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Genesco, Inc.

Second Quarter Fiscal 2022 Conference Call

September 2, 2021

CORPORATE PARTICIPANTS

Dave Slater, *Vice President of FP&A and Investor Relations*

Mimi Vaughn, *Board Chair, President and Chief Executive Officer*

Thomas George, *Interim Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Mitch Kummetz, *Pivotal Research Group*

Steven Marotta, *C.L. King & Associates*

Jonathan Komp, *Robert W. Baird & Co.*

PRESENTATION

Operator

Good day, everyone, and welcome to the Genesco Second Quarter Fiscal 2022 Conference Call.

Just a reminder, today's call is being recorded.

I will now turn the call over to Dave Slater, Vice President of FP&A and Investor Relations. Please go ahead sir.

Dave Slater

Good morning, everyone, and thank you for joining us to discuss our second quarter Fiscal 2022 results.

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 the Company's SEC filings including the most recent 10-Q and 10-K filings for some of the factors, including the impact of COVID-19, that could cause differences from the expectations reflected in the forward-looking statements made during the call today.

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

I want to remind everyone we have posted a presentation summarizing our results that is accessible on our website.

With me on the call today is Mimi Vaughn, our Board Chair, President and Chief Executive Officer, who will begin our prepared remarks with highlights from the second quarter; and Tom George, our Chief Financial Officer, who will review our Q2 results in more detail and provide direction for Q3.

Now, I'd like to turn it over to Mimi.

Mimi Vaughn

Thanks, Dave.

Good morning, everyone, and thank you for joining us today.

Following an incredibly strong start to Fiscal '22, we delivered an outstanding second quarter performance as our top line accelerated even further ahead of pre-pandemic levels and we produced record Q2 EPS that well exceeded our expectations. With much stronger revenue highlighted by robust full price selling and good expense management, our second quarter profit for our footwear businesses also set a new record.

The levels at which our business performed during the first half of the year, following a challenging Fiscal '21, reflected strong competitive positions of our retail and branded content, close connections with our customers, and the compelling execution of our footwear-focused strategy to transform our business and deliver these results. We are a stronger company coming out of the pandemic. Our results highlight the work we've done to accelerate online sales and enhance our store and omnichannel offerings as we create and curate leading footwear brands to be the destination for our consumer's favorite fashion footwear.

Our teams continue to do a superb job providing the right product our customers are looking for, combined with exceptional service and differentiated shopping experiences. Our outperformance was driven by better than anticipated results across the board, with all businesses exceeding pre-pandemic profit levels. As excited as we are with the progress we are making, we are even more excited about our strategy and our future opportunity to build upon this foundation and drive growth, profit, and shareholder value.

I'll begin by providing some highlights from the quarter. Both revenue and adjusted operating income exceeded pre-pandemic levels, increasing 14% and 346% respectively over Fiscal Year '20 two years ago. Higher operating profit delivered a record Q2 EPS of $1.05 compared with a loss of $1.23 last year and positive $0.15 two years ago, all on an adjusted basis. Additional highlights include delivering another strong quarter of digital results with double-digit operating profit to achieve a 19% digital penetration. This was driven by a 97% increase in digital revenue compared to Fiscal Year '20 as we retained almost 80% of last year's volume, which was elevated due to store closures.

Next, driving much higher conversion and transaction size to deliver store sales that were almost at pre-pandemic levels, increasing gross margin by 640 basis points versus last year and 50 basis points compared to Fiscal '20, driven primarily by higher full-price selling, leveraging adjusted SG&A by 230 basis points, compared to pre-pandemic levels, and further strengthening of our already strong balance sheet and cash position, enabling a balanced approach of investing in our business while also returning capital to shareholders going forward.

As the vaccine rollout continued and economies on both side of the Atlantic more broadly re-opened, consumers, aided by government stimulus, stepped up their footwear purchasing in the quarter and chose to shop with our brands to satisfy their pent-up demand. We were pleased that every channel contributed to the beat versus expectation. Digital has been a key strategic initiative, and the investments we've made have allowed us to double our ecommerce business in two years. However, we've also talked about how much our customers enjoy our store experience and the important role of our stores as a strategic asset in a compelling omnichannel offering, which proved out once again this quarter.

Turning now to discuss each business in more detail, beginning with Journeys. The Journeys team once again did a tremendous job capitalizing on current market momentum and achieved record revenue and operating profit in the second quarter, marking the third consecutive quarter with record profitability.

Journeys' performance as we emerge from the pandemic highlights the competitive advantage the business has built and how we are leveraging those advantages to further separate ourselves from the rest of the industry as the destination for fashion footwear for teens. Leaning into decades of experience and its unparalleled vendor partnerships, Journeys deftly navigated global supply chain disruptions to secure supply of the brands and styles most coveted by its customers.

The current fashion cycle, which has been shifting more to casual products, plays into Journeys' wheelhouse with strength in the assortment across the board, highlighted by the balance in its top 10 brands evenly split in the quarter between casual and fashion athletic. On-trend merchandise assortment and effective consumer engagement through social and other channels fueled strong demand and full price selling, with particular strength in women's and kids. Both store and ecomm revenue were up compared to pre-pandemic levels, with digital leading the way even with much higher conversion rates and transaction size driving store volumes.

Over in the U.K., Schuh delivered a solid top-line increase compared to the second quarter two years ago as government mandated lockdowns were lifted and the retail sector experienced its first quarter of mostly uninterrupted operations for the first time since before Christmas. Schuh store business rebounded steadily, driven by pent-up demand and our successful efforts to drive sales of multiple pairs. Even as consumers increasingly returned to physical shopping, Schuh retained much of the online gains from a year ago, resulting in online contributing almost 45% of total sales.

The U.K. retail market is going through a highly disruptive phase, with strong consumer propensity to shop online and with many retail bankruptcies reshaping the landscape. The Schuh team is taking advantage of this disruption, utilizing its advanced digital offering to strengthen consumer connections during the lockdowns, and those efforts are paying off as the market reopens and shoppers once again have the choice to engage with the brand either online or in store. Many of the product and brand trends driving Schuh's performance, as usual, are the same as Journeys' but with a slightly heavier tilt towards fashion athletic.

Another highlight of the second quarter was the more rapid than expected pace of Johnston and Murphy's recovery, boosted by an improving market environment and strong demand for many of the brand's newest product offerings. With the number of social events and family gatherings increasing and more customers returning to in-person shopping, retail traffic improved each successive month during the second quarter, building upon the gains in the first quarter. At the same time, ecommerce revenue grew strongly, increasing over 50% compared to pre-pandemic levels as customers chose the digital channel to engage with the brand.

We were especially pleased with the performance of J&M's new athletically inspired casual assortment. Sell throughs were very strong, with many new items selling out in both our direct-to-consumer channels as well as in the wholesale channel where J&M gained significant market share. These product launches, accompanied by enhanced marketing campaigns, are attracting a younger customer, validating our efforts to reimagine the storied J&M brand beyond its dressier roots into a modern lifestyle brand with broad consumer reach. With second quarter sales nearing pre-pandemic levels combined with strong full price selling, J&M's operating profit exceeded pre-pandemic levels, a remarkable turnaround compared to last year. These trends are adding to our optimism for continued improvement whenever America begins the return to office phase, hopefully later this year.

Rounding out the highlights from the quarter, licensed brands revenue more than doubled versus a year ago, reflecting the growing contribution from the Levi's footwear license we acquired in January 2020. Operating profit improved versus pre-pandemic levels, although not at the rate we expected due to higher price costs which are temporarily pressuring near-term margins. We continue to be very pleased with how Levi's product is selling in accounts ranging from department stores to Journeys, to Journeys Kids, to family footwear. This has led to a strong orderbook for the back half and reinforces our excitement about the potential to create value by combining powerful brand licenses with our fully integrated footwear sourcing capabilities.

Turning now to the current quarter, we have been pleased with our results to date as sales track ahead of pre-pandemic levels in August and we are several weeks into the all-important back to school selling season. Last year's back to school was like none before since most children began the school year learning remotely. This year, the vast majority of students are beginning the school year in person, which is driving more robust sales.

While the Delta variant, back to work timing, and other factors will drive different patterns of consumption in the back half, with a healthy and resilient consumer and the strength of our offerings, we remain confident in our ability to drive sales above Fiscal '20 levels for the remainder of the year. We will work hard to continue to successfully implement strategies to overcome the inventory, supply chain, labor, cost pressure, and other headwinds that are endemic in our industry today. Tom will give additional details on our outlook.

Shifting gears, our footwear focused strategy is working and is delivering results. This strategy, implemented before the pandemic, leverages our strong direct-to-consumer capabilities across footwear retail and brands and the synergies between platforms. Driving this strategy are six strategic pillars that emphasize continued investment in digital and omnichannel, deepening our consumer insights, driving product innovation, reshaping our cost base, and pursuing synergistic acquisitions, all to transform our business and exceed the expectation of today's consumer, who's needs have rapidly advanced. In addition, COVID has provided us the real opportunity to transform our business at a faster rate and we are on a very good pace to deliver growth and improved operating margin.

While each of the six pillars is important to achieving our future objectives, I'd like to expand on just a few of our initiatives which are driving results, while Tom will discuss reshaping the cost base.

Our strong digital growth highlights the progress we're making with this key strategic initiative. In Q2, we welcomed 48 million visitors to our website and new ecommerce customers increased 80% from pre-pandemic levels. Data driven consumer insights, more robust CRM and enhanced marketing are key to increasing consumer engagement and driving our next big wave of growth. Schuh is taking advantage of the market disruption brought on by the pandemic to invest further in new customer prospecting through digital marketing designed to target weakened competitors' customers as well as geo targeting where competitors physical locations have closed. These efforts have helped contribute to an increase of new online customers of more than 100% compared to pre-pandemic levels.

Journeys' marketing efforts are gaining leverage by focusing on influencers who the teen consumer views as more authentic, creating a more organic experience that further builds upon the trust Journeys has established with its customer. This content is being delivered through social media channels and SMS, helping to drive a significant increase of 50%-plus of new online customers. In addition, Journeys continues to make progress implementing an upgraded integrated customer database with enhanced CRM capabilities, which will improve customer retention and acquisition and provide a clearer view of customer lifetime value.

To keep up with this increase in digital demand, Journeys is wrapping up testing and bringing online another bespoke ecommerce fulfillment module which doubles capacity ahead of the ramp up of demand for online orders during holiday.

We are underway rolling out North America new point of sale hardware and software, along with new tablets, advancing our efforts to digitize our stores and enhance the omnichannel shopping experience. For consumers, tablets facilitate easy access to the full assortment anywhere in our system and upgrade our clienteling efforts, and mobile check out allows consumers to skip the checkout line. For employees, this new technology creates efficiencies across a variety of in-store tasks, such as new hire onboarding and employee training and communication.

With J&M's accelerating recovery, we can put greater focus on the next phase, reimagining the brand. Product innovation and technology is at the center of differentiating J&M's casual products and commanding more premium price points. Launches of the athletically inspired Amherst and Activate collections and the expansion of the J&M golf collection were highly successful this spring and another major step moving the brand beyond its dress shoe origins.

J&M's design team is focused on expanding its technology toolbox with innovation, including the Axis Chassis System which offers optimal support, comfort and flexibility, TrueFoam which delivers superior cushioning and lightweight comfort, and Smart Degree which is temperature regulation technology. New product design and technology coupled with consumer insights and amplified marketing messaging will be the winning formula to grow J&M as a fresh lifestyle brand with broader consumer reach.

Turning to ESG, we continue to advance these efforts, including the establishment of our Board's ESG subcommittee and we are working towards publication of a comprehensive ESG report next year. Again, these are just a few of the initiatives that are driving positive transformation for Genesco. We look forward to updating you on our continued progress and on other initiatives.

Before turning the call over to Tom, I would like to thank and congratulate all our people across our Company for your excellent execution, hard work, and great success in the first half of this year. You continue to superbly navigate a dynamic and challenging environment with the health and safety of each other in mind, and I continue to be amazed by your drive and determination. Genesco's future is so bright because of you all.

Finally, our thoughts are with our neighbors to the west of us in Nashville affected by the devastating floods last week and those impacted this week by Hurricane Ida.

Now, I'll turn it over to Tom.

Thomas George

Thanks, Mimi.

As Mimi mentioned, total Q2 results far exceeded our expectations and last year across the board. For comparison purposes, we believe that comparing to two years ago, our Fiscal '20, provides the most meaningful assessment of current performance and the return of our business to pre-pandemic levels.

However, when comparing to Fiscal ’20, I would like to remind everyone how our strategy has changed our business.

Ecommerce has become a larger percentage of sales and our licensed brands segment has become a larger piece of the total as well due to the acquisition of Togast and strong Levi’s sales. These changes come with an overall lower gross margin rate due to the impact of direct shipping expense and the expansion of our wholesale volume, which should be more than offset with lower SG&A from these businesses. While these changes will reshape the P&L, they have a positive impact on operating margins and an added benefit of a less capital-intensive business model.

Turning back to Q2 results, I’m pleased to report that not only did the second quarter continue but it accelerated the sequential improvement of our operating results since the onset of the pandemic. Higher revenue and gross margin combined with SG&A that remains well managed led to significantly higher operating income versus Fiscal ’20 and Q2 adjusted earnings per share of $1.05 compared to $0.15 in Fiscal ’20.

In terms of the specifics for the quarter, consolidated revenue was $555 million, up 14% compared to Fiscal ’20, driven by continued strength in ecommerce, which is up 97% versus Fiscal ’20, taking overall digital sales to 19% of our retail business compared to 10% in Fiscal ’20.

Digital growth combined with much higher wholesale revenue drove strong sales improvements for Journeys, Schuh and licensed brands compared to pre-pandemic levels, while J&M made significant strides narrowing its revenue gap. We did not provide overall or store comp results for Q2, as our comp policy removes any stores that are closed for seven consecutive days, either this year or last year, and therefore we feel that overall sales is a more meaningful metric. With stores open for 97% of the possible days in the quarter, overall store revenue was down only 1% versus Fiscal ’20.

Consolidated gross margin was 49.1%, up 50 basis points from Fiscal ’20, driven by full-price selling, partially offset by the mix shift towards licensed brands and higher shipping costs from higher penetration of ecommerce. While ecommerce puts pressure on our gross margin rate, as I mentioned, it comes with a lower cost structure and double-digit operating income.

Journeys’ gross margin increased 220 basis points, driven by lower markdowns in both stores and online. Schuh’s gross margin decreased 200 basis points due entirely to the higher shipping expense from the shift in ecommerce channel mix. J&M’s gross margin increased 570 basis points, benefiting from fewer markdowns taken on pack and hold inventory and higher full-price selling. Finally, the revenue growth of licensed brands, typically our lowest gross margin rate, negatively impacted the overall mix by 90 basis points.

Adjusted SG&A expense was 45.3%, a 230-basis point improvement compared to Fiscal ’20 as we leveraged from higher revenue and ongoing actions around expense management. The largest year-over-year savings came from occupancy cost, driven by the U.K. Government program which provides property tax relief, rent concession across our businesses, and ongoing rent savings on renewals.

The next largest areas of savings came from the reduction in store salaries thanks to the effective use of workforce management tools to drive higher conversion in the face of significant wage pressure. These savings were partially offset by higher incentive compensation, driven by improved profitability and increased marketing expenses needed to drive traffic in both stores and online.

As the multiyear shift in consumer traffic continues towards online and away from brick-and-mortar, our organization has been intently focused on the critical effort to right size occupancy cost to be in line with store traffic. The pandemic has exacerbated the transition to digital and we continue to have even greater traction on rent reductions.

Year to date through Q2, we have negotiated 75 renewals and achieved a 29% reduction in rent expense in North America. This was on top of a 22% reduction for 123 renewals last year. These renewals are for an even shorter term, averaging approximately two years compared to the three-year average we have seen in recent years. With over 40% of our fleet coming up for renewal in the next couple years, this will remain a key priority for us going forward.

In summary, the second quarter's adjusted operating income was $21.1 million versus Fiscal '20's $4.7 million. All operating divisions achieved higher operating income compared to Fiscal '20, led by Journeys' nearly 170% increase. Our adjusted non-GAAP tax rate for the second quarter was 25%.

Turning now to the balance sheet. Q2 total inventory was down 27% compared to Fiscal '20 on sales that were up 14% as we remain challenged keeping pace with the consumer demand levels and with delivery delays. Our ending net cash position was $284 million, $70 million higher than the first quarter's level, driven by strong cash generation from operations. As a reminder, we currently have $90 million remaining on our Board authorized share repurchase plan and we have a solid track record of returning cash to our shareholders.

Capital expenditures were $8 million as our spend remains focused on digital and omnichannel, and depreciation and amortization was $11 million. We closed eight stores and opened three during the second quarter.

We will not be providing guidance for the third quarter or full Fiscal '22. However, I would like to provide some color around our expectations using the pre-pandemic Fiscal '20 as the reference point.

As we transition into Q3, thus far we have experienced a more normalized back to school selling season for Journeys and Schuh, but as expected, the impact from stimulus has moderated. Due to the spread of the Delta variant, there are more questions around when customers will begin returning to their offices, which will impact J&M's trend, and whether Delta will disrupt in-store shopping. Supply chain disruptions persist, pressuring both the top line and product cost.

Now, getting to more specifics of Q3, starting with revenue. We expect higher revenue compared to Fiscal '20 levels, given the strength of our assortment. This is mainly due to continued strength from the Levi's business and growth at Journeys and Schuh. J&M will likely remain under Fiscal '20's level. Directionally, the overall sales increase for Q3 compared to Fiscal '20 could be up mid- to high single digits. From a channel perspective, the highest growth will once again come from wholesale and direct.

We expect gross margin rates for Q3 will be somewhat under Fiscal '20 levels due to substantial pressure from import freight increases at J&M and licensed brands from supply chain disruptions. We expect the retail promotional environment to remain favorable, offsetting the ongoing pressure from higher ecommerce penetration and the higher shipping costs that come with it as well as the impact of licensed brands growth on our business model, as previously discussed.

We expect that Q3 adjusted SG&A will be a little better as a percentage of sales than in Fiscal '20. Sequentially, we will not see the large SG&A leverage we saw in Q2, as revenue growth will be lower and the benefits from some government relief programs will be less than Q2. That being said, compared to Fiscal '20, higher revenue will boost leverage in both occupancy and selling salaries, partially offset by higher marketing and performance-based compensation as we anticipate higher bonus expense than Fiscal '20.

In summary, we expect the operating income to be similar to Fiscal Year ’20 levels and the margin rate to be somewhat lower than Fiscal Year ’20 due to these factors, in particular, the increased import freight in our branded businesses. For taxes, we expect the Q3 tax rate to be around the 25% we saw in Q2. The annual tax rate is expected to be approximately 30%. In addition, when comparing results, we had some expense pickups like renovatements in the back half of Fiscal ’21, particularly in Q4, we don’t expect to recur in the back half of this year.

Next, I would like to provide a brief update on our cost savings initiative. Given the shift of our business from stores to digital accelerated by the impact from the pandemic, we continue to make progress on reshaping our cost structure and allocating resources towards digital growth. As a reminder, our target for the year is to identify savings in operating expenses of $25 million to $30 million on an annualized basis, or approximately 3% of total operating expenses. The entire organization is focused on this critical initiative and I’m pleased to report that we’ve made significant progress towards our target.

The teams have identified over $20 million of savings with the largest amount coming from rent and the remainder in several areas, including increased selling salary productivity, travel, conventions, inter-store freight, marketing, compensation, and other overheads. These savings benefit primarily the store channel and its profitability. The cost savings initiative is a key pillar in our strategy to transform our business, designed to reflect a more capital efficient model, focusing on driving further improvements and return on invested capital and allowing for improved flexibility in our operating model.

Going forward, we see opportunities to be less dependent on store capital expenditures, have lower lease obligations, and continue to drive efficient use of inventory.

In conclusion, I would like to thank all our employees for such an incredible start to the fiscal year. These results emphasize that we have the right team and the right strategy to continue to drive shareholder value.

This concludes our prepared remarks and I would like to turn the call back over to the Operator for questions.

Operator

Thank you. Our first question is from the line of Mitch Kummetz with Pivotal Research. Please proceed with your question.

Mitch Kummetz

Yes, congrats on the quarter, and thanks for taking my questions.

Let me start with the guidance or the outlook for Q3. I think you said sales up mid- to high single digits on a two-year basis. Can you say kind of where August came in relative to that? Is August better than that and you’re expecting some moderation, or can you maybe just provide a little color around that?

Mimi Vaughn

Sure. Hi, Matt. This is Mimi. Let me start and then turn it over to Tom.

You know, I think that it’s important to put August in the dimension of what happened last year with back to school and also this year. Things were a lot different a year ago. We estimated that two thirds of students attended school only virtually to start the year. This year, we estimated that it was a real push to get kids back into school and we're estimating that, you know, essentially all students went back in person.

You know, we had a great second quarter, and coming into the quarter, we thought that back to school also would be positive and we have continued to see we've been pleased with the results so far. We've got the right assortment. We've been pleased with what we have seen.

One important note is that the Labor Day this year compared to Fiscal Year '20, and that's what we keep comparing to, is one week later. We're going to know basically this weekend what the, you know, comparison period is. We're tracking to and above Fiscal Year '20 levels overall and we'll know more when we complete the Labor Day weekend.

We also think that there is a likelihood of back to school having a longer tail in September and October like it did last year. We didn't see a lot of sales in July and August last year, but people waited to see exactly what might happen with schools and there was more purchasing later on.

Tom, I don't know if you had anything to add to that.

Thomas George

No, I think that's a good summary. We feel really good how we're tracking so far, and keep in mind, we have more of a wholesale business this year as well, relative to two years ago. That tracks really at a different pace than the retail business. We do expect some good growth out of our direct channel as well this year relative to two years ago. Feel really good where we're tracking so far.

Mimi Vaughn

Yes, and I'd also remind you, Mitch, that August is a really important month. It's over 40% of the third quarter because of how heavy back to school is. It's good to have that month behind us.

Mitch Kummetz

Okay, and then, Tom, on gross margin you mentioned that you expect gross margin to be below 2020 levels. For the quarter you just reported, I think you were up around 50 bps ahead of two years ago. Is the difference all on freight, or are there other factors that are putting a little bit more pressure on Q3 versus Q2 on a two-year basis?

Thomas George

The big difference there is freight. You know, there is a significant amount of freight in the second quarter. I mean, we are planning on approximately, rounded numbers, around $7 million of additional freight in the third quarter, and that has a big impact on a gross margin percentage and a big impact on our operating income results relative to two years ago.

Mitch Kummetz

And just to be clear, is that $7 million more than two years ago, or $7 million more than what you saw in Q2? Just help me understand what that's like.

Thomas George

Seven million dollars relative to two years ago, and it's a combination of, you know, additional vessel charges. It's a combination of air freight, things like that to, you know, get the product, you know, into our consumers' hands. It's a big difference relative to two years ago. It's just part of the results of some of the supply chain challenges out there.

Mitch Kummetz

Sure.

Thomas George

But we think we've got our hands around it to manage it and we think we've got our exposure included in the back half projection. We also have some in the fourth quarter as well that we've got in our projections, just to be cautious.

Mitch Kummetz

Okay. Do you know off hand what the other freight was in Q2 versus two years ago?

Mimi Vaughn

Yes, it was more minimal.

Mitch Kummetz

Okay.

Mimi Vaughn

More minimal and we really started to see the back up, you know, of the supply chain and particularly in our branded business. We are having to air freight more product, and that's pretty meaningful. I think you've seen the container costs go up pretty significantly. It's really much more pressure in the third quarter than in it was in the second quarter.

Thomas George

Mitch, in the second quarter it was almost $2 million.

Mitch Kummetz

Okay, and then lastly, just on the supply chain, you know, how much longer do you think these disruptions will occur? I mean, is this lingering through like the first half of next year? And can you speak to kind of your ability to get product maybe versus some of your competition? I know that for a lot of your brands you're the largest or one of the larger customers, and I'm just wondering kind of how much of the competitive advantage that is in the environment of a challenging supply chain.

Mimi Vaughn

Yes, so we think it's a huge competitive advantage in this environment, because this is not a new problem. We've been managing through supply chain challenges really since the onset of the pandemic and we've been chasing inventory all the way through. Basically, last quarter what came in went right back out, you know, yet sales were strong, and sales have just continued to be strong. In our retail business, we're seeing good product flow right now, but it's lower than we would like.

We have worked on mitigating the risk by ordering higher sales than our projections, so that would help us so that we can get caught up with some suppliers. We also ordered early and strong, certainly on some core retail styles.

We're an important partner to our brands. They've worked with us as much as possible. Journeys always gets, you know, more than its fair share of product. We've got the window to re-inventory before holiday and think that it will certainly be a challenge through holiday from what we can see right now, even into the spring possibly, but there's a lot of time between here and there. Factories have been the latest situation and there is time to address some of the situation there. Then, you know, everybody is focused on clearing up some of the problems in the supply chain, but certainly through the holiday and perhaps into spring as well.

Mitch Kummetz

Okay, great. Thanks.

Thomas George

I think, yes, because we are such a strong strategic partner to our key suppliers, we took advantage of that and ordered, you know, early and higher on some key styles for fall.

Mitch Kummetz

Perfect. All right, thanks. Good luck.

Mimi Vaughn

Thank you.

Thomas George

Thanks.

Operator

The next question is from the line of Steve Marotta with C.L. King. Please proceed with your question.

Steven Marotta

Good morning, Mimi, and Tom. Let me offer my congrats, too, on the second quarter.

Can you please remind us, the $25 million to $30 million of cost savings, can you talk about how that will be realized and what the cadence is there? If there is possible that there is anything behind that? You've alluded to in prepared remarks, continued ways of making the business less capital intensive. Thanks.

Thomas George

Steve, so we're good progress. We've identified $20 million. That's on an annualized basis, and we believe, you know, in the back half we could realize half of that in the form of those items I outlined on the call, our occupancy expenses, better selling, salary productivity. We have fewer stores. We're going to have savings in depreciation. We've got some procurement initiatives. You know, roughly half of that $20 million will be realized over the back half.

On the capital-light model, I mean you know, we've got a good wholesale business now. You can manage your inventories well. Our situation we have with the Togast acquisition, it's a very capital-light model. Fewer capital expenditures involved, obviously with the wholesale business because you're not opening up stores.

Another, you know, driver of the capital-light model is our digital business. It's a very variable cost model and we've made investments historically, and we're leveraging off those investments going forward. We feel really good how capital efficient the model has come and we'll continue to look at cost savings as well as working on the capital base to continue to drive good returns on invested capital.

Steven Marotta

That's helpful, and you know, we're seeing across the space when cost savings like this are being implemented, a lot of that is being re-invested in digital marketing and demand creation investments. Is that your intent here as well, or is it literally a net number coming right out of the P&L?

Mimi Vaughn

Yes, so Steve, you know certainly we are investing a lot in digital marketing and in demand creation. We have to do that for both our websites and to our stores. I think the key here is that our ecommerce channel is profitable and the investments that we're making in digital marketing are actually generating a return. We think about that in terms of those channel economics.

When we think about the brick-and-mortar side, the challenges there really are to reduce occupancy expense, and that's why we've been so focused on that. If you think about if we can align occupancy to the appropriate level of traffic right now, and we are spending a little bit more on advertising, so part of the way we're thinking about being able to fund that advertising is through the rent reduction. The way we're thinking about this channel is on a channel-specific basis.

Steven Marotta

Very helpful. Thank you.

Operator

Our next question is from the line of Jonathan Komp with Baird. Please proceed with your question.

Jonathan Komp

Yes, good morning. Thank you, and hope everyone is staying safe.

I wanted just to first to follow up on the supply chain topic. I know you don't have guidance into next year, but just given the situation with the factories, are there scenarios you're hearing from your brands where there might be a shortage of product to sell, you know, even more so than what you've faced so far?

I just wanted to get your current assessment of this, of the situation with the factory closures and the impact it might have.

Mimi Vaughn

Sure, thanks for that question, John.

I think that when you think about both Journeys' and Schuh's business, which represent probably 80% of our business, the key is that we are diversified across a number of suppliers, and I think that that gives us a real advantage.

We've talked a little bit about how important we are to our suppliers, the great partnerships that we have had, and the prioritization that we get as a result of that and how important we are to them. The key for us is just the diversification that all suppliers are working hard, that they are in a number of different factories. In this case, having multiple brands is a benefit for us.

Jonathan Komp

Okay, great. Thank you. Maybe a bigger picture topic, then on really the sustainability of the margin performance. I mean, coming off of a first half where you're typically not very profitable, and you were quite profitable this year. How should we think about really the ongoing ability to drive higher margin with everything you've talked about and the increased focus on being a, you know, footwear portfolio? But how are you thinking about what's sort of sustainable versus other benefits that maybe we shouldn't expect to continue and how that relates to your broader margin opportunity?

Mimi Vaughn

Sure, so John, it's a great question and I think we're so pleased with the results that we had in the first half. There is no question that there were unique factors in terms of the consumer being in a really great place to spend because of stimulus and other government help. There was pent-up demand as well, but I think if you look at what specifically we are doing to drive the business, the first thing is around digital. We've talked about how digital is such a profitable part of our overall business. We were able to double the size of the ecomm business through the course of the pandemic, which means significantly more profit contribution. That will be in every quarter of the year.

We've also talked about rent expense and how important an initiative that is to improve the profitability on the brick-and-mortar side. Tom said today, you know, our improvements are still under 30%, and that's compounding on a 20%-plus last year, compounding on, you know, 8% to 10% in prior years. Through a compounding effect, that helps as well. You know, we feel like there is a real path to be able, with those couple of things plus the growth of the branded side of our business, those licensed brands.

Really, you know, this opportunity to reimagine Johnston & Murphy. We saw the same thing coming out of the Great Recession. We had a chance to really take the brand up to the next level, and we think there is a tremendous opportunity to do that through reinvention of the product, reinvention of the marketing, which is underway right now. We saw a doubling of Johnston & Murphy's brand really coming out of the Great Recession. We think there's an opportunity again to take Johnston & Murphy to the next level.

I think the combination of those three things give us great earnings potential going forward, irrespective of the things that were unique to the first half of the year.

Thomas George

I think I'd add, you know, again, with being a key asset to all the major, relevant brands in the retail side of our business, we have the ability, because another strength we have is our ability to merchandise product and service product and convert sales. We've got the ability, I think everything else being equal, to drive some really good gross margins going forward, to continue to do that.

With Johnston & Murphy and our licensed brands business, we have the ability to drive good gross margins and some improvement in those going forward. Then just a reminder on the wholesale business, on the operating income level, you know, we have got visibility and line of sight that the wholesale business as well is going to be double-digit operating margin going forward.

Johnathan Komp

Okay, great, just last one from me. The incentive compensation piece, can you just, sorry if I missed this, but can you give us an update where you're tracking this year given the increase in the corporate expenses that we can see? And then how should we think about kind of the normalized level after this year? Thank you.

Mimi Vaughn

Yes, so thanks for that question.

You know, I think an important point to make is that we paid no incentive compensation last year. The way that our program works is that, you know, since the pandemic caused substantial disruption to our operating results, even though our team navigated the pandemic so well, constraining expenses and capital and improving liquidity that because we didn't have year-over-year improvement, no performance compensation was paid.

This year, there is a substantial improvement in earnings on a lower capital base and, you know, our plan is designed to be highly aligned with shareholder interest, as the bonus is generated for the incremental improvement. Part of what you are seeing in the corporate expense is the booking of bonus, a higher level of bonus this year versus two years ago, and you know, we will see a little bit of that in the back half as well. But given the strong performance, that's how the bonus ends up being booked in the second quarter.

Jonathan Komp

Any willingness to quantify, just so we can understand the moving pieces in the SG&A?

Thomas George

No, we normally don't get into that level of detail, John. This is another point to be made though is, you know, re-inforce just the huge year-over-year improvement we had in economic value added, because we did have big year-over-year improvement earnings on a much lower capital base that this year would be a year that the bonus-related incentive compensation would be, you know, higher than we'd normally expect in future years.

Operator

Thank you. At this time, we've reached the end of the question-and-answer session and I'll now turn the call over to Mimi Vaughn for closing remarks.

Mimi Vaughn

Great, thank you for joining us today. We look forward to talking to you again at the end of our third quarter.

Operator

Thank you. This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.