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Caleres, Inc. (CAL)

Q3 2018 Earnings Call

CORPORATE PARTICIPANTS

Peggy Reilly Tharp
Vice President, Investor Relations, Caleres, Inc.

Diane M. Sullivan
Chairman, President & Chief Executive Officer, Caleres, Inc.

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.

OTHER PARTICIPANTS

Laurent Vasilescu
Analyst, Macquarie Capital (USA), Inc.

Rick B. Patel
Analyst, Needham & Co. LLC

Steven L. Marotta
Analyst, C.L. King & Associates, Inc.

Christopher Svezia
Analyst, Wedbush Securities, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon. My name is Erica, and I will be your conference operator today. At this time I would like to welcome everyone to the Third Quarter 2018 Caleres Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions]

Thank you. Ms. Peggy Reilly Tharp, you may begin your conference.

Peggy Reilly Tharp
Vice President, Investor Relations, Caleres, Inc.

Thank you, Erica. Good afternoon. I'm Peggy Reilly Tharp, Vice President of Investor Relations for Caleres, and I'd like to thank you for joining our third quarter 2018 earnings call and webcast. A press release with detailed financial tables and slides are both available at caleres.com.

Please be aware today's discussion contains forward-looking statements which are subject to a number of risks and uncertainties. Actual results may differ materially due to the various risk factors including, but not limited to, the factors disclosed in the company's Form 10-K and other filings with the U.S. Securities and Exchange Commission. Please refer to today's press release and our SEC filings for more information on risk factors and other factors which could impact forward-looking statements. Copies of these reports are available online.

The company undertakes no obligation to update any information discussed on this call at any time. Joining the call today are Diane Sullivan, CEO, President, and Chairman; and Ken Hannah, Chief Financial Officer. And I would now like to turn the call over to Diane Sullivan.

Diane M. Sullivan
Chairman, President & Chief Executive Officer, Caleres, Inc.

Thanks Peggy, and good afternoon, everyone, and thanks for joining us. We have a lot to talk about so I'll begin with a quarterly overview of our strategy and results and then finish our conversation with the Vionic acquisition. Let's start with a few highlights from the third quarter where we delivered our seventh consecutive year of positive back-to-school comp sales at Famous Footwear. We also reported Brand Portfolio sales improvement of 8.5% as we continue to grow our top brands and to take consumer share in the market.

We also added Vionic, a growing brand with strong consumer loyalty and a great cultural fit to our Brand Portfolio, and we leveraged our balance sheet as we invested for continued success.

So let's review our performance at Famous Footwear first where our third quarter same-store sales were up 2.8% driven by lifestyle athletic styles and sandals. E-commerce-related sales increased 25% in the quarter and represented 13% of total sales.

In terms of product trends, we didn't see much of a change in the quarter. Women's remains strong with comp sales up mid-single digits, women's sandals and boots comped up low-double digits, while women's lifestyle athletic performed even better with comp sales up around 20%.

For sandals, footbeds and sports slides remain strong while boots were terrific across the board with booties, tall shaft, and shearling all up. We've certainly seen this trend continue into the fourth quarter and we have taken advantage of the situation. We've brought in additional best sellers and now expect boot sales to be up mid-single digits for the season.

Total adult athletic comped up low-single digits as a high-single-digit comp for lifestyle athletic was offset by performance athletic styles. As in the second quarter, retro style outperformed while more traditional athletic products remain soft.

It's very important for our kids business to improve in the third quarter and it did with comp sales up low-single digits. I'm pleased we're already seeing improvement in this area and I expect the teams to make even more headway.

And lastly at Famous during the quarter, the overall environment continued to be more promotional, and we responded as appropriate to drive business and attract more consumers. Our actions included some aggressive tests of new promotions and these efforts helped us to turn our inventory and to deliver our 2.8% comp which improved in each month of the quarter.

Now turning to Brand Portfolio where sales of $327.1 million was up 8.5%. As you know, our 2018 strategy was to take share in the market and to grow our top women's brands: Sam Edelman, Naturalizer, LifeStride, Franco Sarto, Scholl's, and now Vionic. Once again we posted significant market share gains as all six of these brands improved in the quarter. For Sam Edelman, total sales were up strong double digit. Our Naturalizer brand performed well again as did LifeStride, Franco Sarto, and Dr. Scholl's.

Of particular note, our best performing brands were balanced across multiple categories. Boots in particular had an outstanding quarter with sales up nearly 30%. We saw good bootie performance and strengthened some tall shaft styles while slouchy combat and Western boots were also in demand.

Not only do we have appropriately plan boots for the fall season, we also benefited from our speed-to-market program with boot replenishment rates up 10% in the third quarter. We're seeing good strength in November and expect to see a continuation of this trend in the fourth quarter.

E-commerce related sales were another strategic component of our Brand Portfolio growth and up nearly 20% with drop ship up nearly 25%. As we've been communicating all year, this continued growth and being able to respond to the consumer has been the driving force behind our decision late last year to bring our Brand Portfolio fulfillment in-house. Our new in-house fulfillment center is up and running well with automation coming as expected in the second half of 2019. Unfortunately, the third-party facility expense has been far greater than expected. So in an effort to put this behind us, we have committed to exiting this facility immediately following fiscal 2018 shipping.

Due to these expenses and our recent Vionic acquisition, we are updating our 2018 adjusted earnings per share guidance. We now expect to report fiscal 2018 adjusted diluted earnings per share of between $2.25 and $2.35, and this includes approximately $0.05 of dilution related to Vionic interest and amortization expense. The midpoint of this guidance calls for high-single-digit growth year-over-year and Ken is going to provide more details around this guidance a little later in the call.

And now I'd like to spend a few minutes on our efforts to diversify our portfolio, specifically our very reason to an exciting acquisition of Vionic. As I mentioned several times over the past few quarters, we have been actively looking to expand our Brand Portfolio, and Vionic was a fantastic opportunity to add a growing brand with strong consumer loyalty.

Vionic has already proven to be a disruptive addition to the industry and has been taking share of the growing premium contemporary comfort footwear category. It's very complimentary also to our current Brand Portfolio and expands our reach beyond the consumers our existing brands currently serve. And those consumers who know the brand just love the brand. They call them raving fans and on average, they purchase about twice as many pairs each year versus the average footwear consumer. Vionic is also a great cultural fit with Caleres. Their purpose to bring joy to people's lives starting with their feet is in perfect alignment with our mission to inspire people to feel good feet first.

And finally and most importantly, we're thrilled to have the great addition of Chris Gallagher, Bruce Campbell, and Connie Rishwain to our Caleres family, along with the rest of the team at Vionic. These three and certainly many members of their team are a seasoned team with a solid industry experience and a proven track record, and many of you will have a chance to meet them during Market Week.

The Vionic acquisition, along with other actions we've taken this year, is part of our strategy to invest for continued success. Our plans are on track, and as always, we remain actively engaged in improving shareholder value and we'll continue to aggressively adapt as retail continues to change.

Now before I turn things over to Ken, I just want to acknowledge that there were a lot of moving parts in this quarter, a lot to digest. And I'm certainly not happy about the third-party distribution center expense. But I feel really confident in our strategy and in our future. You can be assured we are going to stay focused on executing what's in front of us with excellence.

And with that, I'll let Ken cover our financials in a little more detail. Ken?

Kenneth H. Hannah

Chief Financial Officer & Senior Vice President, Caleres, Inc.

Thank you, Diane, and good afternoon, everyone. For the third quarter, we delivered adjusted diluted earnings per share of $0.81, including $0.02 of dilution in the quarter from our October 18 Vionic acquisition, driven by interest expense associated with the transaction financing and trademark amortization expense.

Our reported earnings per share was $0.67 for the quarter, including $0.14 per share related to our Allen Edmonds, Blowfish Malibu, and Vionic acquisitions. I would like to take a moment to walk you through each of these acquisition-related expenses.

For Allen Edmonds, we completed the previously announced transition of our consumer-facing activities to St. Louis in the third quarter. The only remaining item on our integration plan is the transition of their distribution center from Port Washington to our Lebanon, Tennessee facility, which is planned in the fourth quarter of this year.

For Blowfish Malibu, which we acquired in the second quarter, we had expenses related to inventory adjustment amortization costs. And for Vionic, these were acquisition costs and inventory adjustment amortization cost.

We've provided a breakout of these costs and other items can be found in the earning slides at caleres.com. Through the first nine months of the year, adjusted diluted earnings per share of $1.83 were up 8.9% year-over-year. Our reported earnings per share in the same period was $1.62 and included $0.21 of acquisition-related expense, most of which is associated with the activities that we just walked through.

Our consolidated sales for the third quarter of $775.8 million were flat versus the prior year. At Famous Footwear, where comp sales were up 2.8% in the third quarter, our total Famous sales of $448.8 million were down 5.1% as expected with the shift of one week of back-to-school sales into the second quarter of this year versus the third quarter of last year. We also operated 35 fewer doors year-over-year.

For Brand Portfolio, third quarter sales of $327.1 million were up 8.5% including Vionic and up 6.5% excluding this acquisition. Our year-to-date 2018 consolidated sales of $2.1 billion were up 1.5% versus 2017. Famous Footwear year-to-date sales of $1.2 billion were essentially flat, while same-store sales were up 1.7% and in-line with our low-single-digit annual guidance. For Brand Portfolio, sales of $872.9 million were 4.1% ahead of the same period last year, including Vionic. Excluding this acquisition, sales were up 3.4% in the Brand Portfolio year-to-date.

Let's turn to gross profit which came in at $310.6 million in the third quarter, down 2% year-over-year due in part to the nearly $2 million of Blowfish and Vionic inventory adjustment amortization costs. Our adjusted gross margin of 40.3% for the quarter was down approximately 60 basis points, primarily due to the mix implications of our continued strength in e-commerce and growth in our Brand Portfolio.

On a year-to-date basis, our gross profit of $878.6 million was up slightly including $2.4 million of inventory adjustment amortization costs pertaining to Blowfish and Vionic. Our adjusted gross margin for the first nine months of the year came in at 41.7% and down approximately 60 basis points, again primarily due to the strength of our e-commerce-related sales and growth in our Brand Portfolio.

Before we get into expense, I'd like to once again remind everyone of the new pension accounting standard effective this year, which required a shift of $2.5 million of retirement plan income from third quarter 2017 SG&A expense to other income below operating earnings in order to be comparable with the 2018 accounting standard. There's no impact to third quarter 2017 net earnings or earnings per share due to the adoption of this standard but it does impact geography in the income statement including our operating profit and margin.

Our SG&A expense for the third quarter of 2018 was $265.5 million and represented 34.2% of sales, an improvement of nearly 20 basis points versus the third quarter of 2017. On a year-to-date basis, SG&A expense was $774.6 million, or 36.6% of sales, an improvement of 30 basis points year-over-year and including an increase in Brand Portfolio distribution expense of approximately $10 million year-over-year.

Our depreciation and amortization of $15.8 million was down 2% in the third quarter versus the same period in 2017. And in the quarter, we recognized $500 million of trademark amortization associated with our Vionic acquisition. We're in the process of finalizing the purchase accounting requirements but going forward we currently would expect to see approximately $10 million of non-cash Vionic trademark amortization annually.

Our operating earnings were $39.8 million in the third quarter on a reported basis and $46.9 million adjusted. We delivered operating margin of 5.1% on a reported basis, down approximately 140 basis points year-over-year while adjusted operating margin of 6% was down 45 basis points year-over-year.

At Famous Footwear, operating earnings in the third quarter were $24.4 million while operating margin of 5.4% was down approximately 170 basis points. As Diane mentioned during the third quarter, we remained competitive to drive business and attract more customers and these actions did have an impact on our margin rate for the third quarter. On a year-to-date basis, Famous operating margin of 6.4% was up approximately 5 basis points year-over-year.

For Brand Portfolio, adjusted operating earnings of $29.6 million in the third quarter were up more than 20% and with contribution from virtually every brand. Adjusted operating margin of 9% was up nearly 100 basis points over the third quarter of 2017 including the incremental distribution expense I mentioned earlier.

Year-to-date adjusted operating earnings of $59.6 million were down approximately 1% year-over-year while adjusted operating margin was down approximately 30 basis points versus the prior period. The Brand Portfolio results include the impacts associated with the decision to bring our fulfillment in-house.

Our net interest expense for the third quarter was $4.2 million, which was up approximately 4% versus the third quarter of last year due to the Vionic acquisition, but we expect to pay down the revolver over the next two years with cash from operations. We will see incremental interest expense year-over-year going forward until this balance has been paid off.

Our tax rate for the third quarter was 24.5, on a GAAP basis, a reduction of more than 500 basis points versus the third quarter 2017 rate of 29.6%. For the full year, we expect our non-GAAP tax rate to be approximately 24%.

Our capital expenditures were $17.2 million for the third quarter and $38.7 million year-to-date, essentially flat year-over-year. Thanks to the strength and flexibility of our balance sheet, we were able to sign and close on our Vionic acquisition in October and have $350 million of borrowings outstanding on a revolving credit facility.

We also ended the third quarter with cash and equivalents of $90.5 million on our balance sheet, up nearly $60 million versus last year. Our consolidated inventory position at quarter-end was $698.3 million including nearly $70 million of inventory related to our new Vionic and Blowfish businesses. Excluding these acquisitions, Brand Portfolio overall inventory was up approximately 15% year-over-year primarily for the brands that Diane called out earlier. At Famous Footwear, inventory is in great shape and levels are essentially flat year-over-year.

Overall, the team has done a great job managing our balance sheet and we continue to actively manage our investment base including our real estate portfolio. For Famous Footwear, we ended the third quarter with 1,007 Famous Footwear doors, 35 fewer than the third quarter of last year. At Brand Portfolio, we closed one Naturalizer door, leaving us with 232 total Brand Portfolio retail doors at quarter-end.

Our trailing 12-month adjusted return on invested capital of 18.4% in the third quarter was up approximately 250 basis points over the same period last year. This return on invested capital highlights the increase in our trailing 12-month EBITDA and a decrease in our overall invested capital.

Before we begin Q&A, I'd like to review our fiscal 2018 guidance in more detail. For sales, we are increasing our consolidated net sales to approximately $2.85 billion with Famous Footwear same-store sales up low-single digits and Brand Portfolio sales including acquisitions up high-single digits. Our interest expense with the addition of the Vionic acquisition is expected to be approximately $18 million.

Our effective tax rate is expected to be approximately 24%, and on an adjusted basis, we expect diluted earnings per share of between $2.25 and $2.35, including approximately $0.05 per share of dilution related to Vionic driven by additional interest and amortization expense.

Our guidance as usual includes a number of store openings and closings and these details can be found on the earnings slides available at caleres.com. As a reminder, 2017 included a 53rd week which increased Brand Portfolio sales by $3.7 million and Famous Footwear sales by $19.7 million but have an immaterial impact on our 2017 earnings.

And with that, I'd like to turn the call back over to the operator for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from Laurent Vasilescu.

Laurent Vasilescu Q
Analyst, Macquarie Capital (USA), Inc.

Good afternoon. Thanks for taking my question and congrats on the Vionic acquisition. I wanted to follow up on the guidance for the Brand Portfolio sales. I think last quarter it was guided to be up low-single digits; now it's guided up to be high-single digits. Can you help us bridge the revenues from Blowfish Malibu and Vionic as well?

Kenneth H. Hannah A
Chief Financial Officer & Senior Vice President, Caleres, Inc.

Yeah, sure. I mean, the Blowfish Malibu, as we have said, I think their trailing 12-month revenue was around $30 million. So there's not a lot of incremental there. On the Vionic side, as we had went through – they were trending north of about $180 million, so that's the update there in terms of the additional. I think everything else is coming in, I think, net about where we had thought. So the low-single digits to high-single digits is really some strength in the key brands that Diane called out and then the incremental acquisition-related sales.

Laurent Vasilescu Q
Analyst, Macquarie Capital (USA), Inc.

Okay. Very helpful. Thank you. And then your guidance...

Diane M. Sullivan
Chairman, President & Chief Executive Officer, Caleres, Inc.

A

But, Laurent, actually in the third quarter too just as – it was 6.5% up on the existing Brand Portfolio and then it was 8.5% with Vionic, just gives you another benchmark.

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.

A

That was about a two-week – we closed in the middle of October, I think on the 18th, and so the stub period for the quarter was only a couple of weeks' worth of sales.

Laurent Vasilescu
Analyst, Macquarie Capital (USA), Inc.

Q

Okay. Great. That's very helpful. And then the guidance calls for about $0.36 in costs related to integration of the three brands. Slide 6 is very helpful in just getting the third quarter and then year-to-date. But can you kind of give us – can you help us bridge the $0.36 across Vionic, Allen Edmonds, and Blowfish for the full year?

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.

A

If you go through the schedule that you're referring to, we call out the $0.10 with Vionic and then the additional across Blowfish and Allen Edmonds. What is left is there's $0.15 that is left to go and $0.02 of that roughly is related to the cost to move Allen Edmonds out of Port Washington to our Lebanon distribution center, and then we think that that's worth a couple million-dollar benefit next year to that business.

And then the rest is all Vionic-related and it's primarily the amortization of the interest and also of the trademark. So there's a little bit where we had stepped up the inventory. I think the total number is about $65 million of inventory. And so there's about a $15 million step up there that comes through over the next two quarters. So it's really split $0.13 associated with Vionic and $0.02 for Allen Edmonds.

Laurent Vasilescu
Analyst, Macquarie Capital (USA), Inc.

Q

Okay. Very helpful. And then can you give us a little bit of sense of what the EBIT margin profile for Vionic looks like? And how did you come to the decision to acquire the brand?

Diane M. Sullivan
Chairman, President & Chief Executive Officer, Caleres, Inc.

A

Yeah. Thanks for the question, Laurent. We had been actually talking with the Vionic team for quite a number of months and had been really watching how they were performing in the marketplace and have done a lot of analysis around making sure that whenever we added a brand to our portfolio, that we were really going to be – it would be a complementary brand where we would have additional consumers that would really be new and unique to the existing portfolio.

So it's really something that we had looked at over a period of time and there was also a significant white space in the market. It's hard to say that there's even any white space in such a fragmented market. But in that premium comfort category, there's a lot of opportunity for growth on both the men's and women's side. There's no one that's really targeted that space, and we just thought the team there was a phenomenal team that had an unbelievable track record.

So it was really a confluence of a lot of different factors that really led us to that decision point. And when we looked at the operating margin and how that would line up against our existing Brand Portfolio, we really thought it's being very accretive to the company and we really could see other ways additionally that there would be opportunities for really good value-added synergies, particularly in the sourcing side of the equation.

So, again, it wasn't something that we did in a couple of months. We really took our time to assess that one. Ken, I don't know if you have anything else to add to that.

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.
A

No, I think that as we looked at their margins, I mean, they were strong double-digit. And with the business growing at the rate that they had been growing, we were very happy with that profile. I really think that together we're going to fuel their top line and then help take some of the pressure off of their back office expenses as well. So we're pretty excited about it for all the reasons that Diane laid out in our prepared remarks.

Laurent Vasilescu
Analyst, Macquarie Capital (USA), Inc.
Q

Okay. Very helpful. Thank you very much and best of luck.

Diane M. Sullivan
Chairman, President & Chief Executive Officer, Caleres, Inc.
A

Thanks, Laurent.

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.
A

Thanks, Laurent.

Operator: And your next question comes from Rick Patel.

Rick B. Patel
Analyst, Needham & Co. LLC
Q

Good afternoon, everyone, and I'll also add my congrats on the Vionic deal.

Diane M. Sullivan
Chairman, President & Chief Executive Officer, Caleres, Inc.
A

Thanks, Rick.

Rick B. Patel
Analyst, Needham & Co. LLC
Q

I have a question about the dilution there. So as we think about the next year and $10 million of non-cash amortization expense that'll continue going forward, can you help us think through the pathway for accretion? Ken, you just mentioned double-digit margins. Is that something – do you see accretion as something that can happen in 2019 or do you see that as an out-year event?

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.

A

No. We certainly are expecting accretion in 2019. When we look at their EBITDA margins, they were a strong double-digit. And we're going through the purchase accounting and so we'll have to get all the final valuation done around how we allocate that $360 million across their trademarks. Obviously, we know the working capital that came over and then the goodwill.

So what we're assuming is that the amortization is going to be roughly $10 million a year. And we'll continue to update you as we complete all of that work. And then just on the revolver borrowings, I mean, in round numbers, that's going to be roughly $10 million. And obviously as we pay that down over time, then that number will continue to come down. But we certainly are expecting to have EBITDA greater than the $20 million that we had laid out for interest and amortization. So we'll update our guidance for 2019 and provide more detail when we report for next year. But we are certainly expecting it to be accretive in the near term.

Rick B. Patel
Analyst, Needham & Co. LLC

Q

And a follow-up to Laurent's question, as we think about the potential for Vionic, what are you most excited about as you think about opportunities for growth, whether that's by channel or product category? And as that brand grows, how should we think about investments that might be needed that could affect its attractive margin profile?

Diane M. Sullivan
Chairman, President & Chief Executive Officer, Caleres, Inc.

A

Rick, it's Diane. There's a couple of places where we think there's significant growth opportunity. First of all, they really started off in 2007 and the key categories that they were really known for was primarily in sandals and it was really much more of a spring business.

The team has sort of filled out the lifestyle and the product category. There continues to be a lot of growth within the boot category, the categories outside of what they have historically done, dress, pumps, you name it. So within the lifestyle, there's more growth, and then even from a gender perspective, they've just really started to look at the men's business and assess what the opportunity ought to be there.

So it really is everything from category growth to gender growth to our channels of distribution. They are just really now getting into Nordstrom. They have had built a really profitable and sizable business with Dillard's and with QVC. Now they're moving into Nordstrom. We believe that that's going to be a significant opportunity.

We're really still underpenetrated on our e-commerce-related businesses there. We really think that we will have a lot of opportunity as it relates to that. And then you add to it internationally. We think there continues to be opportunity there. So there are multiple avenues and multiple paths.

And then in terms of investment, I think right now we feel that we have the infrastructure in place in order to help them continue to grow and develop their business.

As we move internationally, we'll have to think about – they do a lot of work today around having their shop in shops that they work with retail partners. It'll be a question of do we need to think about what other retail kind of concepts might we need. But again, I think we have a lot of runway of potential growth without adding a whole lot of expense to the equation at this time.

Rick B. Patel
Analyst, Needham & Co. LLC

Q

And just one last one on gross margins, if I may. As we think about e-commerce penetration in the fourth quarter, is it safe to assume that e-commerce penetration skews higher in 4Q than it does in other quarters? And if that is in fact true, should we expect even more pressure from shipping on gross margins in the fourth quarter than what we've seen year-to-date?

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.

A

Yeah. I think if you're referring to Famous Footwear, I think in consolidated, we were about a 60-basis-point reduction in margin both in the quarter and kind of year-to-date. And in the fourth quarter we would expect that the Famous margin is a little bit heavier due to the incremental shipping cost in the dot-com strength.

Rick B. Patel
Analyst, Needham & Co. LLC

Q

All right. Thanks, guys. All the best for holiday.

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.

A

Thanks, Rick.

Diane M. Sullivan
Chairman, President & Chief Executive Officer, Caleres, Inc.

A

Thanks, Rick. Same to you.

Operator: And your next question comes from Steve Marotta.

Steven L. Marotta
Analyst, C.L. King & Associates, Inc.

Q

Good evening, Diane, Ken, and Peggy.

Diane M. Sullivan
Chairman, President & Chief Executive Officer, Caleres, Inc.

A

Good evening, Steve.

Peggy Reilly Tharp
Vice President, Investor Relations, Caleres, Inc.

A

Hi.

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.

A

Hi, Steve.

Steven L. Marotta
Analyst, C.L. King & Associates, Inc.

Q

Question about guidance. The $0.15 reduction midpoint to midpoint, there's $0.05 of dilution directly from Vionic and related to Vionic. Is everything else the DC or how can we think about the pieces or the balance of that reduction?

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.

A

Yeah. That's the best way to think about it. I mean, basically we had identified through the first half that we were going to have an incremental of roughly $5 million of expense associated with duplicative cost. And as we've worked our way through the third and our expectations around the fourth, we think that all in that that's going to be incremental another $5 million to $6 million. So that total is really what is driving that reduction across the board.

Steven L. Marotta
Analyst, C.L. King & Associates, Inc.

Q

Okay. And as it pertains to the closing of this third-party facility which will eliminate those duplicative costs, if that comes before the full automation in the second half of 2019, is there any risk to [ph] interruption (34:10) of first half shipments? In other words, have you accelerated...

Diane M. Sullivan
Chairman, President & Chief Executive Officer, Caleres, Inc.

A

No.

Steven L. Marotta
Analyst, C.L. King & Associates, Inc.

Q

Okay, go ahead. I'm sorry.

Diane M. Sullivan
Chairman, President & Chief Executive Officer, Caleres, Inc.

A

Yeah. No, no, no. Well we actually automation will go in in the second quarter, late second quarter of next year. But we have the ability to service our customers with the existing facilities. So there should be – that's why we're waiting until the end of 2018 shipping, and then we will be transitioning our goods during that time period.

In fact, we already have a number of our brands targeting actually the goods that are coming in in January going to our new facility already. So our expectation is that we will complete 2018, be in our new facility as we move into 2019, and then continue with lease throughout 2019, getting more productivity out of each one of those facilities particularly as we put the automation in late second quarter of next year.

Steven L. Marotta
Analyst, C.L. King & Associates, Inc.

Q

Okay. And then can you comment at all about the pace of sales quarter – and you mentioned actually in the prepared remarks the pace of sales at Famous Footwear has increased quarter-to-date. Can you offer additional color?

Diane M. Sullivan
Chairman, President & Chief Executive Officer, Caleres, Inc.

A

Yeah. Yes. Sure. Here's what I'd say. Our month of October moved from – we were at really the low-single digits in August and September and then we basically almost doubled that going into October and that is now continued into November as well. So that was very important for us to make sure that we really had the tools in the tool kit to make sure that we could continue to drive our business that way. And I think we're feeling pretty good about the reaction that we've been seeing.

Steven L. Marotta
Analyst, C.L. King & Associates, Inc.

Q

Okay. One last question, your comment regarding boots in the quarter particularly at Famous. And in the channel checks that I've done there, it almost looks a little light. As far as replenishment goes, do you feel that the ability to replenish some of the faster-selling items that may have occurred as an upward surprise in November, can they be replenished by December so that missed sales are avoided?

Diane M. Sullivan
Chairman, President & Chief Executive Officer, Caleres, Inc.

A

Yes. We've been able to go back in and buy some additional goods on the brands and categories of boots that we really felt that were important and that's why we feel that we'll probably finish this year somewhere in the up mid-single digits on boots versus kind of where we had planned it which was really in the low-single digits. So, yes, they can get back in on some of the key items, and that's true certainly of our Brand Portfolio.

We went back in in late, I would say in August, late August and went – after we had seen some – what we thought was going to be some good early selling, we went back in and got additional inventory. So we, again, feel good that we can drive what has now proven to be a really strong category almost across every aspect, whether it's cold weather or tall shaft boots or booties, anything new there seems to be really working. So which will be great, Steve, because now we're talking again about getting to higher AURs which helps lift everything as well. So we're looking forward to that.

Steven L. Marotta
Analyst, C.L. King & Associates, Inc.

Q

Very helpful. Thank you.

Diane M. Sullivan
Chairman, President & Chief Executive Officer, Caleres, Inc.

A

Thanks, Steve.

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.

A

Thanks.

Operator: And your next question comes from Chris Svezia.

Christopher Svezia
Analyst, Wedbush Securities, Inc.

Q

Yeah, hi. Good afternoon.

Diane M. Sullivan
Chairman, President & Chief Executive Officer, Caleres, Inc.
A

Hi, Chris.

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.
A

Hey, Chris.

Christopher Svezia
Analyst, Wedbush Securities, Inc.
Q

Hey. So I just want to go back just to the third quarter for a moment. If I do this mathematically, if I look at Q3 and the extra distribution center cost at our [indiscernible] (37:59) facility, it's $4 million, it's roughly $0.07 give or take, and then there's $0.02 you said dilution related to the Vionic transaction. Do I have that math correct, roughly?

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.
A

That's correct. That's correct.

Christopher Svezia
Analyst, Wedbush Securities, Inc.
Q

Okay. And then fulfillment center cost in response to the prior question, you said that there's another – you've done $10 million so far, there's another $5 million to $6 million in Q4?

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.
A

No. The incremental expense year-over-year is $10 million in our Brand Portfolio. And so that's in total. And then what we were breaking out was how much of that was first half and then the rest was all in the second half.

Christopher Svezia
Analyst, Wedbush Securities, Inc.
Q

Okay. So how much do you have left in Q4 specifically?

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.
A

Well, we don't know specifically. That's part of the acceleration in order to exit that facility and move everything into our own facility. I mean, that's a bit of why we left the guidance range as wide as we did because we're working through our third-party provider to try to nail that down. But we believe we've more than accounted for what that could be in our $0.10 range.

Christopher Svezia
Analyst, Wedbush Securities, Inc.
Q

Okay. Got it. Okay. With regard to Famous, could you just maybe walk through the comp by months if you could just so I know how that unfolded?

Diane M. Sullivan
Chairman, President & Chief Executive Officer, Caleres, Inc.

A

Sure. August was a little over 2%. September was about 2.5% and October was about 4.5%.

Christopher Svezia
Analyst, Wedbush Securities, Inc.

Q

Okay. And could you maybe walk through the thought process behind getting more aggressive promotional, what you're doing, what you're seeing, why you felt you had to do it because it seems like most retailers – well, it seems like for the most part people are [ph] clean (40:14)? So I'm curious it was just a response to – for market share, if there was something you saw and just how do we think about it going forward?

Diane M. Sullivan
Chairman, President & Chief Executive Officer, Caleres, Inc.

A

Well, I think it was a couple of things. First of all, the market was a little more promotional and we wanted to make sure that we did enough test and learn in the third quarter that we could begin to really understand how we were going to be able to push and pull whatever levers we wanted to and understand the value of each one of those different promotions that we ran, so some of them were online, some of them were in-store only, some of them were across everything, some of them were only on certain brands or categories.

So it was really important for us to make sure that we did a number of new things to see how the consumer would react. And again I think we learned a lot, and for the most part, 80% of it, we probably, or 85%, somewhere in there do it all again and some things we've said, maybe we won't do that the next time. And it was also that for the first time in the second quarter, our comps were not up to where we would have really liked to see them. So it was certainly part of, let's get that kids business moving, let's get those comps moving, let's understand what else we can be doing. You can't continue to just do the same things. You got to keep moving. So that was really it, Chris. And we'll continue to apply that to this next fourth quarter and do what we need to do to continue to bring more consumers in and gain market share, but do it also very profitably as well. So it was really a learning.

Christopher Svezia
Analyst, Wedbush Securities, Inc.

Q

Are you going to try to do it with less degradation? You didn't break out what the merchandise margin was, but I'm sure it was down notably. But I'm just curious, are you willing to do that again in the fourth quarter and you take that consideration in the guidance?

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.

A

Yeah. We've considered everything in our guidance. And a lot of it was the very, very strong growth that we got in our dot-com business too. So, yes, so it's all considered in our guidance going forward. And I'd have to say we wouldn't really change a thing about what we did in the third quarter at Famous. We really think it was very appropriate and informative.

Christopher Svezia
Analyst, Wedbush Securities, Inc.

Q

Okay. On Vionic, can you just remind us the seasonality of that business? I would assume, does it make money in the fourth quarter? It seems more spring-weighted, summer-weighted business. Just any color about how we're thinking about that Q4 and seasonality.

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.

A

Yeah, it makes money. It's about a 55/45, I think, spring to fall. They've done a nice job kind of diversifying their seasonality, and I think a lot of that is – they've expanded their product line and they've brought in some men's business, they're doing some boots, they're not just a sandal business. So if I recall, it was like 55/45.

Diane M. Sullivan
Chairman, President & Chief Executive Officer, Caleres, Inc.

A

You got it right, yeah. That's exactly...

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.

A

And so it's – we will see operating earnings in our Q4 just it's going to get dwarfed by the amortization and the interest that's coming out associated with the transaction and the way we have to account for the trademark. So...

Christopher Svezia
Analyst, Wedbush Securities, Inc.

Q

Okay. Thanks very much. I appreciate it. All the best.

Diane M. Sullivan
Chairman, President & Chief Executive Officer, Caleres, Inc.

A

Thanks, Chris.

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.

A

Thank you.

Operator: Your next question comes from Sam Poser.

Q

Hi, guys. This is [ph] Will (44:11) on for Sam.

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.

A

Hi, Will.

Diane M. Sullivan
Chairman, President & Chief Executive Officer, Caleres, Inc.

A

Hey, Will.

Q

Hey, I just want to drill down a little bit into the Allen Edmonds business. Can you talk a little bit how that performed during the quarter?

Diane M. Sullivan
Chairman, President & Chief Executive Officer, Caleres, Inc.

A

Well, it had some really strong points and it was that we had some things that we have to work on. I don't know if you remember well, but we actually had in the third quarter decided to invest $3 million in new direct response TV campaigns to try to drive more consumers and more traffic to our sites and our stores because you know how promotional that the business had become, so it was really about trying to get more consumers to our stores and everything. And actually the good news about that was when we absolutely did that extremely well, the traffic was really high and particularly to our mobile site. But the key thing was that the conversion wasn't quite where we had expected it to be.

So the awareness, we improved our brand awareness, and all of that was fantastic. But I really think we're in the process right now of assessing whether or not that's something that we want to continue, whether or not we're just going to sort of bite the bullet and have to look at the promotional cadence of the business as we go into 2019. So we're in sort of a little bit of an assess phase. So good news, and then some things that we've really got to size up to what kind of investments we want to make going forward on that. So, more to come as we go into 2019.

Q

Got you. That's really helpful. And then I think you indicated on your last call you were launching some stuff, I guess, that goes with the marketing campaign that you guys have. How is the new product received at wholesale and in DTC?

Diane M. Sullivan
Chairman, President & Chief Executive Officer, Caleres, Inc.

A

Yeah, well, the wholesale business is a very small part of our little business today. So there's not enough new out there in wholesale. It's really more in our own stores and through our e-com. And actually the new product is doing nicely, particularly it's hard to even imagine that sneakers are now new to Allen Edmonds. But in the last 12 months they were those that sold very nicely.

We've improved some of the [indiscernible] (46:33) product. The consumer seems to really like that as well. And as we go into 2019 going to expand what we're doing around the casual portion of our line because we think that's going to be a very important part of how we're going to continue to have him add other styles to his Allen Edmonds wardrobe. So we will be doing more and more of that.

Q

Great. Thank you.

Operator: Thank you. Ms. Diane Sullivan, your closing comments, please.

Diane M. Sullivan
Chairman, President & Chief Executive Officer, Caleres, Inc.

Okay. Thank you, all, for joining us this afternoon, and we are looking forward to seeing many of you in a few weeks at market. And in the meantime have a very happy Thanksgiving.

Operator: Thank you. This does conclude today's conference call. You may now disconnect.