Company Name: Genesco Inc. (GCO)
Event: CL King & Associates Best Ideas Conference 2018
Date: September 13, 2018

<<Steven Marotta, Analyst, CL King & Associates, Inc.>>

I'm Steve Marotta, the consumer soft goods analyst at CL King. We are thrilled to have Bob Dennis and Mimi Vaughn from Genesco here in a fireside chat format, which means that for those of you on the webcast we have a nice roaring fire behind us, wearing a smoking jacket.

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

A dog at our feet.

<<Steven Marotta, Analyst, CL King & Associates, Inc.>>

Right, a dog at our feet. If there is any questions from the audience at any time please don't hesitate to pipe up or raise your hand or pipe up. Could you talk first a little bit about an overview of the second quarter dynamics between both footwear and headwear and where do you see that playing out for the balance of the year.

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

So let me – we released earnings Friday morning, so this is a very timely visit. We had a good solid second quarter that we were very pleased with the comp in particular it was a plus-3. And then our earnings were above our expectations. I will give you – everyone heads up, part of that was driven by the calendar shift with brought the first week of back to school into the second quarter versus last year. But the comp is a apples to apples number.

The story that we've been telling for quite some time and to some extent we're still in place which is Journeys and Johnston & Murphy continue to be a very strong businesses for us and we continue to have some challenges at our Schuh business over in the UK and at Lids. We did also note that in August all four of our retail businesses ran comps that were better than their comps in the second quarter. Now in the case of Schuh and Lids that means they were less negative but still improvement, which was encouraging.

Very quickly what's going on by business Journeys, those of you that follow us might remember we went through a fashion rotation now more than a year ago but as we've come out of it as we have seen in the past, we often see and have seen this time a very strong rebound in that business. And we think we're very well positioned on a go forward basis. Johnston & Murphy continues to be a really strong performer for us and the keynote there is that they have really had success in developing a casual assortment that complements their traditional dress shoe positioning. And it really is being driven by growth in casual much of that being product that's a sophisticated upper leather, that upper on an athletic platform. And they're also doing very nicely in our stores with non-footwear product. And so we continue to see the expansion of what the brand means to our customers.

At Schuh over in the UK the business has been tough. Business has been tough on the high street, so a lot of this is an industry factor. Strangely they've got a very low anemic GDP growth and yet the consumer in the UK continues to spend, which is a little surprising given some of the political considerations that are going on in the country. But they're not spending on footwear and apparel. And so we're feeling that eyes are a lot of other people on the high street. And the weakness in that sector is then adding to the promotional environment as people try to keep their inventories right sized and customers are out looking for a deal.

And then finally in our Lids business we continue to be going to a fashion rotation there much as we did with Journeys without a lot of visibility on what the next big thing is. The history of that business is one of cycles similar to what we've seen at Journeys. And we're in a trough and so we're hopeful and working with our vendors very closely to try and develop what might be the next thing. The only other side coming on Lids is, we have a process going on exploring the possible sale of the business. And what we said on the call, which I'll repeat here is that we have made progress, we have narrowed our options and we're not putting a timeline on when we think we will complete that process. And so stay tuned.

And then finally looking forward, we held our guidance for the rest of the year. I'm going to ask Mimi in a moment to talk more about that. But we held guidance because we can – we have concerns about the UK and our business position there and just the overall economy given that Brexit continues to be a threat an unresolved political issue. And then without any visibility on headwear trend right now, we're cautious on Lids as well.

And then finally there is the calendar offset, which we think it's very important that everyone understand. So let me hand it to Mimi, just talk a little bit about particularly the guidance part of things.

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

Yes. So I'll start with the second quarter and overall. What is apples to apples in comp sales? So we had a plus-3% comp in the second quarter, which was a real pickup from the negative comp we had in the first quarter. And what was particularly notable is that our store comps swung from a negative 2% to a positive 2% and that's really helpful to us in terms of leverage that we can get off of our fixed expense base.

Now having said that we swung from minus 10% last year, minus $0.10 last year to plus $0.04 this year. And what was very helpful is that very strong back to school week. So we're going to give that up in the third quarter and we've said, that we're going to give that up in the third quarter. So there are several things that will impact the third quarter and they’re worthwhile calling out because this calendar shift sort of wreaks havoc on the cadence of earnings. But the first thing is that shift.

The second thing is, we actually took up comp sales for the third quarter but we are seeing a – between the last guidance and this guidance we saw devaluation of the British pound. And so that increase in comp is actually offset completely by the devaluation in the pound. The third thing I’d point out is that we are adding sales to businesses that right now we’re paying bonuses in. And so while we end up picking up on the top line, we give a little bit back in bonuses for the businesses we’re taking down don’t have bonuses so that flows all the way through. So net-net there isn’t really a pickup to the bottom line in the third quarter.

The last thing I’d call out, which is even more complication on top of the calendar shift is that the new revenue recognition standard pulls catalog expensing out of the fourth quarter into the third. So net-net all of that is that the upside that we see in the back part of the year is really in the fourth quarter and not in the third quarter.

<<Steven Marotta, Analyst, CL King & Associates, Inc.>>

Bob, you mentioned the fashion shift at Journeys a year ago, two years ago, excuse me. Did you see anything to indicate that fashions are shifting again? Are there any green shoots about the Journeys is performing – exceeding the wall. But are there ways of protecting yourself in case that happens again even during the cycle time and you have a tailwind there.

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

Sure. We’re religiously testing new things and that’s something that we’re able to do reasonably well because of the breadth of our store base. So we’re never sitting back and saying, we’re going to be able to ride the current trend forever. We know that doesn’t work. And so we’re constantly looking at new things. Now that said, fashion trends at Journeys typically have anywhere between two to four year life and we think that the trend that we’re on right now has a lot of life.

There are things on the fringes to the current trend that we’re seeing some green shoots on but nothing that says, here is the next big thing. The teenager just to play with that a little more is very fickle and hard to predict. So if you look at the last fashion cycle one of the things we did forensically is, let’s say, could you have predicted what was going on based on Google searches and all those things. And the answer is, no. You can ask a teenager all day long what they’re going to want to buy in six months, and the only thing you will know for sure is they don’t know.

So they are very exposed to being a teenager and wanting to be right on what’s being worn to school, which is a decision that is influenced by so many factors and it is real time. So we’re working it hard, we think we have a lot of momentum still in what we’re doing right now and we don’t think it’s very predictable.

<<Steven Marotta, Analyst, CL King & Associates, Inc.>>

Can you talk a little bit about your brick and mortar store-base versus digital penetration? What are the optimum number of stores that you see across your concepts? And you can even overlay this with the rent relief currently that you are experiencing.

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

Yes. So this is a tricky story and we have a very specific approach laid out that's built on the belief that we should stay in every mall where the landlord will give us an opportunity to make money. But the more challenge the mall the short of that lease ought to be. The reason we believe that we should just keep that store open even if it's making money is, because we don't believe that if we close that store that that traffic migrates to our other stores in a market.

What we know through malls that have closed is that when a mall closes the traffic of this versus and we pick it up in our other stores. So we're willing to be a hold out even in a pretty down trending C-mall that if we can get a rent deal that works we'll hang around for another year. And our average lease life of those renewals we've done in the C-malls the average renewal has been only for somewhere around a year.

Contrast that with the A-plus-malls that are fully occupied there we are still seeing some rent increases but even it's creeping up the mall universe. So when you get to even the A-minus-malls we're seeing rent reduction opportunities. And the other thing that's happening in some of the A-centers is there are A-centers where the demand for space is less than what it used to be. And so we're actually seeing opportunities for Journeys in particular to go into a mall where they haven't been because we've never been able to find the right space at the right rent. So we're actually doing something new store. So that's the general dynamic that we're playing with. Mimi can give some specifics around that.

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

Yes. So in general we have in the neighborhood of 5% of our store universe that are unprofitable and with positive comps with the cost reduction efforts that we have underway, we are making good progress on addressing that. And so to Bob's point, we will keep the store open to the extent that we can get a good rent deal closed a little over 100 stores last year were slated to do about that same amount, which will address the fair amount of the unprofitable locations.

But as these deals, the unprofitable deals come up for renewal, we will look to see if we can get a good rent deal, if we can, we will stay in place and make money on that store, it's fully depreciated and so incrementally it really does help our bottom line. And we'll continue to work through it. In terms of the progress that we're making on rent reductions, we just announced that this year-to-date we have renewed 180 locations and we have seen reduction on an accounting basis of about 16% and on a cash basis of 20-plus-percent. And that's not all to take effect this here but over this year and next year on a compounding basis that rent reduction will help address the unprofitable stores as well.

<<Steven Marotta, Analyst, CL King & Associates, Inc.>>

Okay. Can you talk a little bit about digital penetration and your investments in digital? Where that is now? Where you see it going across the concepts?

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

Yes. So let's talk – if you look at the pattern over last several years, we've been growing our digital business overall double digit. The penetration varies by brand, so it's highest at Johnston & Murphy, which is a catalog legacy company and at Schuh who was an early mover in the UK and that's a more highly penetrating country. It's least penetrated at Journeys because the teenager although they'll go to the website to check out what we have and what they want to buy. They still have a strong propensity to want to go to the store to make the purchase. So that's the lowest penetrated.

If you look at the most recent meaning the last six months the interesting pattern that has emerged is that our store comps have gotten better, our digital has actually pulled back a little bit. And for our economics that's a big plus because the store-base operates heavily off of a fixed cost. And so having a – we had a plus-2% in the second quarter that's a big win for us because we haven't seen a positive store comp in two years.

And then digital pulled back a little bit. And Digital is still very profitable for us but digital every incremental digital sale brings incremental expense and mostly in terms of shipping and marketing. And so we like the flip that's going on and it's not just us, so ShopperTrak, we're a client of ShopperTrak. And so we get the information on traffic flows to apparel and footwear. Overall retail continues to see traffic declines. Apparel and footwear traffic this year has flattened out. And we find that to be very encouraging, we can't completely explain why that is. But it's terrific for our economics.

<<Steven Marotta, Analyst, CL King & Associates, Inc.>>

I told Mimi about my theory.

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

I want to hear your theory.

<<Steven Marotta, Analyst, CL King & Associates, Inc.>>

My theory is that apparel and footwear traffic is beginning to flat now because unlike four years ago, we are in a position now where brick and mortar has invested so much digitally that the ability to speak to that customer from their standpoint has increased so much that we’re starting to feel now a little bit of a boomerang. A retailers ability to drive traffic through that – ability to communicate frankly with their customer in a manner of like they could have ever had has been a tailwind to…

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

Well, I think it’s certainly the ability to communicate but also the advantages that online have vis-à-vis bricks and mortar have the gap has narrowed because we’ve invested a lot to make inventory available across all of our points of distribution. I mean, that was one of the real advantages of e-commerce is the endless aisles notion. We can actually offer in stores today because anything we sell anywhere we can sell to a customer who’s in our store.

The speed of delivery, if you come into our store and you order something either from one of our other stores from the store you’re in if you want to have it shipped to you or from the D.C. the speed of delivery we have accelerated significantly. And so again, on the e-commerce side, we used to be able to get something quicker than you could, if you shipped out of stores, but we close that gap as well. And so some of the advantages that customers, who really liked and appreciated in e-commerce, if we brought that over to the store channel, customers are going to shop however they want to shop with us, but making it a great experience, irrespective of online or in-stores is what our objective is?

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

And we’re discovering another element of digital is returns that the pure plays have now recognized that’s pinpoint. And so they’ve been trying to innovate around that. We don’t have to innovate. We do free returns to our stores and all the evidence is that that’s for the customer – that’s an easier process than having to do buy the mail return. And so they appreciate that. We get them in the store. We will capture a lot of those sales because a lot of it is exchanges and we actually sometimes get add-on sales on top of that. So the business model that we have in place is really starting to resonate. And we’re investing in that direction, so this is – in last meeting I heard about this is a light, lighter CapEx year for us than the last five years and more digitally tilted than it’s ever been.

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

Yes. So we’re opening fewer stores this year than we have over the last five years. But we’re also anniversarying we’ve done a significant amount of investment in distribution centers and the latest one was expansion but also an investment around the sport e-commerce set of capabilities for Journeys. And so we’ve got a dedicated section with dedicated capabilities in our warehouse that allows us to marry up a single pic allows us to expedite the shipping of that product and that makes that e-commerce experience so much better for the Journeys customer.

And so we've anniversaried than we've invested in every one of our businesses to bring them up to that level of capabilities, going forward, we expect that this year our CapEx should be in the neighborhood of $60 million to $65 million, which is down from on average about $100 million a year over the last four or five years. And we're tilted in the direction of omni-channel e-commerce investment about 40% of our overall investment today is tilted in that direction and the rest is in refurbishing our stores, because again, the store component of what we offer is critically important. We want our consumers to come in and be in an inspiring environment. There's nothing worse than going into a store that hasn't – we have an incredible amount of traffic in our stores, nothing worse than going into a store that hasn't been refreshed. And so we are absolutely committed to refreshing our stores and spending the appropriate amount of capital for the amount of lease life that we're extending.

<<Steven Marotta, Analyst, CL King & Associates, Inc.>>

Can you talk a little bit about the competitive environment uplift from that you have an online only competitor, obviously, there are other players in the model that are somewhat in the category, but not nearly as you uplifted. Can you talk a little bit about where you're see that the shift in markets share playing and how does it played towards other competitor advantage or disadvantage?

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

Well. First of all, there's a consolidation going on. So the new competitor in the space not so new anymore Fanatics, he is clearly the biggest online player and we're the biggest omni-channel player, that's leaving a lot of other people out in the dark, because, it had – it did have a big mom-and-pop component and that's withering away, because it's hard to make the investments to compete if you're not at scale. And then it's also hitting some of the people, who had it as an ancillary business. So people like the Foot Locker Group had cut back on their commitment to license, which makes sense. So the competitive dynamic is really, it's a two horse-race and we feel different needs. In the licensed sports business, there is a very natural home for online, about somewhere in the ballpark of about 30% of sports fans out there, cheer for a team, that is not in their home market.

And we know that, from as we ship, that's true for Fanatics and true for us. And we ship about 70% of what we ship goes to a zip code that's outside that home team markets. Now we accommodate a lot of those, that's known teams by having them in all our stores, leading with the New York Yankees. But when you get down, if you're a Nashville, if you're Tennessee Titans fan and you don't live in Tennessee and I don't know why you would do that? But right now, but if you were, you've got no choice outside of Tennessee than to buy it online. And so there's a natural component that drives it is online. I like our model, because what we're doing is, we're selling that Tennessee Titans gear to Tennessee Titans fans in Tennessee in our stores and all of that inventory is available for online sale.

We also know that the buying pattern in licensed sports has important component that is truly needed now. I'm going to the game or I'm going to watch the game in somebody's house and I need gear. And we know that the patterns in our stores reflects the schedule for the teams and actually whether they're home or away. And so that's hard to fulfill from an online standpoint. We also know that in the licensed sports, there's also a big fashion component. So this is the sale of licensed product that is fun related to what the team is. And Fanatics really plays in the fans space. And we play in both the fan and fashion space. So there's a bunch of different theaters give us a reason to exist. As I said earlier, what's missing right now and we're about two-thirds headwear, where we're missing that headwear trend, which you can really make the business thing. Anything you want to add to that.

<<Steven Marotta, Analyst, CL King & Associates, Inc.>>

Can you talk a little bit of the near-term outlook for what's given the – NFL what happens last year obviously, a difficult comparison and if you compare to this year but I don't know the viewership issued, so Mimi Vaughn, do you want to address the NFL, also on the Major League baseball play out ratio and how it compares with the year ago?

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

Yes. So all of that leaves us a little cautious and that's feeding the guidance right now. We had a good Major League Baseball playoff lineup last year. Yankees, Dodgers, Cubs, who are all in. This year, it's little hard to say, Boston is in, Yankees are in, but they're in a one game playoff, it looks like. And then the Dodgers are still in a dogfight and the Cubs are in a dogfight. So there's a lot of uncertainty about who will be in the playoffs and that makes a difference to our business. In the NFL last year, we announced that we were down 20% in the NFL business, as was the industry for a variety of reasons, a lot of publicity around that, I'm not going to go into it.

This year, we're planning the NFL business to be slightly up, one of the factors that contributed to the challenges last year were a couple teams not making the playoffs that were supposed to be there, almost notably Dallas Cowboys. And then almost a black swan event in terms of how many high profile players got hurt early. And so that's specifically affected name and number sales. But also a little bit just fan interest in the teams, when you lose your quarterback. So we've just started the season, but we're still too early to get a read, and we're a little bit wait and see mode. But all those factors add up to us being a little cautious on the backend that was.

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

So in the meanwhile, we have both teams done really an extraordinary job of managing expenses down. So we've been closing on profitable stores. We haven't overall cost program to reduce expenses across the company to the tune of $35 million to $40 million, we said that. We've identified initiatives that are over the top end of that range. And so even at a negative, pretty negative comp in the second quarter was to narrow their gap to profitability over last year, and so as we continue to squeeze cost out, we're just battening down the hatches until the top line comes back and that lends to a formula, where if we close enough stores manage costs and nothing even on a negative comp, if we don't deleverage then we can hold profitability.

<<Steven Marotta, Analyst, CL King & Associates, Inc.>>

Can you talk a little bit about your capital allocation strategy? What you investing now, what you have your return to cash to shareholders and other, even acquisition that contributes, let's say track of the marketplace in the one in wears evaluation to that?

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

Yes. Well, we have long held a very constant philosophy about cash. First that we don't hold on to it and then our priorities start with investing in our business, and as you heard from Mimi, we're well covered on that. And we've been through a heavy investment cycle. And so we expect in the next several years for the cap requirements to be lighter. I'll also add that the teams have done a great job on working capital. So we've actually had better cash flow off of working capital in this current year.

The next thing is acquisitions and we look at acquisitions that could be businesses, where we're get achieved synergies that would be our primary focus. And as we've said this in the past, we've looked at a lot of stuff over the last five years. So that's last significant acquisition, we made was Schuh in the UK six, seven years ago. We looked at a lot of things and we're very disciplined and the way, we evaluate the economics of an acquisition. So failing that, if you look over the last six or seven years, what we've done is the third choice, which is return cash to shareholders in the form of stock buybacks. And so that would be our philosophy going forward.

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

And just to reemphasize. So this year will be a strong cash flow year, because even after the $60 million to $65 million of CapEx, given our outlook right now the management of working capital we should generate in excess of $100 million in cash flow beyond what we're reinvesting in the business. So we will have – we'll evaluate options and with new acquisitions on the horizon, there's nothing else to invest and then we will certainly return capital to our shareholders.

Q&A

<Q>: [Question Inaudible]

<A – Robert J. Dennis>: Yes. I mean, we look at – again, as I said, businesses that have close synergies to businesses that we currently own a lot of what we have considered in the past have been businesses that could build on, what we call our branded platform, which is Johnston & Murphy. And its related businesses, but we've also looked at – of course Schuh was a business that had a lot of synergies with Journeys. We did that deal when we were exploring the possibility of taking journeys to the UK and in that process recognize that Schuh was probably rather than go on top of Schuh and compete with them the opportunity to buy them, emerged. And we said that's actually a better way to play it. So we run those as heavily there related units. The vendor overlap is huge, a lot of sharing of best practices. But they have their own merchant teams and from that standpoint, they buy independently. Most of the vendors are aligned geographically, anyway. So you'd have to do that nonetheless, but we think that we've got a lot of benefit from having those two businesses together. Of course, we've got a challenging economic environment in the UK at the moment which is unfortunate. So those are the kinds of things that we look at.

<Q>: [Question Inaudible]

<A – Robert J. Dennis>: Well. There's two things about Lids that when we initiated a process to explore its possible sale. We said, first off we think there are changes in the industry structure that might allow a more natural owner to achieve more advantages than we can. And so that's what we're exploring the second part is we have relative to the footwear peers and we're roughly three quarters now of footwear business. We have traded pretty consistently at a discount and in the best of times equal to a reasonable peer group.

And when you try to think about why that is, is that we are a small cap company that is kind of complicated to understand and in particular, if Lids is the outlier to that and when we say to an investor group, the back half depends a little bit on who makes the playoffs and whether the Dallas Cowboys can get back on track. That's never digested very well and it's probably not a good fit for the investor base. So if those two elements that have said that we would take a look at that, now that said, I'll just remind you all that when we announced the process, we said, this is not something we're just going to sell at all costs. We're going to be very disciplined and what we look at in terms of what kind of returns we could get versus what kind of returns we might get from selling it.

<Q>: [Question Inaudible]

<A – Robert J. Dennis>: Yes. The categories got a little more vertical. And so the opportunity is for people who could take advantage of taking Lids from being a pure seller of other people brands to the opportunity of – in one way or another in a couple of ways to get there to be more vertical.

<Q>: Can you talk a little bit about its current terror situation or any other terrors that have been announced affecting you? And if there was another round, how would that affect you?

<A – Robert J. Dennis>: Well. Of course – I don't know exactly how the administrator is playing this and I think, the President is appropriately not showing all his cards. So how much of this is a true belief that we ought to have a lot of tariffs as opposed to trying to level the playing field with China as the trading partner. So we'll see what how all that pans out. In the last round, that the footwear industries had a pretty – done a very good job of pushing footwear off of the list. But in the sporting goods world, there's a bunch of sporting goods categories including headwear that is in the last round, the July round. And so much of what we sell is produced in China. So that's got our vender's attention, it's got our attention. We are bought out through early spring and we expect our vendors to honor our purchase orders. But beyond that, if the tariffs do actually happen and they stick then there is going to be probably the necessity of price increases in the category that all made in China, that we would expect the vendors to do the natural thing and start to look to resource in other countries but that can't happen overnight.

<Q – Steven Marotta>: If there is anything that we've going on over another investor meetings over the last two to three weeks or four weeks that you didn't go over there.

<A – Robert J. Dennis>: No, I think. We've covered most of the stuff, I think obviously Johnston & Murphy gets where it's like touch just because it's about 10% of our

company. But they continue to have a great success with what they're doing. And so I just want to give a shout out to the team on how well they're performing.

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

And there's a store across the street for all of you all in the room. So please check it out, most importantly.

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

Right across the street, there is a new Johnston & Murphy.

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

Beautiful and for those on the webcast – absolutely.

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

Yes.

<<Steven Marotta, Analyst, CL King & Associates, Inc.>>

Bob and Mimi, Thank you very much for your time.

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

All right, thank you, guys.

<<Steven Marotta, Analyst, CL King & Associates, Inc.>>

I appreciate it.