand? I mean what's the impression if Brexit actually happens? If it happens on a hard Brexit or soft Brexit? How the consumer do you think is going to respond there, period, in general?

Robert J. Dennis - *Genesco Inc. - Chairman, President & CEO*

Well, right now, Sam, the economic conditions by conventional measures in the U.K. are actually pretty strong. And as Mimi had noted, the consumer is spending, they're not spending it as much on apparel and footwear. And so -- and consumer confidence is a little weak. In terms of what's going to happen there are so many scenarios in terms of what a Brexit could look like if there will be one at all. So it's pretty complicated. I'm not sure if there's a consensus amongst people who know more about this than we do about whether this introduces a recession to the U.K. or not, which -- if it impacted employment, it obviously circles down through consumer spending. But it's just very, very hard to read exactly what the outcome would be if some form of a Brexit takes place because we don't know what that form is and so it's just really hard to predict. So what we're doing, obviously, is we're doing what a lot of other people are doing, which is you stay -- in that level of uncertainty, you stay as flexible as you can. And to be honest, the amount of investment you put in is not going to be what it would be otherwise if you had a clear line of sight to what the economic conditions are going to be. So we're basically holding on tight. We're hoping that the country resolves this in a way that's favorable for the economy and the U.K. population, and we'll all wait and see.

Samuel Marc Poser - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

And then I've got a few more. One follow-up on Schuh. You mentioned that article that came out and that you're fully committed. Can you -- what are you -- I mean what are you foreseeing with Schuh longer term, given sort of the fits and starts it's had over the last 2 years? Putting together through the 10-point plan, but why do you -- the full commitment to the business, what would it take to change that? And given that there's -- it's sort of been hit and miss and then you have these macro issues as well.

Robert J. Dennis - *Genesco Inc. - Chairman, President & CEO*

Yes. Well, the macro issues are the macro issues. One of the things that we think the macro issues are forcing is a consolidation of retail in the U.K. And so when we saw a flat comp achieved by Schuh with an improved gross margin in an environment where footwear was tough, that indicates that some of that consolidation is happening. So footwear has been sold in a lot of the bigger boxes in the U.K. And as you well know, many of them have been challenged economically. And so if there's going to be square footage reduction in the U.K., that becomes our friend. Our biggest cost opportunity there, as we highlighted in our remarks, is rent. The conventions for rent setting in the U.K. are very different from the U.S., and they're -- the best word I can come up with is a little bit quirky. But given all of that, our team believes that there is an opportunity to partner with a lot of the landlords and to say, let's look at the long term and let's try to get to some rent structures that make sense for us and for you, so everybody in this industry can have a good long run. So that is what we're pursuing. That's what the article was about. It did get misinterpreted by a few people and so we felt it important to clarify.

Samuel Marc Poser - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

And then Journeys, can you -- one thing we noticed when we were visiting some stores was it looks like the assortment is -- have you gone -- I mean has the assortment narrowed or gotten more focused from a brand and item perspective? Have you gone narrower and deeper? And if so, to what degree at this time?

Robert J. Dennis - *Genesco Inc. - Chairman, President & CEO*

No. No, Sam, I don't think it's especially changed. I think you would ask that question, I guess, maybe 4 or 5 years ago and it had happened, and we did get narrowed down. And what's interesting is relating it to the earlier question when we got a lot more narrow, that was when we got slammed with the fashion rotation. So the fact that we're -- if we are broadened out -- if you're perceiving that we're broadened out a little more by brands, I think really by franchises, that's probably true, and we actually like that because of -- for the obvious reasons of our recent history.

Samuel Marc Poser - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

But you're taking bigger bets within the franchises that you have. And I'm just mentioning names, if it's Fanzz or Converse or Adidas, whatever the brand is. It looks like the spread -- the spread is there but it looks like the brand mix looks a little bit narrower than it did in the past. So I guess is that a fair way to put it?

Robert J. Dennis - *Genesco Inc. - Chairman, President & CEO*

Sam, it's a matter of degree. And to be honest, I can't -- I'd have to get the numbers and look at them closely. We think we're very well positioned. We don't think we're taking unusual risks. I wouldn't call it -- I wouldn't put it in the category of big bets.

Samuel Marc Poser - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

I wouldn't -- I didn't mean it that way. What I meant is committing to the hot stuff. So for instance, the fashion athletic shoes or the retro athletics that are doing well regardless of the brand, if brand X is doing well rather than buying 2 shoes for them, you're buying 8 shoes from them and leaving out brand Y, so you have the mix but it's much more focused within the winter versus a little bit of this brand, a little bit of that brand. Is that a fair statement? So the breadth of the overall assortment says Y but it's more focused by these key items, key brands and so on. So I was really inferring much less of a risk than much greater of a risk?

Robert J. Dennis - *Genesco Inc. - Chairman, President & CEO*

Sam, it's hard to answer that. We're -- it's brand and then it's franchises, and we're going -- as we always do, we're going where the customer is taking us. And so our team continues to buy. There's been no conscious radical change in the way that we're assorting.

Samuel Marc Poser - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

Okay. And then lastly, I've asked this question a zillion times, but mobile app for your Journeys Kidz, can you tell us has anything changed there? Many other retailers say they're very successful with it. You've chosen not to go there. Can you give us any update for if unchanged or whatever?

Robert J. Dennis - *Genesco Inc. - Chairman, President & CEO*

Yes. We continue to think that websites perform well. There -- the average app on someone's phone is very short list. We tested apps in other businesses of ours. We continue to revisit it because things can change very quickly. But right now, we're very happy with the way that we're set up at the moment.

Mimi Eckel Vaughn - *Genesco Inc. - Senior VP & COO*

Yes. We have invested a lot in our mobile site and being -- having responsive design so that the screen adjusts to whatever mobile device that you have. We've streamlined the checkout features. We've really made the mobile experience a very positive experience. As Bob said, we found that apps tend to work for businesses that have lots of repeat purchases within several months, the frequency of the purchases is more than the purchase of the footwear. So we think that the right place to invest for now is really within our mobile site and making it as user-friendly and as fast as we can.

Operator

And we will take our next question from Mitch Kummetz with Pivotal Research.

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

Bob, let me start with you. Just -- you mentioned Back-to-School momentum at Journeys and Schuh, and I guess I'm most interested in Journeys. I know back in the good old days, you would have just given us an August comp, and we could call it a day. I'm guessing you don't want to back to that policy. But could you maybe speak to it a little bit directionally? I know there's a little bit of Back-to-School in the quarter, a good 2, 3 weeks of Back-to-School in the quarter. I'm curious if -- in the quarter, if you saw sort of a step-up in your Journeys comp from sort of earlier in the quarter to those last 2 or 3 weeks for Back-to-School? So maybe if you could speak to it that way.

Robert J. Dennis - *Genesco Inc. - Chairman, President & CEO*

Well, we're just going to stick with -- when we saw -- look at the momentum from the second quarter continue into the third, but we're not going to get more specific. And you're right, the good old days we used to give you a number. There's a lot of noise right now in some of the most recent retail numbers because of the hurricane threat that occurred on the East Coast. We saw some huge volatility in the last week. You can just pick out the people who were boarding up their storefronts. So it's -- we're reluctant to say anything more than the momentum from the second continued into the third. We were happy about that.

Mimi Eckel Vaughn - *Genesco Inc. - Senior VP & COO*

Yes. We did write in the comp guidance for Journeys for the third quarter. And I think that we're taking a balanced approach to the outlook for the third quarter.

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

Okay. And then on the margins, incentive comps, I feel like at the beginning of the year, you view that as a pretty substantial opportunity for leverage. I'm just wondering if that has changed, just given how -- particularly how the Journeys business has performed and then also just from a corporate standpoint, is that becoming less of a opportunity for leverage relative to the bonuses you're paying last year?

Mimi Eckel Vaughn - *Genesco Inc. - Senior VP & COO*

Yes. So Mitch, I think you're exactly right. And I think that what we had called out is that for last year bonuses were up quite a bit just because we had had 0 bonuses the year before. When we began the year, if you look at our plan, we had bonuses at a lower level than they are today, but just given the good performance in the first and second quarters, bonus has increased. And so we'll see where we end up for the year. There ought to be, under most circumstances, some pickup from bonus, but not to the magnitude that we began the year thinking it would be.

Robert J. Dennis - *Genesco Inc. - Chairman, President & CEO*

So as you know, we -- our bonus is based on improvement of year-over-year performance, not budget. And so since we're doing better than we thought we would do, it is elevating bonus for this year. If we stay on the trend that we're on, what that creates is an opportunity to possibly leverage bonus next year. So that's where we sit today.

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

Got it. And then Bob, you made some comments in your prepared remarks about cash flows, strength of cash flow. And I know that the authorization -- the repurchase authorization that you're under is near exhaustion, and I'm just wondering how do you think about buyback going forward, just given the cash flow perspective that you're referencing.

Robert J. Dennis - *Genesco Inc. - Chairman, President & CEO*

Yes. So we recently exhausted the second of our 2 recent share buyback authorizations, and we gave you all the numbers on that. And we do expect to end the year with excess cash, which is a combination of still some carryforward cash plus what we generate in the fourth quarter. And as you know, we don't sit on cash for extended periods. So the priorities for us are what they have always been. The first priority is to fund our organic growth, and we're in the midst of our 5-year planning, but I think it's fair to say that we anticipate funding the growth of next year's plan really won't be an issue for us. So then the next opportunity for us is to grow through acquisition. And the last big deal we've done was Schuh 6, 7 years ago, and we've looked at a lot of other deals, and we've demonstrated an improvement and discipline in what we've chosen not to do, but we continue to give consideration to growth down that path with businesses that would fit the focus footwear strategy that we're employing. Failing that, we would return money to shareholders and we've generally done that via share buyback. So our Board regularly reviews all of that, our balance sheet, our opportunities and then our valuation in deciding how to deploy cash. And so we'll continue to take a look at that and so that's just something for down the road for the Board to consider.

Operator

And our final question will come from Laurent Vasilescu with Macquarie.

Laurent Andre Vasilescu - *Macquarie Research - Consumer Analyst*

Congrats on a strong quarter as well congrats, Mel, for your onboarding. I wanted to follow-up on Mitch's question on August and obviously qualitative commentary about August comping nicely. Can you remind us how August last year performed relative to the third quarter results? Or asked a different way, is the third quarter comp guide embedding the slowdown post August's nice performance?

Mimi Eckel Vaughn - *Genesco Inc. - Senior VP & COO*

So we really don't call out comps by month, Laurent. I think we had stated last year that we felt like last year's Back-to-School was also a good Back-to-School and we had a nice, good, positive comp in the third quarter last year and the third quarter is largely Back-to-School. So I mean I think the important thing to call out is that we are encouraged by our Back-to-School results and again, some pretty positive results from last year.

August is by far the most important quarter of the subsequent quarters because of that Back-to-School period. We see some sales into September, but then it trails off before picking back into October. So I think so far so good on the Back-to-School.

Operator

And at this time, I'd like to turn the call back to Mr. Bob Dennis for any additional or closing remarks.

Robert J. Dennis - *Genesco Inc. - Chairman, President & CEO*

Well, thank you, everybody, for joining us. Thank you for your questions. And we look forward to catching up with you at the next third quarter earnings release. Thanks all.

Operator

And this concludes today's conference. Thank you for your participation. And you may now disconnect.
