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Caleres, Inc. (CAL)

Q4 2018 Earnings Call

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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.

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

Rick B. Patel
Analyst, Needham & Co. LLC

Laura Champine
Analyst, Loop Capital Markets LLC

Christopher Svezia
Analyst, Wedbush Securities, Inc.

Samuel Poser
Equity Research Analyst, Susquehanna International Group, LLP

MANAGEMENT DISCUSSION SECTION

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

I'd now like to turn the call over to Peggy Reilly Tharp. Ma'am, you may begin.

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

Thank you. Good afternoon. I'm Peggy Reilly Tharp, Vice President of Investor Relations for Caleres, and I'd like to thank you for joining our fourth 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 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.

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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, and thanks everyone for joining us today. We have a lot to talk about, and I'd like to start by updating you on our strategic progress, Ken then going to take us through the 2018 financials, and I'll wrap up the call with our outlook for 2019.

2018 was another year of significant strategic progress for us. We continued to build on our strategies to move Caleres forward and to ensure the company can effectively compete and win in this new and changing consumer environment [ph] that via (00:01:56) our vision to be a powerful portfolio of footwear brands and the strategic underpinnings of what makes us Caleres absolutely remain relevant and unchanged. And a few of our most important accomplishments for 2018 include: first of all, with Brand Portfolio we delivered market share gains ahead of the market rate across our top women's brands, and it is worth calling out the performance of Sam Edelman as well as Naturalizer. Sam delivered his best year ever, expanding the brand's reach to even more consumers. The team delivered great product across a broader array of categories and wearing occasions and also deepened the brand's connection with consumers. Jay and the entire Brand Portfolio team and specifically the Naturalizer's team's disciplined development sequence and hard work over the past two years really paid off in 2018. The brand once again gained market share and delivered product that was true the brand, as well as relevant to the consumer.

Secondly, we acquired two new consumer brands: Vionic is a dual-gender brand based on proprietary technology with strong consumer loyalty and great upside for growth, and it does have the leadership to support it. And we also added Blowfish Malibu, a smaller and more specialized brand with a casual California lifestyle point of view. And I'm happy to report that with the addition of Vionic that Caleres now owns 6 of the top 25 women's brand in the footwear market.

Third, we continued to drive growth through our speed-to-market strategy and the teams are becoming more proficient in using these capabilities which is evident in our market share gains. A combination of great product and our ability to rapidly replenish key sales in season will remain an essential differentiator for us going forward.

Finally, we successfully completed the transition to our in-house distribution center. The decision to own these fulfillment capabilities positions us with significant agility to meet the rapidly changing needs of our customers. We moved quickly to accelerate this transition in the fourth quarter to ensure we started 2019 with the third-party facility clearly behind us, and we did just that. The new center is up and running, and we expect to complete the automation of this new facility in the first half of this year. These four areas together put Brand Portfolio in a position to deliver approximately half of total adjusted operating earnings for 2018, and you can certainly expect to see this share grow in the future.

Additionally, we continue to invest in and upgrade our digital capabilities across the enterprise, including preparations to launch a new e-commerce platform. This will benefit all of our brands, including Famous Footwear. And Famous Footwear delivered its seventh consecutive year of same store sales improvement in 2018, with comp sales up 1.5%. The team did a great job managing SG&A expense last year, and also they did their best to manage gross margin pressure despite the highly promotional marketplace and the continued growth of our e-comm business.

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In addition to the strategic accomplishments we achieved as a company, we also took further decisive action in the fourth quarter of 2018 so we could start fresh in 2019. Specifically for Allen Edmonds, we made the decision to reduce the level of promotional activity in 2019 in order to strengthen brand equity for the long term. We certainly had hoped that our proactive branding and direct response TV effort in the third quarter would provide a means to offset at least the promotional pressure.

When it became evident that this could not shoulder the entire burden, we made the decision to reduce the level of promotional activity and lower our 2019 sales expectations. Consequently, we were required to record a non-cash accounting impairment in the fourth quarter. This does not, in any way, reflect a change in our assessment of Allen Edmonds, its brand equity, or consumer appeal. We have already taken action around the cost structure and match production capacity to new business expectations. The good news is that we're already seeing positive results from these actions and are really encouraged for 2019.

I'll be back to provide some more details around our overall 2019 plans later in the call, but for now, I think I'd like to let Ken walk you through the financials in much greater detail.

Kenneth H. Hannah

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

Thank you, Diane, and good afternoon, everyone. For 2018, we reported adjusted earnings per share of $2.31 excluding dilution from the Vionic acquisition. As Diane discussed, we made a number of investments and took some decisive actions during the year to better position the company for 2019 and beyond.

We acquired Vionic and Blowfish, two great consumer brands. We completed the transition of two distribution centers. We moved Allen Edmonds to our Lebanon, Tennessee facility and transitioned to an in-house facility for Brand Portfolio to help us continue to meet increased direct-to-consumer demand. We made the decision to pull back the level of promotion occurring in the Allen Edmonds business going forward and, as a result, reduced our Port Washington manufacturing capacity and wrote down the trademark and goodwill accordingly.

Each of these actions and some others required adjustments, and our fiscal 2018 GAAP loss was $0.13 per share. We've provided additional details on page 6 and 7 of the slides available at caleres.com to try to clearly articulate the impacts. Let me also walk you through them briefly.

For Allen Edmonds, we recorded $2.03 for both the year and quarter related to the trademark and goodwill impairment and restructuring expense. For Vionic and Blowfish, we recorded $0.27 of transaction-related expense and inventory adjustment amortization for the year and $0.15 for the quarter. For our distribution center transitions, we recorded $0.08 of expense for both the year and the quarter. We also recorded $0.05 for the year and quarter associated with other brand exits and restructuring. And finally, we recorded a benefit of $0.09 for the year and $0.10 for the quarter, primarily reflecting new regulation's interpretations associated with the 2017 Tax Cuts and Jobs Act.

For the fourth quarter, adjusted earnings per share came in at $0.46 excluding the dilution from the Vionic acquisition. Including the items I just discussed, the reported net loss per share for the quarter was $1.83. As I mentioned earlier, we've outlined the specific adjustments and amounts for the year and the quarter on the slides available at caleres.com.

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Turning to the remainder of our income statement, consolidated sales for the full year of $2,834.8 million were up 1.8% versus 2017 on a 53-week basis. Sales were up 2.6% on a 52-week basis. And for the fourth quarter, sales of $720.3 million were up 2.5%.

For our Brand Portfolio, 2018 sales of $1.228 billion were up 7% year-over-year, driven by strong market share gains at our top women's brands. For the year, Vionic contributed $45.3 million. And in the fourth quarter, sales of $355.1 million were up 14.8% versus the prior year's fourth quarter.

At Famous Footwear, full year same-store sales were up 1.5%. Total sales at Famous Footwear for 2018 were $1,606.8 million. Fourth quarter same-store sales were up 1.1% and total sales for the quarter at Famous Footwear of $365.2 million were down as expected year-over-year as we operated 34 fewer doors in 2018, and additionally, last year's quarter included $19.7 million of revenue related to the 53rd week.

Now, let's turn to consolidated gross profit and margin which were impacted by our continued strength in e-commerce and growth in our overall Brand Portfolio. For the full year, consolidated gross profit was $1,156.3 million. Adjusted gross margin of 41.2% was down approximately 90 basis points when compared to 2017 excluding the acquisition-related inventory amortization and brand exits. For the fourth quarter, gross profit of $277.7 million included nearly $8 million of Blowfish and Vionic inventory adjustment amortization. Excluding these acquisition-related inventory amortization and brand exits, the adjusted gross margin of 39.9% declined approximately 180 basis points year-over-year.

Our Brand Portfolio full year adjusted gross margin of 38.9% was down approximately 20 basis points, reflecting the increased levels of promotion at Allen Edmonds. And for the fourth quarter, adjusted gross margin of 37.1% was down approximately 110 basis points.

For Famous Footwear, our 2018 gross margin of 43% was down approximately 125 basis points versus 2017, as growth in e-commerce sales was compounded by an increase in the promotional environment across the footwear space. Our gross margin of 42.7% was down approximately 190 basis points in the fourth quarter.

Before we get into expense, I would like to remind once again every one of the new pension accounting standard effective this year and the specific details are available in our release. Our SG&A expense for the full year was up less than 1% and represented 36.7% of sales, a reduction of nearly 45 basis points. We did a great job leveraging expenses at Famous Footwear as we drove a reduction in overall facility costs and benefited from the 2017 [ph] field (00:12:59) restructuring. For the fourth quarter, SG&A expense was flat at $267 million, including the addition of both Vionic and Blowfish, and represented 37.1% of sales, down nearly 90 basis points versus the prior year's fourth quarter.

Our depreciation and amortization for the full year of $62.7 million was down 2.1% versus the prior year. And in 2019, we expect to see approximately $10 million of amortization related to acquisitions. For the fourth quarter of 2018, our depreciation and amortization of $17.3 million was up 9.3% versus the same period in 2017, primarily due to the addition of trademark amortization related to our Vionic acquisition.

Our full year adjusted operating earnings were $127 million or 4.5% of sales. Our 2018 reported operating earnings were $401,000. And for the fourth quarter, adjusted operating earnings were $20.5 million or 2.8% of sales. Including the items discussed earlier, which are presented on slides 6 and 7, we reported an operating loss of $94.4 million.

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For our Brand Portfolio, adjusted operating earnings for the year were $78.7 million including acquisition expense, or 6.4% of sales. Reported operating earnings for both the full year and fourth quarter were negatively impacted primarily by the non-cash accounting impairment of Allen Edmonds. At Famous Footwear, adjusted operating margin for 2018 was 5.3% of sales and down approximately 35 basis points year-over-year. In the fourth quarter, adjusted operating margin was 1.7% of sales, down approximately 180 basis points.

Our net interest expense for the full year of $18.3 million was up $1 million year-over-year. For the fourth quarter, net interest expense of $6.8 million was up $2.7 million versus the fourth quarter of last year. The increases for both the quarter and the year were for Vionic as we used our revolving credit facility to finance the October acquisition of the brand. And in 2019, we expect interest expense of approximately $27 million.

Our tax rate for fiscal 2018 was 4.7% on a GAAP basis and 21.5% on an adjusted basis. In 2019, we expect to have an effective tax rate of between 23% and 24%. Our capital expenditures were $66.9 million for 2018, up nearly $16 million, reflecting our decision to bring our Brand Portfolio distribution center in-house. As Diane mentioned earlier, owning this capability will be a strategic advantage to us going forward, as it will allow us to cost-effectively beat the increased demand in direct-to-consumer fulfillment. This is one of the many investments we've made over the past several years to position us for future growth and to meet changing consumer demands.

We were also able to add new brands to the portfolio, thanks to the strength of our balance sheet. We ended the year with $30.2 million of cash and equivalents and outstanding borrowings under our revolving credit facility of $335 million at year-end due to the October acquisition of Vionic. Our consolidated inventory position at the end of the year was $683.2 million. For our Brand Portfolio, we saw an increase in inventory primarily related to the Vionic and Blowfish acquisitions, but also in part due to the earlier Chinese New Year and our decision to pull forward deliveries to be able to meet customer demands in early 2019.

At Famous Footwear, we ended the year with inventory up approximately 2% year-over-year. We ended 2018 with 992 Famous Footwear doors after opening 17 and closing 51 doors throughout the year. For our Brand Portfolio, we opened 7 doors in 2018 and closed 14, leaving us with 229 doors at year-end.

Our cash flow from operations from 2018 was $129.6 million and Famous Footwear delivered an improvement in operating cash flow of more than 10% for the year. Famous Footwear continues to be a solid and consistent contributor and enables us to continue to invest in and grow our overall business, and specifically, our Brand Portfolio.

In 2018, we returned more than $55 million to shareholders through dividends and our share repurchase program. We also maintained our financial flexibility and invested in our infrastructure. Our decision to start this year with a reduction in promotional activity at Allen Edmonds and to put the transition to our in-house distribution center behind us impacted our fourth quarter. However, we remain focused on our long-term performance and believe we are well positioned for 2019 and beyond.

And with that, I'd like to turn the call back over to Diane.

Diane M. Sullivan

Chairman, President & Chief Executive Officer, Caleres, Inc.

Thanks, Ken. And as we turn the page to 2019, our theme for this year is to starve our distractions and to feed our focus, and this has certainly been embraced across our entire organization. We know the market is expected to

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be dynamic once again this year, and we need to make sure that we leverage the investments we've already made and remain focused on superior execution and operational excellence to deliver against our expectations.

So, let's start with our 2019 expectations for the Brand Portfolio. Well, first of all, we will extend our winning results into the new year by intensifying our consumer focus and taking more actions to drive even more growth, and we have an array of internal and external resources to help us deliver a winning outcome again this year.

We will also drive investment in our digital capabilities in 2019 to help deliver even more insights into our consumers to drive higher sales. We're also going to be out first when it comes to product design, development and relevance. We will rapidly respond to emerging trends and season by maximizing our existing speed-to-market strategy. And finally, we're going to continue to drive share gains for our top women's brands.

Let me give you a couple of examples that we expect will help drive those continued gains. At Naturalizer, we have introduced 27 EDIT, a perfectly curated collection of signature premium styles and we're already seeing great consumer response. We also recently opened two Naturalizer flagship stores specifically designed with the consumer in mind and offering the ultimate brand experience. If you find yourself on 34th Street in New York between 5th and 6th or on State Street in Chicago, we'd obviously love to have you stop by.

Our Sam Edelman brand remains on a roll. The momentum in that brand is just exceptional. Sam's consistency and his team's consistency in brand messaging, an unwavering attention to detail and his authentic way of telling the brand story is really unmatched in the marketplace. For 2019, we'll continue to expand awareness and assortment for Sam's flagship brand and also expand our overall distribution by adding new doors for our Circus brand.

And at Vionic, we are working with a strong team already in place to build on the brand's existing energy, and the team is in the early phases of leveraging Caleres' sourcing to maximize product opportunities. So, that's a little bit of a sampling of what you could expect on the Brand Portfolio.

Now, let's turn to Famous Footwear where Molly and the team have assessed and tested and evaluated how best to continue to innovate and deliver consistent, sustainable growth once again in 2019. As Ken said, cash from Famous operations fueled investments across the entire company, and these funds are absolutely important to the continued long-term growth of Caleres. It's really impossible to capture all that's going on at Famous this year, but let me share a few of the most critical needle-movers for 2019.

First and most importantly, we are elevating our assortments to drive growth and give our consumers the iconic brands they love by deepening our relationships with all of our vendor partners. We're also looking forward to a return to positive growth for two of our top vendor partners. We're also going to drive an improved flow of new product this year and a related reduction in SKUs and an improvement in AURs.

We're also going to be deepening our relationship with our consumer, and today we introduce Phase 1 of a refreshed and rebranded rewards program called Famously YOU Rewards. Our new program realizes consumers want to be rewarded differently and feel valued, and Famously YOU Rewards embraces this and deepens our consumer connection.

And to further this connection and to reach our consumers no matter where they are, we are launching a new e-commerce platform designed around the consumer. When it comes to e-commerce, we have a longstanding legacy of leading and innovating, and we're not stopping. We are targeting strong digital growth, again, in 2019.

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And also, we added new leadership as part of the evolution of our marketing when Marci Grebstein joined us as Senior Vice President of Marketing last month.

We've also engaged in new branding agency exploring lots of [ph] newer (00:23:15) opportunities and we're focused on presenting a relevant message that resonates with consumers across all mediums. We're looking to differentiate Famous Footwear even further in the highly competitive marketplace, and you should expect to see many new approaches during this upcoming back-to-school season.

So, that's a little bit about what we're looking forward to in 2019 across our business. As I mentioned earlier, the entire company is operating with the understanding that we absolutely do need to starve our distractions and feed our focus. We must execute what's right in front of us and what we have committed to with excellence, and deliver adjusted earnings per share of between $2.45 and $2.55 this year.

As I said earlier in the call, our vision, which we've had now for quite some time, to be a powerful portfolio of footwear brands and the strategic underpinnings of what has made us Caleres remain relevant and unchanged. I remain convinced our direction is sound, and while we are proud of what we have accomplished as a team, there is no doubt about the fact that we are picking up both our pace and our focus in 2019.

And with that, I'd like to turn the call over to the operator for Q&A.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from the line of Laurent Vasilescu from Macquarie.

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

Q

Good afternoon, and thanks for taking my question. I wanted to follow up on the brand revenue guide to grow low to mid-teens for 2019. I think that would imply about $160 million of incremental revenues. I'm just trying to figure that number out because if we take Vionic, I think Vionic is about $180 million, [ph] now give or take (00:25:21) couple of months on the acquisition, and can you walk us through how much Allen Edmonds is expected to be down and then how big was the DVF license business to weigh on, on revenues?

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

A

Yeah. I think, overall, when we look at the Brand Portfolio, Laurent,

we're really trying to take into consideration [ph] – we've got – and add – it's not a (00:25:41) full year of Vionic. We had $45 million or so in the fourth quarter associated with that. And so, we've got the incremental there and then we're backing off Allen Edmonds. And what we tried to do to give them a little bit of room so that they weren't forced to continue to go chase sales is we kind of took their plan down about 20% to give them a little bit of room to try to continue to pull back on the level of promotion.

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

Q

Okay, very helpful.

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

A

[indiscernible] (00:26:12)...

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

A

Yeah.

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

A

...was pretty small.

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

A

Small.

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

Q

Okay. Thank you, guys. And then, I wanted to follow up on the building blocks to get to the midpoint of EPS guidance of $2.50 for FY 2019. Is it fair to say that Vionic, let's say, contributes $0.10, the reversal of the third-party logistics, I think you guys called out $0.08, and then the 1 million share count reduction in December [ph] 8-K, does that (00:26:38) equals about $0.07, so all-in that's $0.25, is that the right way to think about the building blocks, or was there anything else I'm missing?

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

A

That's a great question. And I appreciate your asking it, Laurent. So, not exactly. So, couple of things. Number one is, the share buyback that we had done was in lieu of actually paying the revolver down even further. So, when we were talking about the incremental accretion from Vionic, it was assuming that 40-some-odd-million-dollars we used to buy back shares, was going to be used to pay that revolver down. So, there's – that share repurchase, yes, is a benefit, but it's offset at least in 2019 by a little higher interest expense. So, I think we'd guided to to approximately $27 million. So, that's going to be up $4 million in the first quarter alone. So, it's not a direct add.

And then on the distribution center, the automation goes in in the middle of the year. And so, we don't get a full year of the complete benefit of that, we only get about a half a year. And so, you're a little bit high in terms of what you're adding back in terms of the distribution center.

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

Q

Okay, very helpful. Thank you. And then I think you've talked about two key strategic vendors at Famous for 2019 reengaging with them. I think Nike – your 10-K from the prior year said it was about 25% of sales at Famous Footwear. It looks like you're introducing new Nike style at Famous, any thoughts on just your overall Nike business for 2019?

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

Yeah. Yeah, Laurent, we're getting very encouraged with our Nike business as we kind of – spring seems to actually not only be here figuratively – or literally yesterday, but it seems to be back in the air again. And so right now, we've seen in the Nike trend continue to improve, which we're very happy to see. The sandal business is picking up its pace as we've seen it really across the landscape. So, we're little more encouraged about two of those [ph] top five (00:28:59) vendors actually really returning to growth which would be an amazing thing that would put us in an outstanding position for 2019.

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

Okay, great. And then maybe lastly, any commentary about just how the comps performed, like, by months, for the quarter, and any thoughts just – it sounds like you're encouraged because spring is finally here, but any thoughts at a high level?

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

Yeah. Well, obviously, I think you've heard it and everybody's talked about the difficulty in February with the weather. So, certainly some pressure there in the month of February. The first half of March was certainly – again, still pressure-related because of some weather issues. We have a later Easter which is out there as well, but we're again hopeful that as we look at the launch of our rewards program, we're also doing some marketing around our Naturalizer and Sam business in the latter part of the first quarter. So, we expect, like most people, we'll be looking at a March and April combination to really be able to assess the business well.

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

Okay. Thank you very much, and best of luck.

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

Thanks, Laurent.

Operator: And our next question is from the line of Steve Marotta from CLK & Associates.

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

Hello, Diane, Ken and Peggy. Congratulations on ending a nice 2018.

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

Thank you, Steve.

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

[ph] Thank you, Steve 00:30:24).

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

Q

Furthering the last question and putting a tiny bit finer point on it, I know you don't guide quarterly. But given the slower start to the quarter, given the increased interest expense, given the distribution center non-automation yet, is it possible that the first and second quarters are negative on EPS comparison and on a year-over-year basis?

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

A

Yeah, Steve. I think in Q1, just with what we talked about and it also goes a little bit to Laurent's question around just some of the new product. And so, we've got – right now our expectations are that we'll likely be flat to down in Q1 from an earnings per share. I mean, we're just about $4 million of incremental interest year-over-year just with the acquisition alone. And then, that starts to build as we go throughout the year. So, really only expecting the first quarter to be down and then the second quarter bounces back nicely.

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

Q

Very helpful. Just to put another finer point, on the Allen Edmonds repositioning, did that occur at the beginning of the fourth quarter and should we expect gross margin headwinds there for the next three quarters?

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

A

Yeah, good question. No, I mean, that was a tough call, quite honestly. Late third quarter last year as we were going into fourth quarter and we – we really almost, Steve, had tried every sort of way that we could figure out how to decrease that promotional cadence, bring more customers into the brand and the store, but ultimately, we're really forced to make that decision. So, I think we have really done a good job of making that decision quickly. We took very quick and bold decisive action through the fourth quarter to make sure that as we entered 2019, we really had the teams in the right position to be thinking about a business that was 15% to 20% less than the top – in top line where we were last year, and really allow them frankly to do the right thing and to build that brand for the long term. And again, it's early, but as we look at February and the first half of March already, we're feeling like things are going very much according to what we had hoped and expected, so don't really see the same kind of headwinds from a margin perspective that we had seen last year.

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

A

Steve, I think from a...

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

Q

I meant sales pressure, by the way, not margin pressure, but go ahead.

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

A

Yeah. Well, sales pressure, it's really going to be all the way through...

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

Q

Right.

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

A

...really throughout the year primarily. You'd probably see a little more in the front half than the back half just because of the way the promotional cadence falls.

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

A

Steve, I was going to just comment that it really is about sales. Unfortunately, what we wrote down was the trademark, which was really tied to the level of sales expectations and so it had nothing to do with profitability. This brand has been and will continue to be accretive to earnings. So, it really is about – the way that we originally accounted for the transaction, because the Allen Edmonds brand had been around for such a long time, we had to treat it as a long-lived asset. And so unlike Vionic that we've been talking about the amortization, the Allen Edmonds trademark valuation was put up when we bought the business, and then every year is non-amortizing, we have to evaluate and it's simply on a sales trajectory and do a present value back of that to validate the accounting that we'd put on the books.

And so, unfortunately, with the rise in interest rates, we were going to have to face into some level of write-down just because the rates are very different today and the present value of those sales were much lower than when we'd bought the business. So, that in a combination with kind of what we had seen in the overall level of promotional activity, we just figured it was a good time to go ahead and address it and set ourselves up to continue to invest and grow that brand. But the 2019 reduction in expectations had a pretty significant impact on the way we had valued the trademark.

A little different accounting with Vionic because it's only been around for four or five years, and so we're going to see $8 million to $10 million of amortization every year, so there's an effective write-down that's occurring naturally over time as you amortize the value of the Vionic trademark.

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

Q

That's very helpful. My last question is cash flow from operations. Ken, can you talk a little bit about that expectations for the current fiscal year and also the primary uses of cash? Will you be more aggressively paying down debt, or given where the stock is, that could be a different calculus?

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

A

Yeah. Well, hopefully with the outlook that we're going to see the stock move in a different direction. So, we're hoping to take the cash flow and continue to aggressively pay down the revolver. And so, if you look – I think our cash from operations this year was impacted by about $70 million just with the incremental inventory and the net out of the payables just where we brought in a bunch of inventory early because of the timing of Chinese New Year. So, we think we'll generate another $200 million of cash from operations in 2019 and then we will be aggressively paying down the outstanding borrowings.

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

Q

Very helpful. Thank you.

Operator: And our next question is from the line of Rick Patel from Needham & Company.

Rick B. Patel
Analyst, Needham & Co. LLC

Q

Thank you. Good afternoon, everyone, and appreciate you taking my question.

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

A

Hi, Rick.

Rick B. Patel
Analyst, Needham & Co. LLC

Q

Hi, Diane. I had a question [ph] of the follow-up (00:36:48) on Laurent's EPS walk-up earlier in the call.

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

A

Yeah.

Rick B. Patel
Analyst, Needham & Co. LLC

Q

So, it was our understanding that you incurred $10 million of duplicative expenses related to the DC that's worth about $0.18 to earnings I believe. Can you dig a little bit deeper as to why that benefit won't fully flow through this year? I guess just the incremental investments you might need to make, and is there anything to call out for how that flows through in the first half versus back half as we think about the timing?

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

A

Yeah. So, let me go back and I'll walk you through the duplicative

in the first half of the year where we were paying rent on the third-party facility and then we also had started moving product into our facility. So, at the time when we were looking at 2018, we were paying rent in both places. When we made the decision to accelerate the exit, we took on another 750,000 square foot so that we could go ahead and get everything out of the third party. The initial plan was to leave it there until everything was fully automated and up and running and then move the rest of it. And if you'll recall, in the third quarter, we were having some issues around the overall cost that we were seeing to operate out of the third party, so we made a decision to accelerate that action and bring all of that into 2018.

So, we now have incremental square footage that we needed to be able to eventually absorb and integrate all of the Vionic inventory into and hopefully at some point Vionic and our next acquisition. So, we're actually now with a larger footprint than we were at the beginning of last year when we were talking about those duplicative costs. So, that was in the context of paying rent for two different facilities, but we accelerated the exit and took on some

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incremental square footage. There was -happened to be a building that was available right on our campus, and so we were able to take that on and get everything into our facility.

Rick B. Patel
Analyst, Needham & Co. LLC

Q

It's very helpful. Can you also talk about the outlook for margins? I know there's a lot of moving pieces here, so curious to get your thoughts on the outlook for gross margins and SG&A as we think about it by the segments, Famous and Brand Portfolio?

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

A

Yeah. I think generally what I would tell you is that the outlook for Famous is that we expect that to be roughly flat over the course of the year. And that's really – the gains that they're seeing in their margins are being offset based on the growth of their e-commerce business. So, they're seeing good improvements in their gross margin on a product standpoint, but the sheer mix of the amount of growth that we're seeing there, it's bringing that margin down. And then, obviously, that's getting offset by lower expenses so that Famous Footwear can show a more profitable business.

On the Brand Portfolio, I think on balance – I mean, we're expecting that to be up, I think, roughly 100 basis points. So, we continue to see opportunities there to continue to refine our costing and our pricing and continue to work there to improve that. So, generally, that's kind of what we're expecting.

Rick B. Patel
Analyst, Needham & Co. LLC

Q

And one last one on Famous, if I may. Diane, you talked about the opportunity to reduce SKUs and improve AUR.

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

A

Yeah.

Rick B. Patel
Analyst, Needham & Co. LLC

Q

Can you give a little more color on how that will play out? I'm just curious, are you talking about the long-tail of brands that perhaps aren't as productive as you want them to be, or are there certain categories that you're looking to deemphasize?

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

A

Yeah, it's primarily, Rick, sort of the long-tail of SKUs more than it is the core vendors that we have. We've done a pretty decent job of building a really smart assortment around our biggest vendors. So, yes, we'll probably make sure we're deepening the SKU base there. We're actually going to make sure that we run that across more genders, so we think that there's – not unlike what you see in Vans, you'll see that across other categories, so we will – and brands, so we'll do it across men's, women's and kids, so there will be opportunities there.

But we think over a period of 12 to 18 months that there's an opportunity to really trim our SKU base somewhere in the 10% to 15% range and get a little bit more efficient about that. Every once in a while you – for some reason,

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it tends to expand a little more than you expect. And with the different kinds of testing that we want to do, we want to make sure that we keep all of that under control. So, we think it's probably 10% to 15% over the next 12 to 18 months, something like that, and staying pretty focused on that.

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

Thank you very much.

Operator: And our next question is from the line of Laura Champine from Loop Capital.

Laura Champine
Analyst, Loop Capital Markets LLC
Q

Hi. Thank you for taking my question. This is kind of a tricky one for Ken. Ken, it looks like your unallocated corporate expenses were way down year-on-year, what drove that change?

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

Well, most of that is going to be a reduction in the overall incentives. So, obviously, based on our initial guidance that we had provided and then we took down – so our -our payout of our incentive was lower this year compared to the prior. I mean, that's what most of it is. Little bit is tied to just the way that our mark-to-market works around our stock compensation. So, obviously, when the stock goes up, there's a little bit more of a charge and when it goes down, then there's a little less. So, those are really the two primary pieces of that.

Laura Champine
Analyst, Loop Capital Markets LLC
Q

Understood. Thank you.

Operator: And our next question is from the line of Chris Svezia from Wedbush.

Christopher Svezia
Analyst, Wedbush Securities, Inc.
Q

Hey, good afternoon, everyone.

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

Good afternoon.

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

[ph] Good afternoon, Chris (00:43:24)

Christopher Svezia
Analyst, Wedbush Securities, Inc.
Q

Hey. I guess first just step back Q4, the range was $0.42 to $0.52, you did $0.38. I'm just curious where – when you step back and look at the business, where things fell short, whether it was on the Brand Portfolio side, or on

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Edelman's, whether it was more aggressive promotions at Famous, just step back and walk through what fell short there in the quarter? [ph] We'll start there (00:43:51).

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

A

Yeah. So, I guess, I would start by separating – and let's go to the year that – we took the $2.30 to $2.40 and on an apples-to-apples basis, that came in at $2.31. So, the biggest change that drove us to the lower end of the range was really some additional pressure on the margin at Famous Footwear. And the distribution center, we did accelerate that and there was some – to not have to spend money to move goods. We actually accepted a little bit lower margin to move some products. So, that's really the biggest driver from that standpoint.

And then we had originally anticipated $0.05 of dilution from Vionic, and that number ended up being closer to $0.10. And a big piece of that was we made a decision when we saw the initial reaction after we purchased Vionic and we saw the stock dip down, we went in and rather than pay down the revolver by $40 million or $50 million, we went and bought back some stock. So, obviously, that had an impact on the dilution associated with the Vionic transaction. So, there's two pieces of that there. I think that's how I would separate them in terms of – $0.05 of it was clearly additional dilution on Vionic and then the rest was just we were at the lower end of the range on the – excluding Vionic expenses.

Christopher Svezia
Analyst, Wedbush Securities, Inc.

Q

So, this $0.08 for a transition, Allen Edmonds to Lebanon, Tennessee facility, et cetera, 3PL settlement. That's separate from the, call it, roughly $10 million to $11 million in distribution center additional costs that you were embedding in the guidance for 2018.

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

A

That's right. That $0.08 is tied to moving Allen Edmonds. And then when we did the final exit, then we actually entered into a settlement agreement with the third party to close all of that out. And so, what we have called out there is simply that settlement agreement to do the final exit.

Christopher Svezia
Analyst, Wedbush Securities, Inc.

Q

Okay. Okay. And just when you think about 2019 and [ph] anniversarying the distribution center (00:46:29) you've talked about a little bit earlier, basically what you're telling us is that you have another facility that you've opened up that you're using right now in addition to the facility that's going to be automated, thus the reason why you're still running, I guess, heightened costs, call it, in the first half. I guess, as we get into the back half of the year, the automation is in place, that cost then starts to moderate and we can see some of the kind of claw-back on that cost, is that how we should think about it?

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

A

Yeah. And I think the way we would look at it is, I think year-over-year we pick up roughly $0.05 of benefit associated with distribution generally. And that takes into consideration the fact that the automation doesn't go into effect until the back half of the year. And, obviously, we're receiving goods and shipping goods and everything there is working as planned. The automation is what significantly improves our throughput and the

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ability to serve the demands that we believe we're going to see going forward for our direct-to-consumer business, so our ability to continue to provide drop ship capabilities for our partners.

Christopher Svezia
Analyst, Wedbush Securities, Inc.

Q

Okay.

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

A

So, that's the mix of that. So, on an apples-to-apples basis year-over-year, you've got these cost improvements. The fact of the matter is, as we continue to ship more loose pairs – we talked I think in the last couple of calls – the cost per pair there on a manual basis is significantly higher than shipping out case packs. That's where the automation comes in and starts to offset the fact that the business is shifting to more and more of the loose-pair processing, which is a natural incremental expense coming through our SG&A because that's where all of our distribution and warehousing costs lie. I mean, that is different than some of the other companies out there that put it in cost of goods sold. So, it is a variable cost.

So, as we're growing our business and shipping more pairs, there is an incremental cost of distribution that's coming through. So, as a fixed cost, we're significantly eating into those duplicative costs we talked about. As a variable cost, the variable is on a more costly distribution model that will be addressed with the automation that comes in the middle of the year.

Christopher Svezia
Analyst, Wedbush Securities, Inc.

Q

Okay. Switching to Famous, kind of this low to mid-single digit comp, I would guess Q1 just sort of given the trajectory it's hard to say that's a flattish sort of scenario that would imply a pretty material acceleration in Q2, Q3, Q4. Am I thinking about that right and the confidence in that acceleration, if that's the case?

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

A

That would be correct.

Christopher Svezia
Analyst, Wedbush Securities, Inc.

Q

Okay. And the confidence in that?

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

A

I guess...

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

A

Yeah. I think we feel pretty good about the Famous business, Chris. And what we have planned as we move into second, third and fourth quarter – as I mentioned, there's lots of things that the teams have been working on. We really are elevating those assortments. We really believe that those top two – top three vendors and that we are expecting some return to growth if that's going to happen and the assortments that the teams have put in place.

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So, all of the indications are and our belief is that as we go through the course of the year, you will see our performance continue to improve.

Christopher Svezia
Analyst, Wedbush Securities, Inc.

Q

Okay. Final just thought processes, when you look at this guidance that you've given, $2.45, $2.55, I guess I'd step back and look at the past sort of two years or thereabouts, it's been kind of tough to hit the bogey. So, I guess what I'm saying is, how conservative do you think you're being in this outlook whereby you don't want to have to revise the outlook lower. I'm just curious how conservative or how aggressive you're being in this thought process.

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

A

I think we're being realistic in terms of what the challenges are and the changing landscape. I think we have done everything that strategically that we think is appropriate and right to position us really well for 2019. I would just maybe add to a little bit of what Ken was saying about the distribution center. All of that was – he articulated that well, but the fact that we actually opened those two centers [ph] move shoes, ship shoes, had a record year (00:51:19) on the Brand Portfolio, I think all of the work that was done in the fourth quarter of this year in particular to set ourselves up well for 2019 was really a, I'd say, Herculean work to make sure that as we turn the corner into 2019 that we had a very realistic set of assumptions and expectations. And we're very clear of – and every aspect and every corner of our business where we really think our attention needs to be, what we need to be focused on with very specific objectives and actions that need to be taken.

So, I feel like last year was a – lot of moving parts last year. You add them all up, there was a tremendous amount [indiscernible] (00:52:05) this year really much more – I guess a little bit more stable and our ability to, again, drive what we do so well, we do it so well, we drive with excellence our operations, and I really expect that we're going to see that this year.

Christopher Svezia
Analyst, Wedbush Securities, Inc.

Q

Okay. All the best. Thank you.

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

A

Thanks, Chris.

Operator: And our next question comes from the line of Samuel Poser from Susquehanna International Group.

Samuel Poser
Equity Research Analyst, Susquehanna International Group, LLP

Q

Good afternoon. Thanks for taking my questions. I've got a few, a couple of them are housekeeping. The new loyalty program with the free shipping, how do you work that in from a cost basis, how do you offset that cost of that shipping and so on?

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

A

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Yeah. Well, actually, we've done a lot of work around that one, Sam, as you can well imagine. And we have other programs that we've put in place that basically makes that a net neutral cost for us going forward in this year. And anything that – that's all reflected in the way that we've guided.

Samuel Poser
Equity Research Analyst, Susquehanna International Group, LLP

Q

Okay. And then, how – can you give me – you might have said this, the store openings and closings for next year and just re-walking through fourth quarter for the stores?

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

A

Sure.

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

A

Yeah. So, we're at Famous opening 15 and closing approximately 45, so a net 30 reduction.

Samuel Poser
Equity Research Analyst, Susquehanna International Group, LLP

Q

And then this year, this past year, I'm sorry I missed it when you said it.

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

A

Yeah. We ended up opening 17 and closed 51, so a net 34 reduction.

Samuel Poser
Equity Research Analyst, Susquehanna International Group, LLP

Q

Okay. And then lastly, in the quarter, could you – or, sorry, can you give us what the adjusted margin – gross margin by Famous and Brand Portfolio is for the fourth quarter or for the full year as a percent of sales and dollars for both gross margin and SG&A?

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

A

Yeah. For the fourth quarter [indiscernible] (00:54:25)?

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

A

Yeah. I'll go through and share, but the Schedule 5 that we've provided with the financials, we went in and did a by-segment kind of look where we showed the sales through earnings with the adjusted. So, the adjusted gross profit at Famous, it was 42.7%, so it was the same as the regular. And at the Brand Portfolio, it was 37.1% versus the reported gross profit of 34.3%.

Samuel Poser
Equity Research Analyst, Susquehanna International Group, LLP

Q

And then on the...

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

A

And that 37.1% compares to a 38.2% from the same period a year ago for the quarter.

Samuel Poser
Equity Research Analyst, Susquehanna International Group, LLP

Q

And then on the SG&A?

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

A

SG&A, the operating earnings from an adjusted standpoint for Brand Portfolio [ph] would have been (00:55:28) 5.4% compared to when you roll through the – the Allen Edmonds write-down was a negative obviously 26.7%.

Samuel Poser
Equity Research Analyst, Susquehanna International Group, LLP

Q

And then on Famous?

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

A

On Famous, it was only a tenth of a point difference, so 1.6% reported, 1.7% adjusted.

Samuel Poser
Equity Research Analyst, Susquehanna International Group, LLP

Q

1.6% or 1 point...

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

A

1.6%. Yes, 1.6%.

Samuel Poser
Equity Research Analyst, Susquehanna International Group, LLP

Q

I guess the question I have is, what is it that's going to accelerate the Famous comp without having to promote to drive the Famous comp this year?

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

A

Well, I think there's a couple of things that I maybe mention again. It's never a guarantee, Sam, as we know that. But we think there's a couple of things: First of all, we believe that this rewards program that we're re-launching and we're supporting with significant marketing, we have had a rewards program for 20 years, we [ph] hadn't (00:56:40) updated in quite a while. And we had a test – we tested it, we soft-launched it in February. So, we've got pretty good sense about what our expectations are for it and we really do expect it to help drive our sales. So, that would be number one, and obviously, our connection to the consumer, so – and build that 11 million customers that we have in the database today to more. So, we think that's number one.

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We've been growing our e-comm penetration nicely over the last couple of years, and we believe that will continue to help drive our top line. So, we think all the work that we're doing in that digital space and new e-com platform that we're going to be launching and you name it, we think that's going to make a heck of a lot of a difference.

Quite honestly, we think in the assortments and the areas there that – there was opportunities for improvement. We weren't doing all the things that we should have been doing. And as I've mentioned a couple of times now, two of our top five vendors were not growing last year. We expect them to turn those trends around and that looks like – that's certainly going to begin happening. We believe that in our women's assortment that there's more opportunity to bring more relevancy there. And I think Molly and [ph] Michelle and Mike (00:58:05) and the teams have all been doing the work they need to do to build and develop that business.

Our kids business had been generally underperforming. And the team has I think a compelling assortment and plan there. We're going to be driving AURs. We're going to be rationalizing SKUs. So, there's a lot of things that I think are frankly within our control that we're doing to change the trend of what we have. So, those would be some of the things that I feel confident about with respect to Famous.

Samuel Poser
Equity Research Analyst, Susquehanna International Group, LLP

Q

Thank you very much, and good luck for a great year.

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

A

Thanks, Sam.

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

A

Thanks.

Operator: And at this time, I'm showing that we have no further questions. Presenters, I turn the call back to you for any closing comments.

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

Thank you very much for joining us this afternoon. We look forward to seeing you over the next 60 or 90 days, and we'll be back at you late in May. Take care.

Operator: Ladies and gentlemen, we thank you for your participation today. You may now disconnect.

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