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GCO - Q4 2018 Genesco Inc Earnings Call

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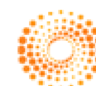

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PRESENTATION

Operator

Good day, everyone, and welcome to the Genesco Fourth Quarter Fiscal 2018 Conference Call. Just a reminder, today's call is being recorded.

Participants on the call expect to make forward-looking statements. These statements reflect the participants' expectations as of today, but actual results could be different. Genesco refers you to this morning's earnings release and to the company's SEC filings, included in the most recent 10-Q filing for some of the factors that could cause differences from the expectations reflected in the forward-looking statements made during the call today.

Participants also expect to refer to certain adjusted financial measures during the call. All non-GAAP financial measures referred to in the prepared remarks are reconciled to their GAAP counterparts in the attachments to this morning's press release and in schedules available on the company's homepage under Investor Relations.

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

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

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

Fourth quarter adjusted earnings per share of $2.15 were in line with our expectations towards the lower end of our guidance range and flat with last year. Comps increased 1%. Tremendous results in Journeys and Johnston & Murphy were offset by difficult comps and Lids increased promotional activity in the U.K. and challenges in our Licensed Brands business.

Fiscal '18 adjusted earnings per share were $3.13 with flat comps for the year compared with $4.33 in fiscal '17. While it was a very challenging year overall the profit gap to last year improves sequentially each quarter and the gap closed in q4.

In spite of the notable changes in retail, our well positioned businesses remain undisputed leaders in their categories and we believe they have much more potential than our results reflected this year. The strength of our concept and compelling assortments have allowed us to largely maintain our top line, but we need to do more to bring those sales to the bottom line. We have launched a major multiyear initiative to reshape

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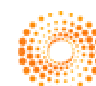

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the heavily fixed cost structure of our brick and mortar channel and counteract profit delusion of building the e-commerce channel which we will discuss with you today.

From a high level in Q4, our performance was once again defined largely by the divergence in our 2 biggest businesses. With this exceptional talent and experience, we were confident the Journeys team would deliver strong results with the year preceded after battling through the fashion rotation in the first half. And in usual pattern, Journeys' built on the momentum of back to school and delivered a remarkable double digit comp gain for Q4, a meaningful improvement over Q3's positive result. Cold weather gave a boost to our boot business. We saw a nice improvement in select casual styles and the fashion and classic athletic trends, which had been driving sales continued to gain momentum. The acceleration was driven by both door and direct comps and both were up double digits.

Our current assortment which is now more balanced and diversified across brands than in the previous fashion cycle is performing above our expectation. We're enthusiastic about our prospect as the retro athletic and lifestyle athletic trends, we have benefited from, have proliferated into a greater number of brands and franchises, which they provide us with momentum through the year. This classic fashion lifestyle product plays into the sweet spot of Journeys' positioning at the house the fashion for teen footwear. And so congratulations to the entire Journeys team for an incredible finish to the year. And while we would greatly miss James Estepa, who stepped away from day to day leadership at year end, he has left Journeys in good hands with Mario Gallione and the rest of the Journeys leadership team.

Shifting to Lids, after significant recovery and profit improvement in fiscal '17, fiscal '18 was more difficult than we anticipated due to several specific headwinds that we don't believe will last forever. While comps began into positive territory, they became more difficult and ended the year with a notable decline in Q4 against the strong positive comp the year before due to a confluence of category specific factors we have discussed before. The start, we were lapping the impact of the World Series win a year ago on Cubs sales, which carried into the holiday gift giving season. On top of this, sales of NFL license merchandise was down during what is typically a big selling period. These two factors accounted for a substantial portion of the comp decline in the quarter. In addition, our NCAA license business was down to the team specific wins and losses.

And finally, the absence of a strong headwear trend, which began over the summer negatively affected the balance of sales. Notably Lids e-commerce comps continued to be positive in the face of all these headwind. Like our other businesses, Lids is subject to fashion cycles and headwear is currently between trends, position now for that type of strong resurgence that Journeys is now enjoying once a new fashion driver emerges. That we don't know the exact timing of when this will occur, history points to a rebound. Our long history with Lid Cub stores shows almost a decade-and-a-half of store for well profit in the teens and 20s which remains the case today demonstrating tremendous resilient and ability to cycle through trend successfully.

As you know, we announced a few weeks ago that we were exploring the sale of Lid. I will talk about the rationale for this decision which we discussed in our press release last month. After Mimi discuss the specifics of the results which will add a little time to our call today.

Meanwhile across the Atlantic after a very strong start to the year, Schuh sales and profitability in Q4 were hampered by weak demand for footwear and apparel which feels an extremely promotional environment in the U.K. throughout the holiday selling season. A Strong black Friday boosted by sale product push Schuh's November comps into positive territory as sales gains more than made up for the markdowns. Unfortunately, in spite of even more promotional activity comps were pressured in December and January as the consumer had no appetite both price product and because of the promotional activity margins were pressured as well.

In spite of a slow start to the year Johnston & Murphy like Journeys, had a very strong finish and its results were another highlight of the quarter. J&M had record fourth quarter sales with a comp increase and meaningful gross margin expansion. Sales were driven by growth both in footwear and another categories with casual footwear leading the way. This marks a noteworthy 8 consecutive year of sales increases for the J&M team and so congratulations to all of you.

Finally license brands ended a tough year with a tough quarter, given the overall week demand for men's dress and casuals, during this strong athletic cycle and a renewed commitment by the private label development. With respect to our outlook, we believe our near term performance will continue to be shaped by the divergence of our two businesses Journeys and Lids, although not to the degree that we saw in the fourth quarter.

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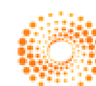

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And this is what we've experienced in fiscal '19 thus far, in addition to the headwinds of a major late winter snow storm in the U.K., which [impeded] stopping and has limited our visibility into current trends at Schuh.

While we believe Journeys' current product assortment is well positioned to drive continued growth, the near term uncertainty around the timing of a Lids rebound, combined with generally weak store traffic across retail causes us to be cautious about the coming year. As such, we are projecting adjusted earnings per share to range between $3.05 and $3.45. This guidance includes the impact of Lid as if it were owned by us for the entire year.

This was a wider range than we have given in the past reflect in the many variables in the current retail and licensed sports environment. And we do regard our guidance as a range something close to the middle reflects our best belief of where we might come out with the [toss] and representing more upside and the lower end to tougher scenario. All of which we see as real possibilities.

Looking ahead, there are clear opportunities and challenges as we begin fiscal '19 and we are addressing them head on with specific action plan. We remain confident that our footwear businesses represent a solid foundation to support future growth. At the same time, the ongoing evolution of consumer purchasing behavior requires changes to our operating model. These changes will focus on strengthening our customer connections and fortifying the leadership positions of each business in addition to streamlining our cost structure and capital spend. We will discuss the specific initiatives to achieve these goals later in the call today, but for now, let me turn the call over to Mimi to go over the financials can guidance in greater details.

Mimi Eckel Vaughn - *Genesco Inc. - Senior VP of Finance & CFO*

Thank you Bob, good morning. As usual we have posted more detailed information in our CFO commentary that you can access online at our website. The strength of Journeys & Johnston and Murphy allowed us to hold Q4 EPS flat to last year in spite of challenges elsewhere in our businesses. We reduce the gap to last year's EPS that began in the first quarter in each subsequent quarter this year and finally closed it in Q4. While we had a small pickup in EPS from the tax reform benefit in January. The 53rd week in fiscal '18 was dilutive to earnings since the sale in early February, a period of low sales for us. And the impact of these few things netted each other out. Even with positive consolidated comp Q4 EPS was flat, due to the expense of the extra week, gross margin pressure specific issue and Licensed Brands and higher e-commerce shipping and other expense. Without the impact of the extra week, we were pleased that we generally maintained our overall expense leverage in spite of negative store comp. Q4 consolidated revenue increased 5% to $930 million. Excluding the extra week, the impacts of exchange rate and the sale of a small business last year, revenue was relatively flat. Consolidated comps were up 1% with store comps down 1% and direct comps up 15%. While store comps were negative in total, they were nicely positive for J&M and up double digits for Journeys, on the strength of the assortment and in-store execution.

Direct as a percent of total retail sales in Q4 was 14%, up almost 200 basis points for both the quarter and the year, demonstrating the great progress that we have made driving e-commerce and pushing e-commerce to over 11% of total retail sales in fiscal '18. Journeys has experienced a very strong acceleration of sales, comps grew from positive 4% in Q3 to positive 11% in Q4. The business performed well across every dimension, highlighted by year-over-year increases in traffic in conversion and in average ticket size. This was driven by both boots higher priced fashion athletic product and both footwear unit and ASPs increased.

While year-over-year traffic was better than mall averages, it was higher conversion and average ticket size plus strong digital sales that generated Johnston & Murphy's positive 4% comp. Sales of both footwear and non-footwear were up, but J&Ms compelling assortment in footwear, led by casual is what drove topline and brought comps from negative in Q3 to positive in Q4. Price increases on select products at retail contributed to the better average ticket size and did not affect conversion. Fashion athletics footwear drove higher unit sales of Schuh, but ASPs were hurt by a higher mix of sale products and lackluster sales of boots in the highly promotional U.K. environment.

Lower traffic, conversion and ASPs led to a negative store comp for Schuh, but very robust e-commerce sales resulted in a positive overall comp of plus 1%. Bob described the current issues facing Lids. As a result, Q4 store traffic was of double digits and conversion was down to leading to a negative 14% comp. This was against a strong positive 8% comp last year on the back of the Cubs World Series win, which drove higher than usual traffic in sales. Comp declines were more heavily weighted to Locker Room given its higher concentration in the NFL.

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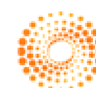

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On a positive note, dollars per transaction were 5% higher. Q4 consolidated adjusted gross margin decreased 30 basis points to 47%, without increased shipping and warehousing cost from higher e-commerce sales, gross margin would have been up 10 basis points. Another bright spot for Lids was a significant 140 basis point pickup in gross margins, which contributed meaningfully to this consolidated improvement. Without the extra shipping and warehousing cost, Lids gross margin would have been even higher by about 80 basis points. Thanks to improved merchandising practices and systems, Lids have been taking markdowns earlier throughout the year with the goal of clearing products sooner and with more shallow marks. This was especially important with the vendor changeovers in 2 professional leagues this year.

The results really showed up at year-end and were significantly better than we expected and we ended the year in a clean inventory position in spite of the comp trend. At J&M gross margin was up 100 basis points benefiting from the retail price increases and lower markdown. Journeys gross margin decreased 10 basis points without the extra shipping and warehousing cost, it would have been up 30 basis points, as a result of lower markdowns and slightly lower IMOs. Gross margin at Schuh was down 490 basis points, a measure of how difficult the consumer environment was and the level of markdowns required to move products.

Finally, weak demand for men's dress and casual shoes in the midst of this very strong athletic footwear cycle drove much lower license brands gross margin. These factors also contributed to our decision to terminate the Bass footwear license agreement and buyout the remaining minimum royalty obligations.

Total SG&A expense as a percent of sales increased 50 basis points to 40.2% with the leverage on rents, selling salaries and central expenses due to the extra costs of the 53rd week. Without this our expense leverage would have been roughly flat in Q4. Digital and other marketing spend stimulate sales and drive traffic to our sites and stores and IT spend to build omnichannel capabilities were higher in the quarter as well.

We have talked about pressure from minimum wage and competitor wage increases and we saw this continued impact on wage rate in both Journeys and Lids this quarter with a mid single-digit increase. Q4's net result was adjusted operating income of $62.8 million versus $66.7 million last year. Adjusted operating margin decreased 80 basis points to 6.8%. Journeys and J&M was up for the quarter and the other businesses were down.

Turning now to the balance sheet, inventory is clean. Q4 total inventory was down 4% on a sales increase of 1%, adjusting for the extra week, but not adjusting for foreign exchange. Journeys inventory was down 4% on a sales increase of 11%. Lids' inventory was down 8% on a sales decrease of 17%, as Lids carried some products over into the New Year, rather than market down to rebuy it again later.

Capital expenditures were $24 million for the year and were higher than -- were $24 million for the quarter and for the year were higher than usual, due to the Journeys distribution center expansion and depreciation and amortization was $21 million. We did not repurchase shares during the quarter and we have $24 million remaining under the current $100 million repurchase authorization. We had expected to end the year with US borrowings due to the Journeys DC project and a higher working capital needs from timing of the 53rd week. However we tightened up both capital spending and working capital and ended the year with about $40 million less in borrowings and plans.

Turning now to guidance for fiscal '19. We estimate adjusted earnings per share to range from $3.05 to $3.45. As Bob indicated, this wider than usual range is largely because of 2 potential variables. The first is whether the decline in mall traffic and sales shift out of stores and into digital that has been dilutive to earnings will continue at the pace we saw last year. The work comps underlying our guidance range from roughly flat to down 2%. The second is the timing of the Lids rebound. We anticipate a tough first half for Lid until the anniversary the start of more challenging comps in the summer. And since we don't yet have visibility into a new fashion driver, we remain conservative for the back half as well in spite of the much easier comparisons.

For the year, we expect consolidated sales will range from down 1% to up 1%, but consolidated comps including direct ranging from flat to up 2%. We plan to open 55 new stores, roughly 10 each for Journeys Kidz, Schuh in the U.K. and our Concepts in Canada. The balance of the stores were mostly the fill-ins for our more mature concept in strong malls where we haven't previously been able to get the right rent deal. Some have suggested that we shouldn't be opening any new stores, but our analysis of recent store openings suggests we are earning on average above our cost of capital. So we will continue to pursue these openings selectively. We plan to close almost a 100 stores for a square footage decrease for the second year in a row. However, we will keep a store open with short lease term as the rent deal is attractive, so this number may change. The stores

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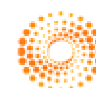

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that we opened will be far more productive than the ones that we closed as we saw this year, as we selectively prune the unproductive stores from our portfolio.

We expect gross margin to be up 20 to 30 basis points in total in the coming year, when the improvement in most division. With the low-store comps and our largely fixed store expense base, we expect SG&A expense will delever in the 30 to 50 basis point range, which with the cost savings I'll discuss, is a meaningful improvement over last year. In addition, we will be investing in store labor as Bob will explain, which these savings will also help offset. This all results in an operating margin percent at or a few cents below last year's level and EPS that ranges from down a little to up double-digit. Our fiscal '19 tax rate is estimated at 26.8% inclusive of the benefit of tax reform and subject to refinement as the details of this reform are worked out. One important call out for modeling quarterly guidance in fiscal '19 is the shift in the calendar as a result of the 53rd week last year. While this impact all quarter somewhat, the biggest change is the shift of one of the largest volume back-to-school weeks at the beginning of August, out of the third quarter and into the second which will help earnings in Q2 and hurt them in Q3.

Another call out relates to pressure on Q1 EPS, given the low comp and deleverage we expect in a low sales quarter making it difficult to have positive EPS then. Capital expenditures will be in the neighborhood of $75 million, down substantially from last year and the previous 5 years when we have been investing in upgrading our distribution facilities. We plan to spend a greater proportion of capital on digital while still investing to refresh our store fleet. We estimate depreciation and amortization at $78 million. Lastly, we are assuming 19.5 million average shares outstanding. This guidance assumes no stock buybacks, but we can use repurchase availability opportunistically going forward.

We are working toward a 10th of a turn improvement in inventory turn, which should help cash flow for the year as well. Shifting to the critical initiatives we have underway for fiscal '19, we recognize that added costs of operating 2 channels, driving traffic to the stores dilutes profitability and that we must reduce the store cost structure and improve efficiency in e-commerce to combat this. Over the last several months, we have carefully examined our expense space and launched a profit enhancement initiative to take out $35 million to $40 million of annual expense. This cost reduction program is a key priority in every one of our businesses.

We talked about the success we're having with renewals and rent reductions, partnering with our landlords to achieve acceptable rents while often increasing flexibility and reducing risk with shorter term. This is a huge focus for us and is a critical part of this program. To give an update, we negotiated almost 300 renewals last year and achieved in total a 16% reduction in cash rents or 9% on a straight-line basis. With over 350 expected renewals this year, we'll keep working at this. We also renegotiated our freight carrier contract which went into effect in the fourth quarter and is already yielding benefits. This overall program is broad reaching and includes headcount reductions we have already made additional opportunities in stores by credit card fees through network costs and store supplies, opportunities and benefits in IT the DCs and beyond. This is the start of a multi-year effort to reshape our store cost structure and allow for continued investment in e-commerce and digital.

Now I'll turn the call back over to Bob to comment on the other key initiatives we're working on.

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

With Mimi already providing the update on our work to reduce real estate risk and rent expenses as well as a broader cost savings program and our plans to reduce capital spending, I'm going to focus on the 4 other key initiatives to evolve our businesses and strengthen our strategic positioning for the longer term. Much of this builds on our efforts from last year with one new area of focus. So first we're working to improve the customer experience in all channels and to gain a single view of the customer. To be able to enhance the experience we must understand better each customer's journey in the different ways to interact with our brands in both the digital and physical world. Johnston & Murphy is leading Genesco in building these capabilities, which is also a major focus for Journeys and Lids this year.

We added this to our top priorities with the belief that by continuing to improve the customer experience we will build loyalty and better maximize each customer's value to us as a result. For Journeys, it's a three-pronged approach. First, we are tackling the stores business of friction that customers encountered during the omnichannel interactions with us. This approach identifies all the major pain points in stores and online such as order not [done] when tracking with the intent of bringing process and technology solutions to solve them.

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Next, Journeys is looking to build a single view of the customer from multiple internal and external data sources and this concludes gathering transactional, behavioral and demographic information such as past purchases, shipping preferences, social preferences, promotional history, gender and location that reside in our various systems and consolidating it into a unified view of the customer across Journeys. And lastly Journeys will use this data combined with other customer insights to better understand and solve our customers footwear needs, increase conversion and average order value and resolve problems more effectively.

For Lid, establishing these capabilities begins with enhancing the robustness of customer data platform which way -- they will embark on this year.

Number two, we are working to enhance our in-store experience and drive traffic to our brick and mortar locations, review our stores, strategic assets and [critically] import to delivering the omnichannel experience. We've talked a lot about driving traffic on prior calls. So, I will focus on the store experience this time. Two most important aspects of this are our store employees and our store environment. We continue to invest in both to ensure that we provide a compelling and differentiated experience for the millions of customers across our lease lines every year. In fiscal '19, we are increasing our investments in our store employees with a particular focus in Journeys on our co-managers, the second most critical position after the store manager, in order to fortify our store leadership teams.

We are also conducting surveys and dedicating time in resources to better understand opportunities to build engagement with our store employees. Finally, we will be testing a few new bonus programs to keep store employees engaged and motivated and reduce turnover. In terms of our physical presence we will continue to invest in enhancing our store fleet, especially in high volume, high profit, positive trend locations with close to 200 models planned for the coming year. When a customer enters our store, we want them to be in an environment that is inspiring and showcases our product assortment in a compelling manner. The majority of our spend will be directed towards the evolving our current concepts, with an emphasis on lighting and display modifications.

Beyond this as we've discussed previously, Lids is testing a new store design. The updated look and feel features cleaner product presentations, narrower assortments with more of a showcase orientation and a larger emphasis on interactive experiences such as custom embroidery, which is a real differentiator. And we are pleased with the early results of the test.

Number three, we're building out omnichannel and digital capabilities with initiatives across all of our companies. This year we will test mobile point-of-sale technology in select US footwear stores, in addition to speeding up and making the checkout process even more convenient, mobile POS gives our associates and added opportunity to engage with customers on the sales floor and potentially sell them other merchandise they may need. Schuh already enjoys this capability. Schuh is also reaping the benefits of a new web platform launched late last year that is faster and offers quite a bit more functionality and plan to further refresh of its website this year.

Meanwhile J&M is testing 2 initiatives, we are very excited about. First is online to offline attribution. Here we're working to improve our understanding of what digital marketing tactics are most impactful to store conversion. We currently touched about 20% of the consumers we transacted in J&M stores with some form of a digital marketing impression; e-mail, pictures, digital ads, social, seven days prior to purchase. We'd like to become even more intentional with those impressions to see if we can drive higher traffic and conversion in our stores.

Next, we are testing predictive technologies using artificial intelligence, this takes customers previous browsing behavior and purchase history, as well as what other similar customers have bought in the past to show each customer a different arrangement of merchandise on the product listing page. The goal is to increase conversion and average order value by showing product that appeals most to an individual customer.

For Lids, the implementation of a new order management system that brought us closer to complete by online, pick up and store capabilities gave us visibility into an increase in customers electing actually come in to the store for immediate pick up, instead of having the product shipped to them. This reinforces they need-it-now mindset comment in this category and shows the willingness of many customers to make the trip to the store to get it. This is the capability we continue to evaluate for our divisions who do not yet offered it.

And number four, we are working to strengthen the equity of our retail brands. We are looking to build on the momentum of our marketing investments generated during the holiday season with a host of compelling programs throughout this year. This spring, Journeys is partnering

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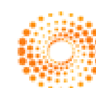

with Converse, on a national promotion and celebration of this quintessential team moment, with a twist that will culminate in an ultimate Prom for one lucky city.

Little Burgundy will leverage its 10th anniversary celebration with marketing events to promote the brand and reinforce the Concepts authentic positioning with its core customers. At Lids, the focus is on enhancing Access Pass, the new loyalty program launched last year to drive increased engagement fan followership and ultimately incremental sales.

Now shifting gears a bit, as you know, we announced a few weeks ago that we are exploring the sale of the Lids Sports Group. This decision came out of the most recent iteration of a thorough and comprehensive strategic review that management and the Board have conducted annually for several years now.

On the basis of the most recent analysis, which was completed in the fall last year and prepared as usual with the assistance of outside financing advisers, the Board looked at the range of strategic possibilities and concluded that a sale of Lids makes the most sense for Genesco to deliver enhanced value for our shareholders over the long term. As we addressed in our press release last month, the primary reason for the Board's conclusion is the great potential in each of our footwear businesses and in a Genesco that is focused more sharply on realizing that potential. Individually the components of a footwear-focused Genesco are compelling.

Our strong strategic positioning, close connection with our customers and enduring leadership positions what make each of our footwear businesses distinctive combined the footwear business are even more compelling. We also believe that a company focused solely on footwear would be easier for investors to understand and therefore easier for the market to value appropriately. Journeys is the leading omnichannel retailer branded fashion footwear to teens in North America a position that has held for 2 plus decades. As its strong sales in the fourth quarter once again demonstrate, Journeys understanding of teens and unrivaled access to merchandise this customer want, equipped uniquely well to serve this regular customer, and navigate the fashion that are inherently part of life in this segment of the market.

Likewise Schuh has a similar leadership positions telling fashion footwear, not only to the team, but also to the young adult shopper in the U.K. What further differentiate Schuh and in genders allegiance from its customers are its advanced omnichannel capabilities and equally passionate focused on customer service. We've already talked about the long-running record of stellar performance that Johnston & Murphy has posted over the last decade. J&M's leadership position is bounded on brand equity that has taken more than a 165 years and 30 Presidents to create. This heritage and its ability to interpret its customers every evolving fashion needs into a product offering that resonates season after season, this what maintains Johnston & Murphy's preeminent positioning.

Johnson & Murphy also provides a footwear focused Genesco with one of its most promising platforms for future growth. This platform is built to allow sales direct to consumers to both brick and mortar and e-commerce complemented by a vibrant wholesale business, offering the opportunity to add additional vertical brands that can plug into this infrastructure and control their own destiny in today's retail landscape where brands increasingly go direct to consumers.

Together, the footwear businesses are even more compelling, since Journeys and Schuh enjoy a significant overlap in their vendor base. Their combined scale allows for a stronger relationship with vendors, that is demonstrated in the activities such as top-to-top global summits held jointly to step marketing and product direction.

Their combined scale allows for leverage and merchandise cost and purchase terms and then access to both hot and unique products such as special makeups of certain franchises carried only in Journeys and Schuh. Additionally, the sharing of best practices between these two related businesses provide great benefits in both directions, as their functional heads pair up regularly to compare KPIs and exchange what is working best within their respective businesses.

And finally, these businesses provide the platform and infrastructure to plug in other branded businesses in North America and potentially in Europe, as we did with the purchase of Little Burgundy from the Aldo Group, 2 years ago. One of the areas of most significant benefit across all our footwear concept is the ability to detect and interpret fashion trends that start in one area of our business and then spread to others. Whether trend start in Europe and then come to America or vice versa, whether trends starting the young adult market and spread to teens, starting in the

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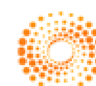

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youth market and spreads older customer groups to start with all demographics and go younger. The ability of our merchant and product groups to go to market together and to share information and insights is a store's real advantage.

Well, Journeys and Johnston & Murphy may look separate and distinct from the outside, they share almost all of their retail systems and services, providing significant cost synergies. From point of sale to merchandising systems, loss prevention to help desk, real estate to lease management, the retail infrastructure of these two concepts is completely integrated. Likewise, the wholesale infrastructure of Johnston & Murphy and the licensed brands group are completely integrated as well. Focusing on further enhancing these synergies would be an important future step in the profit improvement initiatives, Mimi described earlier in the call. Regarding Lids itself as you can understand it would not be appropriate for us to comment further on the ongoing process on today's call.

We also will not be addressing questions pertaining to the process during the Q&A period today. But I'd like to close on this topic by reiterating that we are believers in Lids strategic positioning and that it's unrivaled breadth of on trend and exclusive product make Lids to go-to destination for in demand fashion and fan headwear. Lids Sports Group is the leading omnichannel retailer of licensed sports merchandise by far, with very strong leadership in place and a talented organization behind them. However, we believe Lids Sports Group has been undervalued as part of Genesco and that its sales with unlocked value and provide us the capital either to support the growth of our leading footwear platform and or return to shareholders, whatever the best mix use might be.

We do see great fundamental value in Lids and won't go forward with a sale unless that value can be realized in a transaction. Let me conclude by recognizing the entire Genesco team once again for your dedication and talent. In a year full of market challenges and external distractions you have remained remarkably focused on the task at hand. We have a lot of hard work ahead of us, but I am confident that with continued focus ingenuity and persevere given the tremendous potential in our businesses and the extraordinary strength of our people behind them, we will meet the test retailers presenting us and look back a year from now with pride and what we accomplished together. And so thanks for all that you do. And with that operator, we are ready to take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question we'll hear from Erinn Murphy with Piper Jaffray.

Eric Thomas Johnson - *Piper Jaffray Companies, Research Division - Research Analyst*

Hi guys, this is Eric on for Erinn this morning. Thanks for taking the question. I guess first for just regarding Lid, I know you guys don't have visibility yet into potential inflection. But can you remind us historically how those kind of play out in terms of timing from when you start to see a trend happening before you can move into it and becomes material enough to sort of alter the trajectory of the business. And then secondly on Lids, is the improvement year-to-date, you guys are seeing more reflection of just the NFL business being a smaller piece in this period? Has that trajectory with the NFL sort of change year-to-date from what it was during the second half of last year?

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

So let's go backwards on your historical question. When we evaluate what went on with Lids, we can isolate a lot of the comp decline specifically to first the Cubs then the decline in the NFL category and then, thirdly the lack of a fashion driver in the headwear business. And so -- you're correct. When you get into the first quarter, it begins with the Super Bowl and then the NFL is done, so that trajectory is not anywhere near the factor that it was in the fourth quarter. So looking at headwear trends, we've had a dozen headwear trends that have occurred over the last 10 or 15 years. And they come and go, and they occasionally overlap, we're just in a trough right now. And it's a little hard to generalize when they show up, summer prompted by an event, celebrity wearing something that also catches fire, some of them emerges what looks to be a more of a fashion bump like snapbacks got really hot and then we figured that would be a fad and that would go away and snapbacks actually persisted for years,

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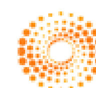

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and in fact it's become a permanent part of our assortments. So, there's a lot of different ways to look at it, we just or in a bit of a trough right now and so it's a little hard to be predictive about when it would happen and what shape it would look like, but we just rely on 20 years of history that says something generally comes along. Specifically, with the NFL, we have no crystal ball. There was a lot of things going on in the last season, and a lot of players were hurt or sort of a black swan event with how many top players were down, some of the important teams were not there. And so, in our guidance we planned it up slightly, but given how the trend was last year that probably release some room for greater upside given how tough it was then.

Mimi Eckel Vaughn - *Genesco Inc. - Senior VP of Finance & CFO*

One of the other things I would say is that the lead time to get products in the headwear space is shorter than in footwear. I mean footwear is as you can appreciate the construction some of the less being able to get that product here we've talked in the past about that, that lead time being 6 plus months. The headwear lead time, we can actually chase into a fad and into a trend much more quickly. And so, in the past when we've seen things like snapbacks come into play, we have been able to really grow our assortments more rapidly than we can on the footwear side.

Operator

And next to move on to Janine Stichter with Jefferies.

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

I just want to get some color on the comp guidance for Journeys. Is there a pretty nice color there in the fourth quarter and seems like trends even got better into January, but there is a significant acceleration embedded in the first quarter guidance. So is there anything specific you are seeing there driving that expectation? And then kind of along those same lines on the current trend cycle, it seems like it follows really right into your sweet spot, but we are seeing trends come and go quicker than the past. So what's your expectation to the length of the current cycle? And is there anything you are doing differently and how you manage the business just that you prepared when the trends ultimately do change again?

Unidentified Company Representative

In general, I mean -- talk to a couple of the comments, as we said in the script what we really like about where we are right now is, there is more diversification amongst brands and franchises all sort of playing off both the classic and then the lifestyle athletic, which are in Journeys' sweet spot. And we think that we get a good long-run out of that. So with respect to the fashion cycle, the same question got put to Foot Locker last week on their call and our answer is pretty much the same. Our business is largely dependent on branded merchandise and as Mimi just noted what the lead times are. Those lead times are still pretty much what they've been. Our vendors are working pretty hard to figure out other ways to shorten up that timeline and we're certainly there to help and do whatever we can. What we're doing in terms of playing defense against the possibility that there is a quicker pattern, is just being more diversified in the store and so that we're showing a range of opportunities to our customers. And that we believe that allows us to jump on whatever get [spot net] a little more quickly. In terms of the general guidance, Mimi let me turn it to you.

Mimi Eckel Vaughn - *Genesco Inc. - Senior VP of Finance & CFO*

So, Janine, I think that it's important to look back to last year. Last year, we were really trying to move our inventory so that we could change our assortment and as a result we had a -- we cleared a lot of products in order to bring in a very large shipment in January to accelerate the fashion rotation. And so, when you look at our plus 11% comp in the fourth quarter, that is against an easier comparison in the fourth quarter given everything that was going on. We had a lot of confidence in the Journeys business, there were a lot of great things that happened in the fourth quarter but we felt like it would be prudent to moderate that look into the first part of the year, because the factors were a little different than they were in the fourth quarter. And so you can appreciate that during the peak times holiday selling periods, we are able to really drive Journeys'

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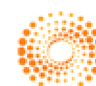

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volume. We have seen a moderation and that plus 11% comp, but we think that we are tracking nicely to 3% to 4% guidance that we have in the first half of the year.

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

Just to finish up on this topic, one of the challenges for us is, with this last fashion change that was kind of painful for us. Thankfully, the team did a great job of navigating through it, but the navigation period was tough. We did some forensic work if you will on, what could you have been predictive about this change and when you go back and use Google Trends or any anything that you would regard as a protective resource, nothing really seem to call the [charts] a very effectively and that's because if you ask a teenager right now what they think they're going to be wearing in 6 to 9 months, they might tell you what they think it is, but it is a very [feeble] customer and the truth is they don't know. And so our challenge is to try and do some of the things we were referencing on the call touch our European exposure, touch the fact that we're a national footprint retailers, so we see what's going on the coast that might move to the middle of the country and I think we're positioned to do as good a job as anybody in being predictive of what's going on, with that said is a challenge for this category.

Operator

And next move on to Steven Marotta with C.L. King & Associates.

Steven Louis Marotta - *CL King & Associates, Inc., Research Division - Senior VP of Equity Research & Senior Research Analyst*

Couple of quick questions [as it pertain], I believe you said CapEx you've said that $75 million this year, could you impact that a little bit between technology investments, store refreshes and I guess few openings and to other items? And also my follow-up is that historically the profitability trade of incremental sales between offline and online, online obviously the incremental profitability was higher, offline incremental profitability was lower because of the variable costs associated with it. Does the new cost reduction program address that differential and perhaps make the incremental profitability for online a bit greater in future years?

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

Steve, we always manage to confuse you guys enormously about online and offline sales. We are profitable online and profitable offline to the same degree. The distinction is that how profitable are we on incremental sale. And so offline, when you're in a store and if you pick up 5% more sales that 5% on an incremental basis, is very profitable because you've already paid the rent and you generally can service 5% more with your existing staff. When you get 5% increase online, you get an increase in your expenses of picking and packing and shipping and so you are adding variable costs. So that doesn't mean ones more profitable than the other, in an absolute sense, it means on the increment, it's more -- what happens is we are delighted to get more sales online because it's -- those are profitable sales you just don't get the kind of leverage with more sales, but it's a variable cost business. And then if the shift is such that we get increases in online and we actually are flat or negative in our stores, then you're getting the deleverage of the fixed cost and that's the issue, so when we goes looking at cost, first of all, everything's on the table. So there is not a line item that we're not going to take look at, but the big opportunity is to figure out how to continue to get the store cost in line, and obviously the number one item in that area is rent. So, I hope that clears up that question, let me pass it to Mimi on the CapEx.

Mimi Eckel Vaughn - *Genesco Inc. - Senior VP of Finance & CFO*

Yeah, I'm going to pile on to the question about profitability and sales, our whole profit improvement program is exactly as Bob said it focused on both the store channel and the e-commerce channel, so when you look at our store channel outside of product cost, outside of merchandise cost, the rent expense selling salary expense and depreciation all add up to about 80% of the cost base. And so to really make an impact in a world where we've had negative store comps and we've had negative store comps for a number of orders, we have to be able to reshape those factors. We've set aside selling salaries, we've made a lot of progress on selling salaries by substituting part-time labor for full-time labor by optimizing using ShopperTrak. But with the headwinds of minimum wage pressure and the wage rate increases that we've been seeing, we don't have a lot

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of optimism for being able to reverse the increases that we've been seeing in store selling salaries and so we're really working hard on rents and then our cost reduction program will be focused on many of the other pieces of the store cost structure and it's the reshaping of the store cost structure that is one of the primary motivations in our cost improvement program. So, when you look at capital expenditures and looking at the $75 million, we have been investing in upgrades to all of our major distribution centers to accommodate e-commerce and also just accommodate the growth of our businesses over the last several years and so, some of the decrease in CapEx comes from not having to make some of those investments. It also comes from reducing the number of new store openings, we're estimating that we'll be opening 55 new stores this year versus 75 last year and 80 the year before, so some of the reduction comes from not as many new store openings.

We are still investing heavily in e-commerce and IT that represents in the neighborhood of a third of our overall capital spend; the balance is on renovations, our belief is, it's important to continue to refresh our overall store portfolio. And so we have dollars put in there for almost 200 renovations. We are spending a little bit less trying to really focus on those elements that will highlight the products like lighting, things like display and really making the customer feel like we have been keeping pace with and refreshing our overall fleet.

Operator

And next we move on to Mitchel Kummetz with Pivotal Research.

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

I guess I just want to ask Steve's question, maybe in a little bit different way about channel mix. So this past year, you guys were flat comp with minus 2 stores, I think, plus 22 direct, your comp guidance for 2019 is flat to plus 2. I mean, are you looking for sort of a similar kind of mix in terms of the store performance of the drive performance '19 versus '18 and if that were to happen then, so what is the impact on the margins with that kind of a mix? And I have a follow up.

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

Let me give you, on the guidance breakdown specifically, but what we're doing now is being more aggressive than we've been in terms of what we need to see in terms of our rent structure in order to renew our stores. We've been quoting a lot of success with that we've had mentioned with rents, but let me remember -- you do your rents renegotiations ahead of the renewals, so a lot of times we renewed stuff this year and the new rent structure kicks in next year. So a large part of how we work this problem is really hammering on rents to make sure that we have a viable economic formula in the stores even with those comp numbers.

Mimi Eckel Vaughn - *Genesco Inc. - Senior VP of Finance & CFO*

Yeah, so Mitch, just to compare to last year, so that's right, our store comps were down 2% last year and e-commerce comps were up 22% and so this year we have on average seen in the neighborhood of 15% growth rate on average for e-com, last year it bumped up. We are anticipating it will be somewhat in the range of what we've seen on average, so going back to sort of that 15% range on stores. So over the past several quarters, I think it's been 7 or 8 quarters, we have seen pressure in our stores and negative store comp and at that negative 2% store comp in fiscal '18 last year, we see leverage to the tune of about 90 basis points that high fixed expense base that I talked about; whenever we don't get traffic, whenever we aren't able to convert in our stores, we tend to deleverage. The other side of that is really positive that when we do get -- when we are able to convert and we do are able to drive comp store sales, we see lots of nice leverage on a fixed expense pace and so for this year in thinking about guidance and reflecting the trends that we've seen, our store comp is at the high end of our range is flat. At the low end of our range in the neighborhood minus 2% of what we saw last year. Now the positive news as far as the impact on our cost reduction program is that last year when we saw 90 basis points of deleverage, this year at a minus 2% comp. We expect that we'll see a 50 basis points of deleverage and so, as we work at reshaping the cost -- as we work at beating down rents as Bob mentioned, over time, we are able to leverage in our stores at a much, much lower comp rate. And so for this year, I think it's going to be somewhere between 1% and 2%, as we continue to bring rents down, we ought to be able

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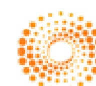

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to leverage at a lower level of store comp. And then when store comp become positive driven by trends, driven by pickups from competitor fallout, then we'll be in a situation where we see very nice for economics.

Operator

We next move on to Laurent Vasilescu with Macquarie.

Laurent Andre Vasilescu - *Macquarie Research - Consumer Analyst*

I wanted to follow-up on the earlier question regarding the Journeys' first quarter comp guidance. I think the comp guidance is 3% to 4% on a 2-year stack basis suggest some deceleration. Are the recent winter storms maybe tax returns or any other factors influencing that comp guidance?

Mimi Eckel Vaughn - *Genesco Inc. - Senior VP of Finance & CFO*

Yes, I think that. Again, we feel very positive about the assortment for Journeys for the coming year. The winter storm certainly have been a factor, but we tend to think of those are fleeting and that they don't impact the trend for the quarter. And so when we look to see what the assortment is for spring, it is -- as we talked it's diversified across the number of brands and the key for us is to continue to see positive store comps and we've seen nice positive store comps in Journeys as Journeys has come out of the fashion rotation and I think that what you're seeing is a measure of conservatism to see how the first part of the year unfolds as far as, as overall traffic in a store comps for Journeys.

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

Yeah, I just reiterate that when we look at winter storms, they're very disruptive to the business, but we're not sure that it actually hurts the business over the course of the quarter. The pace of tax refunds has been a little perplexing to us because the generalized data has shown that the tax refunds are kind of in the same ballpark as the pace last year, but we think the big driver is the subcategory of the earned income credit and so we're not sure we got complete visibility on that, we should be reaching the end of the tax period right now. The other factor that kicks in for Journeys which always gets in the way of visibility at this time of year is the timing of spring break and so when the kids are out of school, we get a bounce. So spring breaks through all over the board. So it's just -- it's a little tricky in the first quarter. It's a low volume quarter and then you have all these variables that with sales around so. So, I would emphasis on the fact that it's a low volume quarter, what really matters is what we expect to see in toward us 2 and especially, 3 and 4.

Operator

And next move on to Jonathan Komp with Robert W. Baird.

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

A couple of broader topics and Rob my first one is on the announcement to pursue the sale of Lids and I understand and appreciate you're not going to give updates on the process, but I was hoping just more behind the rationale, you could expand a little bit just on the surface, the comps are under significant pressure and the profitability is back to very low levels. So, can you give more comfort why right now is the right time to pursue those actions?

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

Look, we think that this is a business that in the long run ends up being a winner. There will be a retail brick and mortar presence in the license sports business and Lids is the biggest player there. They've got the scale in which to do omnichannel correctly, which none of the regional guys

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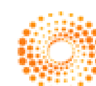

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have done. We're seeing regional consolidation already, there is a business called (inaudible) that original chain just got stalled. It looks like it got sold a bid on a distressed basis and some of those stores are closing and we just think that's a sign of things to come. We think the team is great, the leadership team is great. We have a number of reasons why we think now is good timing, even though as you know, the performance in the last year wasn't terrific, but I am going to leave it at that.

Operator

And next move on to Scott Krasik with Buckingham Research Group.

Scott David Krasik - *The Buckingham Research Group Incorporated - Analyst*

Thanks and kind of trying to think a few in here. Mimi, I know, you get it (inaudible), but can you just tell us what your occupancy for this year? Should be up or down year-over-year and then in FY '19 as well, just because of the timing when the renewals and [what not]?

Mimi Eckel Vaughn - *Genesco Inc. - Senior VP of Finance & CFO*

Scott, I think occupancy, so with the puts and takes, so the way to think about overall occupancy expenses that we have opened some new stores, we closed a number of stores and then we're rolling in the impact of these rent decreases. So I would anticipate that for fiscal '18 that occupancy wouldn't be that different than the year before. For fiscal '19 might be up a little bit just because we've opened some new stores, and we haven't yet seen the full impact of all of these rent decreases. For fiscal '19, we actually believe that rent will go backwards, so we see rents certainly as a percentage of sales, but also just in total dollars going backward.

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

And Scott, rent is a tricky thing in small box retailing. We live with much higher percent rent in a high volume store than we do in a low volume store. So I can make more money in a $1 million dollar Journeys store, I don't know make up a number 17% than I can in a $500,000 Journeys store at 15%. So I might choose to close the $500 [million] store, which was at 15% keep the store to $1 million at 17% that increases my rent as percentage of sales when you add them up, but I'm more profitable, because the million dollar store is leveraging all the other expenses much more effectively. So I wouldn't focus too much on the rent percent, I really focus on how well we're managing the total fleet and as I said it's the math is just a little more complicated than just simply looking at the percent, so I am just giving you that heads up.

Operator

And now, we will conclude today's question and answer session. At this time, I would like to turn the call of over to Bob Dennis for any additional or closing remarks.

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

Well, thank you all for joining us and we look forward to updating you in 3 months on how it's going. Have a good day.

Operator

And that will conclude today's call. We thank you for your participation.

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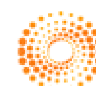

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