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GCO - Q4 2017 Genesco Inc Earnings Call

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CORPORATE PARTICIPANTS

Bob Dennis *Genesco Inc. - Chairman, President & CEO*

Mimi Vaughn *Genesco Inc. - SVP, Finance & CFO*

CONFERENCE CALL PARTICIPANTS

Jay Sole *Morgan Stanley - Analyst*

Pamela Quintilliano *SunTrust Robinson Humphrey - Analyst*

Jonathan Komp *Robert W. Baird & Company - Analyst*

Laurent Vasilescu *Macquarie Research - Analyst*

Mitch Kummetz *B. Riley & Co. - Analyst*

Sam Poser *Susquehanna Financial Group - Analyst*

Steve Marotta *CL King & Associates - Analyst*

Scott Krasik *Buckingham Research Group - Analyst*

PRESENTATION

Operator

Good day, everyone, and welcome to the Genesco fourth-quarter fiscal 2017 conference call. Just a reminder, today's call is being recorded.

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

Participants also expect to refer to certain adjusted financial measures during the call. All non-GAAP financial measures referred to in the prepared remarks are reconciled to their GAAP counterpart in the attachment to this morning's press release and in schedules available on the Company's homepage under investor relations.

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

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

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

Fiscal 2017 adjusted earnings per share were above last year's levels and exceeded our most recent guidance. Adjusted EPS improved to $4.33 versus $4.29 a year ago with flat comp for Q4 and a comp decrease of 1% for the year. Nonetheless, it was still a challenging year overall. The strong gross margin and operating recovery at Lids helped offset to some degree the impact of the significant fashion rotation that emerged at Journeys.

Year-over-year operating income was down, but EPS benefited from share repurchases we have made since the end of fiscal 2016 and a lower tax rate. Mimi will walk you through the numbers in a bit, but let me set the stage for where we think we sit right now. The multiple initiatives we undertook to improve Lids' profitability paid dividends throughout the year. This, along with the tailwind from the Cubs' first World Series win since 1908, drove stronger year-over-year results with a large pickup in Q4.

With inventories nearly right-sized, several new merchandising practices implemented, direct capabilities expanded, and a strong leadership team in place, we are poised to better reap the benefits of Lids' positioning as the leading omnichannel retailer of licensed sports merchandise. By improving operating income by about $25 million, we began the process of recapturing the operating margin we have given up in the last few years and will build on that success going forward. Congratulations to the Lids team on its terrific results.

Following two consecutive years of record sales and peak profitability, Journeys results in fiscal 2017 were challenged by the intense fashion rotation that began right as we hit back to school. As we said before, based on over three decades of managing teen fashion, we know that every two to four years the Journeys teen customer is ready for something different and embraces a new fashion direction.

While Journeys had to deftly manage this shift before through several cycles including grunge, urban, and skate, among others, the sharp turn this time was exacerbated by our unusually concentrated positions in a small number of brands. Journeys made good progress adjusting its assortment at the beginning of this year to better reflect current consumer demand, but until Journeys anniversaries the negative comps from last summer, we will continue to face some headwinds given the concentrated position from which we started and the sharp swings we saw our customers make. Simply put, the declining part of the assortment has to level off or at least slow its decline before the rapidly-growing part of the assortment can overtake it.

With this exceptional talent and decades of experience, we are confident the Journeys team is well-positioned to deliver stronger results as the year proceeds and continue its long record of success.

Across the Atlantic, Schuh ended fiscal 2017 with a very strong finish. Business pick up late in the year after a slow start due to a difficult UK retail environment for soft goods that had been aggravated by heightened competitive promotional activity. Schuh contributed to our solid fourth-quarter results as it enjoyed one of the strongest full-price selling periods in sometime, fueled by consumer demand for the latest must-have athletic products.

Nonetheless, Schuh's reported results for the year would've been stronger if not for the negative impact from the pound decline against the dollar, which became more pronounced following the Brexit vote in June. Operating income for the year was up 20% on a constant currency basis and congratulations to the Schuh team on these great results.

After eight consecutive quarters of comp sales gains, Johnston & Murphy witnessed a slowdown in customer traffic in Q4 that coincided with the run-up to the election and persisted throughout the fourth quarter. Even so, for the year, J&M once again added top- and bottom-line growth and expanded its leadership position in its segment of the market. And, finally, licensed brands had a challenging finish to a challenging year, reflecting the difficult retail trends experienced by its wholesale customer base.

Looking ahead, there are reasons to be positive about each of our major businesses in both the near and the long term and about the opportunity for multiyear margin recapture. Our strong strategic positioning, close connection with our customers, and enduring leadership positions of each business will allow us to weather the numerous challenges that are prevalent in the retail sector today. And I will outline this in more detail later in the call.

Fiscal 2018 is off to a sluggish start, which was expected with the IRS delaying close to $68 billion at its peak of income tax refunds compared with February a year ago. Journeys and Lids are impacted in particular by delays in tax refunds, making current visibility into our sales trends more limited. Comp trends improved significantly when the IRS started catching up and the refunds injected a higher level of spending into the economy.

However, like any scenario when sales are pushed out, there is a degree of uncertainty as to whether we will make it all up. And this, combined with our outlook that it will take a little longer to get to the other side of the Journeys fashion rotation, plus some uncertainty with the direction of the overall retail economy causes us to be cautious about the current year, particularly in the first quarter. And so given this, we are projecting adjusted earnings per share for fiscal 2018 to range between $4.40 and $4.55 with the majority of the earnings improvement coming in the back half.

With that, let me turn the call over to Mimi to go over the financials and guidance in greater detail.

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

Thanks, Bob. Good morning, everyone. As a reminder, we have posted more detailed information online, as usual, in our CFO commentary.

When we last updated guidance in early January, we said EPS for the year would be at least at the high end of our guidance range, which was $4, driven by better comps and gross margins at both Lids and Schuh and less negative comps at Journeys in December versus expectations. We left room in our updated guidance for additional markdowns to clean up inventory at Lids and Journeys in January and for year-end adjustments, like inventory reserve.

We came in at $4.33 as our markdown and other assumptions proved to be conservative and we benefited from a number of favorable items at year-end, like foreign exchange pickups and shipping rebates, which also contributed to the EPS beat.

For Q4, total sales decreased 5% to $883 million. Excluding Lids team sports sales from last year, total sales were down 2% for the quarter. This included flat consolidated comp sales and an 8% decrease in wholesale sales. The balance of the sales decrease was due primarily to foreign exchange, with the pound devaluing versus the dollar, but also due to the sale in December of the SureGrip business, which was a very small part of our total revenue and has previously been included in the wholesale sales number.

In Q4, positive comps for Lids and Schuh were offset by negative comps for Journeys and J&M. Going by division, at Lids, better full-priced selling during the holidays and from the Cubs' victory delivered a very strong 8% comp. Better full-priced selling and must-have athletic products drove 2% comps at Schuh. Comps at Journeys continued to be impacted by the fashion rotation and ended down 6%. Finally, at Johnston & Murphy, comps were down 1% with a drop in traffic that began with the election and didn't pick up again until after the holidays.

Consolidated store comps were down 2% and consolidated direct comps were up 12%, marking the fifth consecutive year that direct comps were up double digits in the fourth quarter, the most important one for the direct channel given the holiday selling opportunity.

Direct as a percent of total retail sales was 12% in Q4, up 90 basis points over last year. Comps for all our direct businesses were positive for the quarter, highlighting the strength of the direct and omnichannel capabilities we have been building over the years.

Last year in Q4, Lids' new Locate system, which gave online access to an additional 50,000-plus SKUs from inventory located only in stores, coupled with promotional sales from the inventory cleanup, drove a noteworthy 39% direct comp. Lifted by online holiday sales and boosted by the Cubs, Lids' direct comps were up double-digits for the quarter against this very challenging comparison.

Gross margin for Q4 improved 190 basis points to 47.3%, led by Lids and Schuh, where better results offset declines in Journeys. Gross margin for Lids improved almost 700 basis points, partly reflecting the sale of Lids team sports, which was a lower margin business. But the improvement in the retail business by itself was a very healthy 400 basis points, as Lids anniversaried its inventory rightsizing and a particularly intense level of clearance activity in last year's fourth quarter.

Schuh's gross margin improvement of 380 basis points was also significant as Schuh anniversaried very heavy promotional activity that resulted from last year's difficult holiday season. Schuh's business has also benefited from an expanded assortment and larger mix of children's products in standalone kid's stores and hybrid shoe and kid's stores on much larger XL kid's towers and in expanded departments within existing shoe stores, as Schuh builds on its initiative to grow the children's business.

Journey's gross margin decreased 190 basis points. Initial margins were a little lower, but most of the decline came from additional markdowns as Journeys worked diligently and successfully to keep inventory clean.

Total SG&A expense as a percent of sales increased 230 basis points to 39.7% for Q4. The sale of Lids Team Sports, which operated at a lower expense level than our retail businesses, drove some of this increase. With a flat comp, however, Journeys and J&M also deleveraged due to rent expense, higher credit card charges, and higher advertising spend to stimulate sales. Bonus expense at Lids and Schuh contributed to this deleverage as well.

One callout continues to be how effectively we manage selling salaries in our retail business, holding them flat as a percent of sales in Q4 in spite of the minimum wage pressure and overtime requirements we have been grappling with and the top-line weakness. Journeys managed selling salaries very aggressively and expenses came in a little better than last year, even with the negative comps.

ShopperTrak, which is our system for measuring store traffic and conversions, has been an extremely effective tool in efforts to manage staffing based on customer traffic.

Throughout this year we have been flagging increased credit card chargebacks in connection with the chip and signature fraud liability shift from issuing banks to retailers. In Q4, we rolled out new EMV technology in the highest-risk Journeys stores and are working on finishing the rollout for the rest of our retail stores in the first half of this year so that chargeback expense will be significantly less of a factor in fiscal 2018.

Lastly, the stronger US dollar against the pound created foreign-exchange headwinds for Schuh as the pound declined 17% year over year. Schuh's bottom line grew 32% in Q4 including the devaluation. In constant currency, it was up over 60%. Foreign exchange across all currencies in total cost us $0.15 in EPS for the full year.

Consolidated operating income came in better than expected in Q4, but was worse than last year as better results in Lids and Schuh were not enough to offset declines in Journeys, J&M, and licensed brands. Adjusted operating income decreased to $66.7 million from $74.4 million and adjusted operating margin decreased 40 basis points to 7.6%. We delivered fourth-quarter adjusted EPS of $2.15, which benefited from share repurchases, as well as a lower tax rate, and was higher than last year's $2.11.

Turning now to the balance sheet, in Q4 total inventory was up 6%, or $34 million, on a sales decrease of 2%. This increase at year-end was attributable primarily to Journeys and to Lids. Journeys' inventory was up, as anticipated, 10%, or $23 million, on a sales decrease of 3%. This was due to almost $40 million of new receipts in January.

In efforts to accelerate the fashion rotation by changing the merchandise offerings, Journeys brought in new spring product early. Inventory was down 4% at the end of December versus a year ago prior to the receipt of this new product. Moreover, Journeys took action in January to markdown and properly value existing inventory in order to be clean at year-end.

Lids' retail inventory was up 8%, or $12 million, on a sales increase of 5%. While Lids' inventory was higher than we had planned at year-end, carryover product from MLB and NFL playoff teams that were contenders for the championship more than accounted for this overage and will reduce our buys of the same product in this new year.

Capital expenditures for Q4 were $28 million and depreciation and amortization was $19 million. Finally, we repurchased no shares in Q4.

Turning now to guidance for fiscal 2018, we believe Journeys will comp positively once it anniversaries the start of the fashion rotation this summer and comps will strengthen for back to school and holiday with the easier comparison. In addition, we believe Lids will build on the momentum from its turnaround this year, but lapping the Cubs' victory in the fourth quarter will present a challenge to comps. Finally, Schuh will continue the solid trends that began in the back part of last year.

Our optimism is tempered, however, by the current lack of visibility due to tax refund delays and some uncertainty with the direction of the retail economy in general. Thus, we've made conservative assumptions for comps in the low single-digits for all of our businesses this year.

We anticipate total sales will grow in the 2% to 4% range, with consolidated comps, including direct, increasing 2% to 3%. We're planning on opening 101 new stores concentrated in Journeys Kidz and then spread out across the rest of our other concepts. We analyzed very carefully our recent store openings to see that they exceeded pro formas on average, giving us the confidence in our store opening program.

We also plan on closing over 100 stores as we prune our portfolio upon lease expirations for no net gain in stores once again this year.

We anticipate gross margins will be mostly flat in total for the Company, with pluses and minuses depending on business. Journeys' gross margin is expected to decline as we rotate into a product mix of lower gross margins. This will be offset by increases at Lids and Schuh. Continued improvement in Lids deploying earlier markdowns and a chase strategy will grow gross margin a bit, but the improvement will be substantially lower than last year, which largely saw the recovery from the inventory rightsizing.

That said, we are comping against extraordinarily clean inventory for Lids in the first quarter a year ago and we're a little heavier in inventory than we had planned this year, so there will be a higher level of markdowns pressuring gross margins in Q1. Schuh's margin will continue to improve due to mix.

So, with the low comp, we anticipate SG&A expense will delever a little, including rent, selling salaries due to continued minimum and living wage pressure and overtime requirements, and from investment spending that requires more than one fiscal year to pay off. While we pick up leverage from the Lids bonus, this was offset by bonuses in Journeys and corporate since we paid minimal bonuses last year. We expect the strong dollar will weigh down earnings by $0.03 per share, assuming exchange rates stay where they currently are, but given the uncertainty with Brexit, this could become more of a headwind.

In addition, the 53rd week adds about 120 basis points of sales, but since this occurs at the beginning of February without income tax refunds, it's a low sales period and we expect will be dilutive to EPS by a few cents per share. This results in an operating margin percent we believe will be close to last year's level and our fiscal tax rate is expected to be 35.6%.

Taking all of this into consideration, our earnings-per-share expectation for fiscal 2018 is a range of $4.40 to $4.55. Last year we earned 80% of our EPS in the back half and we believe it will be even more heavily weighted to the back half this year, given the trajectory of the Journeys recovery.

Importantly, while we don't give guidance by quarter, we expect earnings in the first quarter to be substantially less this year due to a negative comp in deleverage at Journeys, gross margin pressure at Lids and Journeys, and timing of an elevated level of spending at Lids to fund initiatives that payback later in the year and beyond, but hurts earnings in this smaller quarter of sales. We are planning capital expenditures in the $135 million to $145 million range, including a major investment in a planned expansion of the Journeys distribution center, which causes a more elevated level of CapEx this year than usual.

Depreciation and amortization is estimated at $77 million. Lastly, we're assuming average shares outstanding of 19.4 million for fiscal 2018. We have repurchased almost 140,000 shares for roughly $8 million at an average price of $59.49 per share as of the end of fiscal February. $32 million remained under the current $100 million repurchase authorization. This guidance assumes no additional stock buybacks, but we can use repurchase availability opportunistically going forward.

Now I will turn the call back over to Bob.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Thanks, Mimi. As I said earlier, there are reasons to be positive about each of our businesses in both the near and long term and the opportunity for multi-year margin expansion.

It has been some time since we talked about a long-term view, given our focus recently on fixing the challenges we face in various businesses. We believe this year will be sufficiently stable in Lids and Journeys to provide a solid baseline from which to build a new growth plan. And so we recently updated our five-year plan and so I would like to describe our approach and outlook as a result of this work.

I think it's helpful to remind everyone of Genesco's overarching strategy. We aim be in retail and branded businesses that first serve distinct segments of the consumer market and that, two, achieve leadership positions that are difficult for others to replicate. Serving targeted groups of consumers with retail formats that outposition competitors has historically allowed us to deliver superior return.

This forms the foundation of our five-year plan and is what we believe gives us a more defensible position in today's challenging retail environment. If we don't believe we can attain a leadership position in a business we operate, we will consider alternatives, as we did twice in the past two years, through the sale of two businesses at a gain in both instances.

We enjoy significant competitive advantages as a company. Lids has an incredible brand awareness, evidenced by the fact that over 25% of e-commerce searches at Lids.com, beginning with customers putting Lids.com directly into their browser. Lids is currently the only national standalone omnichannel retailer of licensed sports merchandise and is the clear leader in headwear. No other large retailer makes as deep a statement in the headwear category as we do.

Headwear business is one that has been historically, and still today, has four-wall contribution the high teens. A key tenet of the Lids Sports Group's five-year plan is to lead with headwear and build further on the strength we already have. We will continue to improve the Locker Room business, increasing the merchandising focus and exiting underperforming locations, but for now we will work within the existing footprint of stores to further refine the fan model.

Likewise, Journeys occupies a similar leadership position in teen fashion footwear. Our market research has told us that Journeys has a remarkable 75% brand awareness among teenagers. We own the mall for teen fashion footwear, where teenagers still like to shop and especially like to engage with our store associates to get trusted advice and recommendations.

Our most recent research following back to school last year confirmed that our customer uses a variety of sources to look for shoes, but usually start with a physical store. They continue to visit the mall one to four times a month; however, they are more likely than ever to shop both the Journeys store and the website, requiring Journeys to build robust capabilities for both. And the strong vendor relationship that Journeys' scale and experience provide are invaluable in accessing must-have product that is often allocated and are also critical for managing through the fashion cycles that are a fact of life in this market.

For over 30 years, Schuh has built a strong following among UK teens and young adults using a model similar to Journeys. Quoting some third-party independent footwear sector research, Schuh has established itself as one of the most popular destinations for footwear brands on the high street. Its multichannel proposition is light years ahead of footwear rivals.

This same research showed Schuh gaining market share over the last five years. It's advanced omnichannel capabilities, excellent customer service in stores and online, and more exclusive assortments is what separates Schuh from its competition. And its association with Journeys gives Schuh global scale in many of the vendor relationships they have in common.

Finally, Johnston & Murphy has leveraged its leadership position in the better men's dress shoe market to extend the brand into higher growth categories of footwear and apparel with great success. According to industry data, J&M was the number one bridge designer brand the year ended January 2017, growing share in department stores in both dress and casual by significantly outperforming the market in both categories.

J&M remains at the top of its game after more than 165 years in business. Its ability to understand its customers' fashion needs and to translate that into a product offering that resonates season after season is as strong as it has ever been.

Starting with these strategic strengths, our current five-year plan was constructed using a bottom-up approach by division, as is our usual practice. The plan includes specific initiatives to drive growth, expand margins, and evolve each division's strategic positioning.

Beginning with the top line, we are forecasting average annual growth in the neighborhood of 5% off our fiscal 2017 results, driven primarily by comp games including strong digital growth, combined with some targeted new store openings in concepts where there is still whitespace like Journeys Kidz. Compared with more recent plans, this one assumes much less square footage growth, and in the case of our more established concepts, actually has us paring back our brick-and-mortar footprint for roughly flat annual square footage growth overall.

With respect to comp assumptions, we anticipate that as Journeys emerges from the current fashion rotation it will at some point deliver another breakout year or years with higher-than-average comps to fulfill pent-up customer demand. We've seen this in the past following similar rotations and this is averaged into our plan. Including this uptick, we assume low single-digit positive consolidated comps on average each year across all our concepts in the next five years, led by double-digit digital growth.

For reasons we have discussed at length in prior earnings calls, both Lids and Journeys recently had five-year operating margin low points. Both businesses have achieved double-digit operating margins in the recent past. Given their strong strategic positions, we believe we can get back closer to these levels over time and, as a result, the plan has more bottom than top-line growth.

Based on where we ended fiscal 2017, we expect operating income to grow at a faster pace than revenue in the range of 10% an average annually, as we move toward an overall 7% operating margin. This outlook for operating margin expansion would be better if it weren't for the dilutive investment in digital as we do the important work of continuing building our omnichannel platform, which hinders us from hitting the higher levels of operating margins we have achieved in the past. Once we have completed this transition, achieved scale in digital, and right-sized our store network, we believe there could be upside for operating margins beyond this.

The plan I just described generates significant cash flow in the range of $400 million to $500 million after increases in working capital and capital expenditures. This cash flow will either be used to make acquisitions, for which we have a solid track record of success, if the market allows for valuation levels that can achieve desired returns or else return money to shareholders likely through additional stock repurchases. Our history shows we will not sit on a substantial cash position for very long.

Turning to fiscal 2018, while each business has its own specific growth drivers, there are four major initiatives spanning all divisions that I will touch on briefly.

First, building out omnichannel and digital capabilities. These initiatives are not just e-commerce-specific, but are targeted at facilitating interaction across the channel. Buy online, pickup in-store is one to highlight. We have had this capability for some time at Schuh, which drives a fair amount of our web purchases and, importantly, gets customers into our stores where we have been successful in encouraging add-on purchases.

Rolling out this offering is a key focus of Journeys and Johnston & Murphy in fiscal 2018. We will also invest in targeted digital advertising campaigns aimed at driving traffic to our sites and our stores and increasing conversion. Our focus will be on the continuous enhancement of the mobile and website experiences for of our customers as well.

Second, increasing our use of social media to strengthen the equity of our retail brand and increasing our follower tip. For example, reaching influencers in our current Journeys catalog will leverage their social circles to build awareness of the Journeys brand. Tapping into bloggers to highlight the Johnston & Murphy brand and its product offering, and increasing the frequency of our social media voice to add followers across the major social channels: Instagram, twitter, YouTube, among others.

We will also be focusing on initiatives aimed at strengthening customer relationships such as launching a revised Loyalty Club at Lids.

Third, enhancing our in-store experience. One example is the brand breakout strategy at Journeys, an integrated initiative to highlight a specific brand that touches the catalog, social media, and email campaigns and is supported by in-store merchandising, product education for store employees, and significant vendor support.

Another is the customization initiative at Lids directed at increasing customer awareness of embroidery and personalization, drawing attention to this interactive in-store offering.

Then, finally, reducing our real estate risk. We carefully evaluate each lease that comes up for renewal, shortening lease life where it makes sense -- in C malls in particular -- and managing capital spend to match lease renewals. In general, we keep stores open when the landlord agrees to a rent deal in which we can make decent profit, but we are managing that risk carefully.

For example, the average lease life for Lids store renewals in C malls last year was one to two years, while the average in A malls was six. Again, in the plan, square footage growth is largely flat, but should more malls close, which is a real possibility, our square footage would decline. And we are well-prepared for that possibility.

In closing, this five-year plan, to a greater extent than many of our previous ones, reflects a challenging environment characterized by modest GDP growth, consumer behavior tilting away from the mall, and continuing pressure from e-commerce pure-plays that live by a different set of performance metrics than we are measured by. In an environment like this, the strategic leadership of our businesses in their respective markets is clearly more important than ever. So, too, is our focus on excellence and execution and our commitment to diligent management with rigorous financial discipline.

And of course, all of this highlights our greatest asset, an experienced, committed, and highly able team of people who consistently make the most of our strategic strength by the way they perform their job. So I want to conclude by thanking all of them, once again, for their efforts this past year and for what they will contribute to Genesco's success in this new year and beyond.

We will be on the road over the next several months to provide more color and detail on the five-year plan. And thank you for joining us on the call today.

Now, operator, we are ready to take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Jay Sole, Morgan Stanley.

Jay Sole - *Morgan Stanley - Analyst*

Great, thank you. Bob, thank you so much for the detail on the five-year plan. Wanted to ask you about your EBIT margin guidance for the five-year plan of 7%. Can you talk about the timeframe to get to the 7%? Is it back-half weighted? Is it kind of in the beginning of the five-year plan? Thank you.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

It's a gradual increase, but obviously the first year in the plan we are looking at a 10% increase and we're guiding to 5%. So it's going to be choppy along the way. Obviously what we have said about Journeys in particular is that we would expect somewhere along the line a little bit of a break out, which is what we typically see after they come through a fashion cycle, but we are not predicting that breakout to be this year.

So it will be a little choppy and so we're up -- the guidance is up 5% and we will make some of that up in future years wherever the breakout event occurs. So that's the general theme in terms of the timing.

The other thing to comment on while we are on the 7% is we've drafted plans in the past that have contemplated reaching 8%or 9%. Right now we contemplate reaching 7% for a couple of reasons. One, we do this plan bottoms-up, very simply, and so the math when you sum up the plans of the operations. But, second, within these plans the headwinds from the past -- we are very mindful that the headwinds are a little stronger than in the past, primarily due to e-comm taking share from stores and then a little bit of pressure on labor.

And then with respect to the e-comm point, as our comps are stronger on the digital side where costs are more variable, then we have the fixed cost base of the stores deleveraging as they don't grow as much. So even though we are derisking our real estate portfolio with short lease terms and we are making smart store-by-store decisions, despite all that, the leverage equation swings a little bit against us.

If we had a major number of lesser malls actually close over this five-year period, then we believe traffic flow into our remaining stores would drive comp and actually give us more expense leverage. But, unfortunately, poorly performing malls die slowly, so we haven't actually weaved that into the plan.

And then, finally, we're coming off a couple years of subpar performance. We've been in the neighborhood of 5% this year, so we think getting back to 7% feels like an appropriate goal before we stretch for more. So there's more color on just how we are thinking about the margin equation today.

Operator

Pamela Quintilliano, SunTrust.

Pamela Quintilliano - *SunTrust Robinson Humphrey - Analyst*

Congratulations, guys, and thanks for all the detail you provided.

If you could give some more commentary possibly on what's going on at Journeys with the fashion rotation, how do you feel about the recent allocations of some of that newer exciting product? You mentioned $40 million in new receipts arriving in January. Just any insight into how the customer is responding to that.

And then along the lines of the Journeys customer, there's a lot of fear out there regarding mall traffic. You've touched upon it with your cautious outlook, but it seems like you have fared well relative to others. I can't remember if you have traffic counters or not, but any insight into how you are doing relative to others in the mall, traffic wise, would be really appreciated. Along with when you get the customer in the store if the conversion is higher because they are already looking online and when they come there's more of an intent to buy.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

I'll take your questions in reverse order. The customer -- we do have counters; we have seen traffic going down and, until we hit the fashion rotation, we were seeing higher conversion. That's what a lot of people have been calling out: people arrive at the mall with greater purpose.

That's the trend, but the overall reality of teenagers is that, as we cited in the script, the research says they still really like to start in the store. Now maybe a little less than last year and so the traffic trend is down, but we start at a stronger base.

The teenager likes the advice that they get from our store people. They like the social experience of being out in the mall. I have two teenagers; I can attest to that. So we feel like Journeys is well-positioned.

In terms of the fashion rotation, Pam, the product that we cited as being important in the back half of last year as we watch the fashion rotate, those are as strong as we had expected and we have gotten a great allocation and a great assortment.

Where we started, though, was with a very concentrated and narrow key position and we called that out over several years as a performance driver. It was a big advantage at the time. It allowed us to give great in-store service with in-stock position and we got great sellthrough to margin.

So what we are seeing right now is that we've increased the depth and breadth of what product the customer really wants right now, so those new styles and brands that everyone has been waiting for. And those customers are still after it and the uptick on those brands is very strong. But the decline of some of the brands and styles that have been out of favor are falling a little harder than we had expected.

So given all of that and then add in the lack of visibility because of taxes and Easter, we're going to have much more visibility on all of this when we get through the month of April. If you think about it, we have a really significant brand in our assortment that was very important; those brands never go away, they just slow down. And as concentrated as we were, the pace at which they slow down is a big factor in what will drive our comp.

They are slowing down a little more than we had expected and that's what is driving the caution. We are not cautious because the new stuff isn't performing. The new stuff is performing extremely well.

Mimi, anything you want to add?

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

Just to pick up where Bob left off talking about this year and the impact of tax refunds, I'm going to start first with Journeys. As you would expect, given the great gap in tax refunds, traffic was down for us and for everybody else in the mall in the early part of February. Once we see tax refunds coming back into the economy, it's just injected and a surge of traffic comes into the malls, which we saw in Journeys.

In Journeys, we have the products that customers want now and so we actually saw with the increase in traffic a pickup in conversion. The conversion was still positive for Journeys, even with lower traffic, so that customer who is coming to the mall has a great intent to buy and to purchase.

For Lids, even though traffic was down in the early part of February, our conversion was up consistently in every week of February. Again, demonstrating the fact that if you have the product that customers want, they come with the intent to buy. They are more educated because they do their shopping online and the conversion, as a result, ends up increasing.

So for Lids, where we had a really good in-stock position, we had higher conversions with drop-offs in traffic. And then once traffic increased, we actually saw continued conversion and so that ends up with pretty good results for Lids in the month.

Operator

Jonathan Komp, Robert W. Baird & Company.

Jonathan Komp - *Robert W. Baird & Company - Analyst*

Thanks, I wanted to clarify one question first and then my actual question. But, Bob, just on the long-term guidance, I'm a little confused. It sounds like you are assuming at some point a rebound year for Journeys, but I am just wondering did you say in total you are expecting or embedding kind of low single-digit total comps to drive margin expansion in that horizon?

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Yes, we're putting in comps of overall low single-digits. Now, we are also managing the store portfolio, so what's going on inside of that is the net square footage growth is pretty flat, but within that is a rotation of getting out of stores that are significantly unproductive. And the things that we are opening obviously we are assuming are productive.

So there's a rotation of getting into more productive space which actually -- it doesn't necessarily show up in comps. Because if I close a $300,000 store and I open a $600,000 store I have picked up sales, but I haven't really -- it doesn't show up in comps. So that kind of explains it.

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

Just to elaborate on that, if you go back and you see the last time, when we came out of the Great Recession and the downturn, of course we had muted comps. And given our high fixed expense in our stores, we need to have breakout comp years in order to really drive gross margin.

So going back four or five years, if you look we had high single-digit comps; we actually had double-digit comps in one year. Those are the years that end up really having us pick up operating income margin. We can't predict exactly when that's going to happen for Journeys, but we know it will happen during that five-year timeframe, so we have averaged in the numbers. We haven't picked one year to say this is the year it's going to happen, so that's really the averaging affect that Bob is talking about.

Jonathan Komp - *Robert W. Baird & Company - Analyst*

Okay, and maybe -- I'm just trying to clarify. I know you're projecting 2% to 3% comps for this year and not really expecting operating margin expansion. I know there's a lot of moving parts, but I'm just trying to maybe reconcile. Maybe it's not averaging that big pickup or some of the additional productivity, but anything else this year that's preventing the operating leverage?

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

I think you have to think in this year about the fact that Journeys is still coming through the rotation. We're expecting a negative comp in the first quarter for Journeys and, again, until we anniversary the negative comps that began last summer we will continue to face headwinds. So that's one factor that has an impact on this year.

The second factor is the Cubs' victory in the fourth quarter last year. And so we had an 8% comp that we are going against in this year and so we are expecting a lower level of comps. We have got to be in about that 3% range to be able to get leverage. And so when you think over time we believe that we will be able to gain leverage over time; we will have that breakout comp. It isn't this year that we are anticipating that we are going to have that breakout.

Operator

Laurent Vasilescu, Macquarie.

Laurent Vasilescu - *Macquarie Research - Analyst*

Good morning and thank you for all the color on the five-year plan. I wanted to ask about the omnichannel initiatives. Can you talk about the current operating margin differential between bricks and mortar and online? And where do you think those percentages go over time?

And then, secondly, more near-term question. On the quarterly guidance I think in the prepared remarks you mentioned that 1Q guidance -- 1Q earnings will be down. I understand there is no explicit quarterly guidance, but should we think about 1Q EPS with a four handle or a five handle? Any color on that would be great, thank you.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

When you talk about an operating margin differential between stores and online, we obviously don't -- we share a lot of stuff. The merchants are buying for both; systems group supports both. We don't explicitly allocate all of our overhead all the way down, so then you would have to think about it on a four-wall basis.

On a four-wall basis, you have to go business by business, but basically the e-comm business, in aggregate, operates sort of like a score. Mimi could get into the differences.

But I think the more important part is not necessarily what their operating margin is, but what is the incremental margin on a sale. And that's kind of what I was referencing when I say that we don't quite get to the margin we need. Because the incremental margin on a sale -- if I take one pair of shoes out of Journeys and, rather than sell it in a store, I sell that one pair online so I could basically get a share shift within our business, that's actually slightly dilutive because there are more variable expenses in the e-comm business than there is in the store business.

If you think about it, the store business has a fixed cost. Most labor -- on an incremental basis, labor is fixed, rent is fixed, so you get really -- you recapture most of that gross margin. In the e-comm channel you have a discrete picking expense and you have a discrete shipping expense, and at this point we are spending -- I don't know, 70% or 80% of our orders are going free shipping with the thresholds that we have in place.

And so the reference I was making about what's going on in omnichannel is that as we see the share shift that dilutive impact is in play. We are mindful of the balance we strike between chasing share, but making sure that we operate in a profitable manner for current earnings. And that's just the balancing act that we are running every day.

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

Or as far as first-quarter guidance, just want to remind you that we had a really good first quarter in this year and we had some improvements, a lot of improvement within Lids. We expect quite a bit of pressure on the first quarter this year and that earnings are going to be substantially less than the $0.62 that we had last year.

There are three or four factors that are driving that: it is gross margin pressure in Lids and Journeys; it is deleverage because of the negative comp in Journeys for the quarter. In Lids, we are doing a little bit more clearance activity -- actually a lot more clearance activity than we did last year in last year's first quarter and so the pressures overall on earnings in the first quarter are going to be several.

Operator

Mitch Kummetz, B. Riley.

Mitch Kummetz - *B. Riley & Co. - Analyst*

Thanks. I guess I've got one question on the guidance and one question on the five-year plan. I don't know if that's one question but --

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Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

It's not; it's two, but go ahead.

Mitch Kummetz - *B. Riley & Co. - Analyst*

Well, yeah, 1 A and B. I guess on the guide I'm a little surprised that you aren't being a little more cautious on the Lids comp in the back half, just given the positive impact of the Cubs. Is there any way to kind of quantify how much the Cubs helped your comp in the back half?

My recollection is that those comps came in way better than what the guide was before the Cubs won, so I don't know how much of that upside was Cubs versus maybe something else. And if there is a something else, maybe you could talk about that.

And then on the five-year plan, just want to bridge the gap between the 5% sales growth and the 10% EBIT growth. How much of that is gross margin versus SG&A and what are the key drivers of both?

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

On the Cubs, look, we are expecting a challenging comp in Q4 for Lids, but keep in mind there's a lot of other things, first of all, going on in Q4. Q4 is as much -- keep in mind, it's as much an NFL business as it is an MLB business, MLB in November. The October classic in November that's the way sports goes now, and March Madness goes into April. But we have a big NFL business and so it gets a little bit mitigated by that, so it's a third quarter and a fourth quarter event.

Also, just be mindful of a couple other things. First of all, the Cubs are -- we are going to go into baseball with the Cubs as a very hot item. You do get a really good after-tick on a championship like that when you start the next season.

Secondly, we did look at the Cubs and tried to get an assessment of how much it diluted sales of other things, but we had dents in sales of other teams and leagues that basically got crowded out by the Cubs' success. The best example of that was, based on their record, you would've expected at that point in time big uptick in Blackhawks and we were actually significantly down in Blackhawks.

The other thing to keep in mind in the fourth quarter is neither the run up -- the Super Bowl and the college football championships, neither of those were very special for us. So our business is a blend of a lot of things and, yes, we are going to have the headwind of the Cubs -- I don't mean to say it doesn't matter; it will matter -- but there's a lot of other things going on in the business and we've modeled it with all of that.

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

Then, Mitch, just to answer your question, I think it overlaps a bit with Jon's question. When you think about the point at which we get leverage, it really isn't about that 3% range. This year comp guidance is the 2% to 3% range, but in the five-year plan we expect higher than 3% comp.

Overall we said that top-line sales growth would be 5%. My much of that growth will come from comp, so you can assume a comp in the neighborhood above 3%. And so with that greater than 3% comp we get operating leverage.

When you think about we are in the 5% range of operating income and growing to 7%, we are expecting some gross margin expansion. That gross margin expansion is going to come primarily in Lids and Schuh, but also a little bit in Journeys. We're going into a product mix that has a lower gross margin than the product mix we had before, but we expect that's going to average out over time for Journeys.

And that 200 basis point pickup, when you think about how much do we get for margin, how much do we get from SG&A, it's a little bit more pickup in SG&A than it is in gross margin, but equally split between those two over the five-year period.

Operator

Sam Poser, Susquehanna.

Sam Poser - *Susquehanna Financial Group - Analyst*

Good morning. Thank you for taking my question. I just want to get more details on the value of week 53 and why you think it's dilutive. You said 120 basis points. Is that over and above Q4 of this year? Dollars?

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Sorry, Sam. Say that again.

Sam Poser - *Susquehanna Financial Group - Analyst*

I think that maybe you mentioned that it was 120 basis points of revenue.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

On the week 53?

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

Yes.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Yes.

Sam Poser - *Susquehanna Financial Group - Analyst*

Is that about $14 million, if my math is right?

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

It's a lower week than usual, if you take the average across our weeks. But, Sam, think about February. We're a high fixed expense business and so we've got a lot of expenses during that week and we don't have enough sales to have that week be positive for us.

With the change in the tax refund schedule, there is really -- it's pretty hard to gain leverage over our expenses then, so it's not a positive week that we add on in week 53.

Operator

Erinn Murphy, Piper Jaffray.

Unidentified Participant

This is Eric on for Erinn today. Thanks for taking my question. I just had a quick one. It looks like you guys have been doing a really good job managing wages and optimizing that. I'm just curious what innings are we in there and how much room do you guys have to go on that front in getting better as you go forward.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

It's a good question. We have deployed traffic counters across all of our concepts at this point and that has given us great visibility in how we need to staff to match up against the actual traffic. And that has allowed us, in many cases to get some benefit. First, just by obviously putting staff against the most productive hours of the week can give us some uptick in sales, everything else equal.

And then particularly in Lids, given the pattern that we've seen, we've gone to more part-time and more part-time is less expensive labor for us. But in terms of what inning, we still think we are improving our ability to staff against the traffic, but we probably have picked the low-hanging fruit. So when we look at going out we are not expecting that we duck the pressure of the future minimum wage pressures with that same kind of reaction. We have taken that bit of fruit off the tree so we will be exposed to that down the road.

Mimi, anything you want to add to that?

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

I think that's right. I think we've done about as much as we can shifting full-time to part-time and now it's just trying to optimize based on traffic.

Operator

Steve Marotta, CL King and Associates.

Steve Marotta - *CL King & Associates - Analyst*

Good morning, Bob and Mimi. I have two questions. The first is -- and please forgive me if I missed this on the five-year plan -- did you offer an EPS growth rate? Are there --?

I know that you said you would build -- you would generate significant cash over the period of time. That could be acquisitions or buybacks. Are either of those included within whatever EPS growth rate you are going to give me and what would you expect it to be?

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

Steve, we didn't give a specific EPS growth rate. We more just talked about the growth rate of earnings. I think that the buyback of stock will be really dependent on whether we can find additional acquisition opportunities.

We have been locked out of the market recently just because valuation levels have been so high. So I think you can take that operating income improvement and assume we will either buyback some stock or we will have an accretive acquisition over that timeframe.

Operator

Scott Krasik, Buckingham Research.

Scott Krasik - *Buckingham Research Group - Analyst*

Thanks, I'm going to try to sneak a few in. Just in terms of your guidance, when you incorporate the inflection in Journeys, how are you expecting the trends for the styles that have been negative? Do you expect those to flatten out?

Then on the CapEx plan, how much is for the Journeys DC and does any of that flow into fiscal 2019? Then just this credit chargeback issue. I had never heard about that so I'm just wondering how material that is and how that benefits you. Thanks so much.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Yes, I'll handle it. On the Journeys side, yes, we are expecting the brands that were the lead brands in the store to moderate their decline.

Our history -- brands just never go away or rarely go away in Journeys. They usually still have a presence. And don't think that these brands are sitting still and not figuring out how to adjust their assortment given what the trends are in the market. And we are working with them to try and help them get that done. So there's a lot of activity going on.

We just, in the very near term -- and in the near term we lack some visibility because of the crazy traffic trends because of tax and Easter coming up. We just haven't seen them moderate to the level that we had expected and hoped. And so that's why we're saying let's wait until we get into -- past all the offsets and into spring and see what really is happening here.

Chargebacks, Mimi?

Mimi Vaughn - *Genesco Inc. - SVP, Finance & CFO*

Let me answer about the CapEx for Journeys that we are talking about and then talk about chargebacks. But on CapEx, Scott, we have been spending about $100 million in CapEx. This year the greater amount is really all due to the Journeys distribution center. And that should all be within the fiscal year because we need to finish that project before back to school and it's currently underway, so we anticipate we will do that.

On the credit card chargebacks, there was a shift in fraud liability to retailers that occurred in October a year ago. We made the decision not to implement the chip and signature readers, because we were rolling out new point-of-sale software and decided that it would be better to do that together. And we anticipated -- we actually forecasted a higher level of fraud.

That level of fraud came even higher, multiples higher, than we had expected and so it did impact our bottom line last year. I think we probably had somewhere in the neighborhood of $4 million to $5 million worth of expense from these chargebacks.

We've rolled out the readers in Journeys for the most part. We are working on finishing rolling them out for Lids and we will roll out for Johnston & Murphy as well and so we don't anticipate it will be an issue in the back part of this year, which is when most of our volume is done. So it was an issue for last year, but not for this fiscal year that we are in.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Just a little more on the DC, just to give a little color on the Company. Over the last four years or so we have built a new DC with a lot of capacity at Schuh and we have built a news DC with a lot of capacity at Lids. So this is -- short of having a major acquisition or anything, this sets our DC capacity up for the future quite nicely, including investments in all of the DCs for very efficient operation against the e-commerce business, which is an important part given some of the things that I cited earlier on this call.

So we are excited by getting this last project done and we're excited for what it will mean in terms of being able to run an efficient e-commerce operation.

Operator

That concludes our question-and-answer session for today's call. I will now turn the call back over to Mr. Dennis for closing remarks.

Bob Dennis - *Genesco Inc. - Chairman, President & CEO*

Thank you, everybody, for joining us. And as I said, we will be on the road to a number of conferences and we are excited to sit with you and talk more about our five-year plan in particular, but with everything else that's going on as well. Thanks, all. Have a great day.

Operator

And that concludes our conference for today. Thank you for your participation. You may now disconnect.