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GCO - Q1 2019 Genesco Inc Earnings Call

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PRESENTATION

Operator

Good day, everyone, and welcome to the Genesco first-quarter fiscal 2019 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-K filing, for some of the factors that could cause differences from the expectations reflected in the forward-looking statements made during the call today.

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

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, and CEO*

Good morning and thank you for being with us. I'm joined today by our Chief Financial Officer, Mimi Vaughn. Our first-quarter results for the Company in total were in the range of our expectations.

We experienced continued strength in our US footwear businesses and improving, although still negative, trends at Lids following a difficult fourth quarter. Journeys in particular delivered a robust comp sales gain and significantly improved profitability.

Johnston & Murphy began the year with accelerating comp sales and a strong profit improvement as well. While across the Atlantic, a number of headwinds pressured Schuh's performance to start the year. In total, comps decreased 1%, with stores down 2% and e-commerce up 10%, building on our strong track record of e-commerce growth averaging double-digit increases over the last nine years.

First-quarter adjusted earnings per share was negative $0.06 compared to adjusted earnings per share of positive $0.06 a year ago, as strong improvements in Journeys and Johnston & Murphy were more than offset by the challenges at Lids and Schuh.

As you know, the first quarter for Genesco is typically a low volume one with monthly comps shaped by the timing of tax refunds and the Easter holiday. From a merchandise perspective, sales are heavily influenced by how far winter stretches into the fiscal new year and when spring finally arrives.

After major shifts last year to a later February, tax refunds followed the same cadence this year, with the timing and levels of refunds aligning closely, resulting in little impact year over year. A cold snowy March allowed us to extend the boot season, which, along with an earlier Easter, led to strong comp results for the month.

While April sales were affected early on by the Easter offset, momentum on both sides of the Atlantic picked up during the last three weeks of the quarter, which coincided with the arrival of warmer weather that boosted sales of seasonal products. And this has carried over into May, with second-quarter-to-date comps trending better for all of our businesses than their Q1 results.

Looking at the performance of each of our businesses, starting with Journeys. The positive top-line momentum we experienced during the holidays continued in the first quarter on the strength of Journeys' current assortment.

The retro athletic and lifestyle athletic trends that have been driving our business have proliferated into a greater number of brands and franchises, which should provide us with momentum throughout the year. This classic fashion lifestyle product plays into the sweet spot of Journeys' positioning as the house of fashion for teen footwear.

Comps moderated as we thought they would after a strong double-digit Q4 performance. But came in above our expectations in Q1 with both store and e-commerce results nicely positive, fueled by demand for boots early in the quarter, athletic product throughout the quarter, and sandals and other spring merchandise later in the quarter. With the warmer weather, this momentum has carried into Q2 with a nice uptick in Journeys' comps thus far.

Shifting to Johnston & Murphy, following eight consecutive years of sales increases, it was a great start to the new year as we saw comps accelerate following a very solid fourth-quarter performance. J&M's on-trend casual footwear and apparel offering is resonating strongly with consumers, driving conversion and strong full-price selling, both in stores and online. And with the warmer weather, comps have accelerated even further thus far in Q2.

Lids' comps, while still negative, also showed a nice improvement in Q1 compared with the fourth quarter. We expected this to happen as we cleared the biggest headwinds by lapping the Cubs World Series win and as MLB became a larger part of the overall sales mix.

Comps halved the Q4 loss and were slightly better than we anticipated. And while SG&A deleveraged on the negative store comps, the impact on profitability was not as pronounced as it would have been had we not closed a number of underperforming stores and implemented aggressive cost-saving measures over the past several months.

Lids, like our other businesses, is subject to fashion cycles, and headwear is currently between trends, which we believe is a major driver of the lower traffic we have experienced. Lids as a category leader is positioned for the type of strong resurgence that Journeys has been enjoying once a new fashion driver emerged.

So we don't know the specific timing of when this will occur; history points to a rebound. Our long history with Lids hat stores shows almost a decade and a half of store four-wall profit in the teens and 20s, demonstrating tremendous ability to cycle through trends successfully.

Thus far in Q2, comps have improved further above Q1 levels. But we remain cautious until we anniversary the steep traffic declines that started toward the end of summer last year and we see the emergence of a new major fashion trend.

Turning to Schuh, the weak demand for footwear and apparel that drove a very promotional holiday season in the UK persisted into the new year. On top of this, Schuh was up against double-digit comps from Q1 last year.

While winter lasted late into the quarter in the US, the unseasonably cold weather persisted even longer in the UK, significantly diminishing demand for spring merchandise in March and April. The extreme weather conditions and difficult trading environment resulted in some of the worst UK retail sector results in some time.

Schuh's performance was also impeded by some product constraints due to certain vendors' decisions to pursue a scarcity model, limiting supply of some top-selling styles in the UK. So as a result of all of this, comps declined double-digits, which generated significant expense deleverage in this low volume quarter.

The Schuh team is working hard to navigate these headwinds and performance has become much less negative in Q2 thus far. While the comparisons become easier going forward and the weather is gotten warmer, the UK retail environment remains challenging, characterized by tepid spending, particularly on footwear and apparel.

In addition, while we expect availability of the scarce product to improve in Q2, the extent of this will have a direct effect on the degree of improvement in results, given the relevance of this product as a driving force behind current fashion trends.

In summary, Q1 overall performance was better than we expected in all our retail businesses, except in the UK at Schuh. And with more summerlike weather stimulating sales of seasonal products, comps in Q2 have gotten off to a solid start.

With respect to our outlook, we are encouraged by the signs of improvement elsewhere, but remain cautious about Schuh's near-term prospects. We are reiterating our guidance of adjusted earnings per share to range from $3.05 to $3.45. This guidance includes the impact of Lids as if it were owned by us for the entire year.

We do regard this guidance as a range with some upside and some downside potential reflecting the many variables in the current retail and licensed sports environments. Something close to the middle continues to reflect our best current belief of where we might come out for the year.

As we look out in fiscal 2019, our focus has been on executing the key initiatives we've talked about to change our operating model in response to the ongoing evolution of consumer behavior and the evolving retail environment. These initiatives are aimed at strengthening our customer connections, enhancing our in-store experience, building omnichannel capabilities, and fortifying the leadership positions of each business in addition to streamlining our cost structure and capital spending.

Mimi will cover the work we are doing to reduce real estate risk, rent expense, and capital spending as well as our broader cost savings program in her comments. Let me briefly update you on our four consumer-facing initiatives.

While a wide range of initiatives are underway in each of our businesses, I will highlight one or two examples to illustrate the progress we are making. In all of these initiatives, the name of the game is continuous improvement as competitors and technology keep raising the bar, especially on the digital side. And for each of these initiatives, category scale is important and therefore represents competitive advantage.

Number one: improve the customer experience in and across both the digital and physical worlds to build loyalty and maximize each customer's value to us. The first phase of the work at Journeys is to tackle the sources of friction and major pain points for customers in stores and online with the intent of bringing process and technology solutions to solve them.

Journeys now has a three-year roadmap to implement these improvements and also gather data from internal and external sources to create a unified view of the customer to better understand and serve their footwear needs.

Lids' efforts here are focused first on building the customer data platform that will allow them to have a single view of their customers' behavior, preferences, and transactions across all channels and devices to present personalized content, messages, and offers through their marketing channels.

Number two: enhance the in-store experience and drive traffic to our brick-and-mortar locations. An exciting example of the work we have done here is the May product launch of the Lids Color Prism Pack in Major League Baseball and NBA collections. This features seven trend-worthy colors of the new era 5950 iconic silhouette with two-tone embroidery and color-matched interiors, exteriors, and stickers.

This follows a blackout launch of an all-black product, which was exclusive to Lids and a few select independent accounts. Lids supported the launch with enhanced displays, banners, and window clings to create excitement in the stores and draw attention to the collection and gave exposure to the event through its own digital channel and social media accounts.

We are also excited to announce the opening of a remodeled Lids Times Square location using the new store design, which features cleaner product presentations, narrower assortments with more of a showcase orientation, and a larger emphasis on interactive experiences, such as custom embroidery. Those of you in the area, be sure to stop by and check it out.

Number three: building out omnichannel and digital capabilities. We recently held the ribbon-cutting for the expansion of the Journeys distribution center. We've invested here to build a customized module for e-commerce picking which features dedicated singles workstations and put-and-pack walls to marry up multiples for direct orders. This specialized capability will support Journeys' rapid e-commerce growth by not only making direct shipments more cost-effective, but also by getting product out to the customer faster.

In addition, we're enthusiastic about the work Johnston & Murphy is doing with artificial intelligence aimed at enhancing predictive search capabilities to individualize the user experience based on customers' browsing behavior and product affinity. And finally, we are pleased with the Schuh website redesign that went live in Q1, which gives a new look to complement the greater speed and functionality of the new platform.

And number four: strengthening the equity of our retail brands. The Journeys prom promotion is a great example of our unique efforts here. Starting in February, Journeys ran a 90-day nationwide all-store prom campaign to bring a massive citywide prom-themed celebration to one lucky city based on votes gathered through social media.

Houston was the winner of the big party, and Journeys was the winner overall, with tens of millions of impressions garnered across multiple social media platforms. Both the direct and store channels were important parts of this campaign, which captured a quintessential moment in a high school student's life, leveraging Journeys' positioning as the destination for teen fashion footwear for moments like these.

Now, shifting gears. Since we are in the middle of the Lids sale process, we won't have anything to say about that today and don't expect to provide any updates until the process comes to a conclusion. As soon as we have news to report, you will be hearing from us. But in the meantime, as you can appreciate, we are not commenting about or taking questions on this topic.

Finally, I'd like to thank our teams for their efforts to get the year off to a solid start. We have well-positioned businesses that are undisputed leaders in their categories and great people behind each one of them that can maximize their potential.

We are especially pleased with the prospects for a very strong year at both Journeys and Johnston & Murphy and would like to salute the talent and the dedication of our people there. We are pleased to see signs of improvement in the Lids business and want to recognize the focus and commitment required to make that happen in the midst of exploring a possible sale of the business and all the distractions that [cause].

Finally, we appreciate our skilled and dedicated teams at Schuh and licensed brands who are working hard to make their way through the current headwinds facing these businesses. Our thanks go out to all of them and to all the rest of our employees as well.

And with that, let me turn it over to Mimi, who will go over the financials and guidance in greater detail.

Mimi Vaughn - *Genesco Inc. - SVP Finance and CFO*

Thank you, Bob. Good morning. As usual, we have posted more detailed information in our CFO commentary you can access online at our website. We have also posted a new brief presentation that summarizes our results and guidance, which you can find there as well.

The strong performance of Journeys and Johnston & Murphy offset in part the declines in our other businesses in Q1. While results across all our US retail businesses were better than expected, this was eclipsed by the significant turn in Schuh's business. Even with improved gross margins, SG&A expense delevered and impacted the bottom line due to the negative store comp and our largely fixed store expense base, which is especially difficult to manage down in this low volume first quarter.

Q1 consolidated revenue was flat at $645 million. Excluding the impact of exchange rates, revenue would have decreased by 1%. Consolidated comps were down 1%, with store comps down 2% and direct comps up 10%. Although store comps were negative in total, they were nicely positive for Journeys and J&M.

Direct as a percent of total retail sales in Q1 was 11%, up almost 100 basis points, demonstrating again the tremendous progress we have made driving e-commerce sales in our business.

Journeys posted significantly improved sales and profits. Comps were positive 6%, marking the fourth consecutive quarter of increases. The business performed well across multiple dimensions, highlighted by meaningful year-over-year growth in-store traffic and improved average ticket size. This was driven by a combination of more boot sales and higher-priced fashion athletic product and sandals, which together delivered higher footwear ASPs.

Considerably stronger conversion and higher average ticket size in stores plus strong digital sales generated Johnston & Murphy's positive 7% comp. Sales of both footwear and non-footwear were up, propelled by J&M's casual assortment, which drove a nice acceleration over Q4 comps.

Price increases on select products that J&M began taking at retail last fall continued to contribute to the better average ticket size and had no impact on conversion. Both ASPs and units were up in the quarter.

Schuh began the quarter up against a very stout comp comparison of plus-10% from Q1 a year ago. While ASPs this year were higher, both traffic and conversion were quite difficult due to the unseasonably cold weather and lack of availability of some in-demand product we've discussed.

Both store and direct comps were negative, highlighting the degree of the challenge and yielding a negative 13% comp in total, which was a big swing from the positive comp achieved in all four quarters last year.

Lids' store traffic continued to be challenged in Q1, but conversion was much improved and transaction size was higher. We have been working to improve the markdown cadence in this business, taking more shallow marks earlier in the season.

These actions have been informed by better merchandising decisions as we have invested in both people and systems to accomplish this. The result is paying off, with the more shallow markdowns leading to higher transaction size.

Q1 comps of negative 7% were much improved over fourth-quarter levels. The increasing importance of MLB in the sales mix was a positive factor in Q1, but the continued lack of a major fashion driver, less representation of strong Canadian teams in both the hockey playoffs and the start of the baseball season, and softness in the branded hat business all had a negative impact. In addition, last year's continuing strong Cubs sales and sales related to the World Baseball Classic, which is an every-four-year event, made for tough comparisons this year as well.

Q1 consolidated gross margin increased 30 basis points to 49.9%. Without increased shipping and warehouse expense from higher e-commerce sales, gross margin would have been 10 basis points higher.

At J&M, gross margin was up 210 basis points, benefiting primarily from higher retail sales in its channel mix and lower warehouse expense this year. Journeys' gross margin increased 40 basis points. Without the extra e-commerce shipping expense, it would've been higher by 10 basis points as a result of higher IMOs due to brand mix and lower markdowns.

Gross margin was down 70 basis points at Schuh due to lack of full-price selling and some additional markdown activity to clear slower-moving product. At Lids, gross margin was down 40 basis points due largely to extra e-commerce shipping expense. Finally, weak demand for men's dress and casual shoes in the midst of this strong athletic footwear cycle and increased closeout sales drove a licensed brands gross margin decrease of 130 basis points.

Total SG&A expense as a percent of sales increased 80 basis points to 49.9% with deleverage primarily from selling salaries and benefits and higher bonus expense in connection with our better-performing businesses. Without exchange rate increases, total expense dollars would've been flat for the quarter due to the impact of store closings, rent, and other cost reductions. We experienced a small amount of rent expense deleverage due to the negative store comp, but without the significant rent savings we have been getting, the deleverage would have been greater.

We've talked about pressure from minimum wage and competitor wage increases and we saw this continued impact on the wage rate in Journeys and Lids this quarter with mid-single digit increases. Schuh has been facing similar challenges with the living wage increases as well.

So Q1's net result was an adjusted operating loss of $0.3 million versus operating income of $2.9 million last year. Adjusted operating margin decreased 50 basis points to flat for the quarter. Journeys and J&M OI was up and the other businesses were down.

Turning now to the balance sheet, inventory is in good shape across all businesses. Q1 total inventory was down 4% on flat sales, not adjusting for foreign exchange. Journeys' inventory was down 5% on a sales increase of 8%. J&M's inventory was down 1% on a sales increase of 4%.

Lids' inventory was down 10% on a sales decrease of 10%, even including product Lids was carrying over into the new sports season rather than marking down to rebuy later. Finally, Schuh's inventory is up 8% on a sales decrease of 6% on a constant currency basis, but much of this is seasonal product that will sell through as soon as the summer advances.

Capital expenditures were $20 million and depreciation and amortization was $20 million, as we have already taken the steps this year to bring these two in line. We did not repurchase shares during the quarter and we have $24 million remaining under the current $100 million repurchase authorization. Total debt at the end of the first quarter was down 23% versus a year ago.

Moving now to guidance for fiscal 2019, we reiterate adjusted earnings per share to range from $3.05 to $3.45. As we have discussed before, this wider-than-usual range is because of a few potential variables.

The first is whether the decline in mall traffic and sales shift into digital and out of stores, which has been dilutive to earnings, will continue at the pace we have been seeing. Store comps underlying our guidance range from roughly down 2% to flat.

The second is the timing of the Lids rebound. We have anticipated a tough first half for Lids until we anniversary the start of more challenging comps late this summer. Since we don't yet have visibility into a new major fashion driver and how much of an improvement we will see in football sales this year, we remain conservative for the back half as well, in spite of the much easier comparisons. Finally, Bob has talked about the more limited visibility into Schuh's current trajectory.

For the year, we still expect consolidated sales will range from down 1% to up 1%, which is on the basis of 53 weeks last year versus 52 this year, with consolidated comps including direct ranging from flat to up 2%.

While our overall guidance remains the same, there are a few moving parts in the underlying assumptions, which I will now update. We plan to open about 50 new stores, not including new Macy's locations, and including seven stores we are reopening in Puerto Rico after last year's hurricane. About half of these new stores are Journeys Kidz and Journeys stores.

The new stores for Journeys and our more built-out concepts will be mostly opportunistic fill-in locations in strong malls where we haven't previously been able to get the right rent deal, which these market conditions today currently afford.

The results of recent store openings validate these new store and fill-in opportunities since we have been earning more than our cost of capital in similar situations. So we will continue to pursue these openings selectively.

We plan to close over 100 stores for a square-footage decrease for the second year in a row. However, we will keep a store open with short lease term if the rent deal is attractive, so this number may change.

We don't believe we transfer a significant amount of sales to our other stores when we close a store. So keeping a store open if we can get a good rent deal on a lease that is short enough to eliminate any long-term risk in a mall we believe is the right approach. Additionally, as you saw last year, stores we open will be far more productive than the ones we close as we selectively prune the unproductive stores from our portfolio.

We expect gross margin to be up 30 basis points to 40 basis points in total, with improvement in most divisions. With the low store comp and our largely fixed store expense base, we expect SG&A expense will delever in the 40-basis-point to 60-basis-point range, which, with the cost savings I will discuss, is a meaningful improvement over last year.

In addition, we are investing in store labor, which these savings will also help offset. So this all results in an operating margin percent at or a few tenths below last year's level and EPS that ranges from down a little to up double-digits.

Our fiscal 2019 tax rate is estimated at approximately 26.9%, inclusive of the benefit of tax reform and subject to refinement as the details of this reform develop in the course of this year.

One important call-out for modeling quarterly guidance in fiscal 2019 is the shift in the calendar as a result of the 53rd week last year. While this impacts all quarters, the biggest change is the shift of one of the large volume back-to-school weeks at the beginning of August out of the third quarter and into the second, which will help Q2 and hurt Q3.

Even with this shift, it will be difficult to make money in the second quarter, as the shift will simply help to offset some of the headwinds we are facing in the quarter. So we still expect all our positive earnings to come in the second half this year.

Capital expenditures will range from $70 million to $75 million, down substantially from last year and the previous four years when we have been investing in major upgrades of our distribution facilities. We plan to spend about 40% of this capital on digital, IT, and other projects while investing the balance in refreshing our store fleet and opening the new stores we discussed. We estimate depreciation and amortization at $78 million. We are working toward a 10th of a turn improvement in inventory, which should help cash flow for the year as well.

Lastly, we are assuming 19.6 million average shares outstanding. This guidance assumes no stock buybacks, but we can use repurchase availability opportunistically going forward.

We've talked about the efforts to manage down capital spending and I will finish up by discussing our critical initiative to reduce cost. We recognize that the added expense of operating two channels and driving traffic to the stores dilutes profitability and that we must reduce the store cost structure and improve efficiency in e-commerce to combat this.

As such, we launched a profit enhancement program to take out $35 million to $40 million of annual expense. This program is a key priority in every one of our businesses. We have invested significant effort here and we are making good progress.

As an integral part of this program, we are having very good success with renewals and rent reductions, partnering with our landlords to achieve acceptable rents. To give an update, we have negotiated over 100 renewals so far this year and achieved in total an 18% reduction in cash rent or 12% on a straight-line basis.

With about 250 more renewals to go, we will keep working at this. The compounding effect of last year plus this year's decreases leads us to project rent expense below last year's level, both in terms of dollars and as a percent of sales.

Another important aspect of these renewals is the shorter term, which gives us flexibility and allows us to start thinking about rent increasingly as more variable than fixed. This year's renewals have an average term of 2.2 years, with B malls down to a little over a year.

Other significant areas of cost reduction are targeted headcount reductions we have already made and benefits from renegotiation of our freight carrier contract, which went into effect at the end of last year. When it comes to closed stores, we are counting only the losses and not the entire cost base in the savings.

This overall program is broad-reaching and includes additional opportunities in stores such as utilities expense, bank and credit card fees, store network costs, and store supplies. It includes opportunities in benefits in IT, the DCs, and beyond. This is the start of a multiyear effort to reshape our store cost structure and allow for continued investment in e-commerce and digital.

Now we are ready to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Pamela Quintiliano, SunTrust.

Pamela Quintiliano - *SunTrust Robinson Humphrey - Analyst*

Great. Congratulation, guys, on the execution and thanks for all the detail. So just had one quick one first on traffic. Sorry if I missed this, but although you were pressured, was it above or below the overall mall levels, specifically Journeys and Lids?

Mimi Vaughn - *Genesco Inc. - SVP Finance and CFO*

So Pam, when you look at Journeys, Journeys was actually above the mall levels. Journeys is positive with traffic; the mall levels were still for the first quarter negative. Lids has been facing traffic challenges, so Lids was actually below the levels of mall traffic.

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

And Pam, you know our interpretation of that, obviously, is we've got Journeys very much on-trend. And their traffic comparisons are against a period when they were less on-trend. And then the opposite is true at Lids.

So there is the overall traffic trend in malls, which continues to be slightly negative. But Journeys is outrunning [Macklin] and Lids is slipping a little bit behind at the moment.

Mimi Vaughn - *Genesco Inc. - SVP Finance and CFO*

Well, and the thing that we remind you of is that even with the traffic trends that we are seeing in malls these days, we are seeing higher conversion. What the customer is doing this days is they are doing all of their window-shopping and using their digital devices to determine what they want to buy prior to coming into the store and prior to coming to the mall.

So we are actually seeing, particularly in Johnston & Murphy, some very nice conversion increases, which along with the ticket size is what has been driving their very nice comp.

Operator

Janine Stichter, Jefferies.

Janine Stichter - *Jefferies LLC - Analyst*

Good morning. I just want to dig a little bit more into the Journeys business. Can you give us just some color on how you would compare the level of either vendor concentration or product category concentration to prior positive comp cycles?

And then any thoughts on how you see the current fashion cycle evolving. How long you think it will stay in this cycle that seems to be playing [prevalent] to Journeys' sweet spot. Thank you.

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

So in terms of the concentration, we continue to first of all assort the store to give the customer what they want. We have seen with the retro athletic trend and with the fashion trend in athletic to be an opportunity to diversify beyond the concentration that we had in the last fashion cycle. So we are feeling pretty okay about the concentration at the moment.

In terms of the fashion cycle, that's a big wildcard. We feel like we are in a good spot for this year. We see the brands coming in and refreshing the look that they are providing our customers in a way that reinforces newness inside of what the current overall trend is. So we are feeling it is pretty good.

If you look at the history, we've had two-, three-, four-year runs with these fashion trends. There have been concerns that social media shortens that. Right now we feel like we are on a very good trend, and as I said, we feel pretty confident about the rest of this year.

Operator

Jonathan Komp, Baird.

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

Yes, hi, thank you. I want to just clarify. Mimi, first on Q2, when you said it would be difficult to make a profit, you called out some other headwinds. So I just wanted to clarify what those other headwinds were specifically.

And then bigger picture question, just going back to the Journeys sales trends. I think last year, comps turned positive around April. So I want to get your thoughts on the business sustaining pretty positive levels and even accelerating here quarter to date against what looks to be tougher compares and how that factors with your outlook ahead.

Mimi Vaughn - *Genesco Inc. - SVP Finance and CFO*

So Jon, I will take the first one and then hand it over to Bob to answer your second question. But in terms of the second quarter, so you will just have to think a little bit about our business.

First and second quarters are very low-volume quarters until we get into back-to-school. And the third quarter and in holiday in the fourth quarter, we are at smaller sales levels and therefore it's difficult to leverage our fixed expense base. And so we will take staffing down to one person in stores. We have got the same rent in May that we have in December. And so we are doing all we can to manage our expense base.

And so the headwinds specifically that I was referring to are that we still expect that Lids' comps will be negative in the second quarter. And while we didn't initially anticipate that Schuh's comps would be negative, we now, just given the experience we had in the first quarter, have taken their comps and guided their comps to be negative in Q2.

We are very encouraged by what we are seeing in both Journeys and in Johnston & Murphy. But in such a low-volume quarter, the combination of those negative comps from those couple of businesses is what we would describe as a headwind.

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

I will just first add on to that one. The other thing that we are experiencing in our business, which has been going on for years, is the expansion of our digital business and the negative comps in our stores, which we have repeatedly said is dilutive.

So over many years, what has happened is our operating margin is not what it used to be. We want to see it start to climb back up. But while we are at a lower operating margin, the quarters that take the real hit are the first and second quarters because we have very little flexibility on costs, given that those are -- the stores in particular are fixed cost machines for the first two quarters before we start ramping up our labor for back-to-school and Christmas.

On your question with regard to the improving comps at Lids -- at Journeys. You are correct; last year, they improved meaningfully in every quarter. And so when you look at our projections for this year, we are bringing the expectations for Journeys' comps down a little bit every quarter.

The best way to probably understand it, though, is I would encourage you to go back and look at a three-year stack. Because when you look at some of the strong comps from last year, much of last year's strong comp was a rebound from the weak comp the year before that.

And so you really have to go back in history to understand the shape of the comp. And I would encourage you to go back -- I won't go through all the numbers here, but go back and look at a three-year stack to get a feel for what we are doing with our expectations.

Operator

Mitch Kummetz, Pivotal Research.

Mitch Kummetz - *Pivotal Research Group LLC - Analyst*

Thanks for taken my questions. Bob, I was hoping to get a little bit more color on Lids, just in terms of the quarter and then the outlook over the next quarter or so.

So on your negative 7%, is there any way you can kind of parse out or give some color between sort of the headwear side of it versus Locker Room and Clubhouse? Can you talk about the impact of Cubs and NFL on the quarter? I know it was less this quarter than last. I don't know if it was meaningfully less.

And then on MLB, it sounds like MLB is doing well. Can you say if that is actually comping positive? And can you speak to how that business ramps as a percentage of Lids' sales as you go into the second quarter versus the first quarter?

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

Yes, let me give you some general themes and then I ask Mimi to give you more specifics. The headwear business has gotten a little more difficult for us. It's -- ballpark, we do two-thirds of our business in headwear and about a third in the Locker Room business.

And so the headwear business, because we are just searching for that next fashion trend, has been more challenged than it has been in a while. The Locker Room business on a trend basis is actually getting a little better. It's not as negative as it was.

Underneath that, there is a lot of stuff, which is just the nature of the licensed sports business. So for example, last year we had the International World Series, in which we did a lot of business. And so we missed that this year. Cubs -- obviously the tail end of the Cubs was going on right now a year ago, the excitement of the new season after winning the championship.

Then we have some good things. The Yankees doing as well as they are; that's our number one team. And so the Yankees are terrific for the business. So when the Yankees are doing well, MLB is doing well.

For more detail, Mimi?

Mimi Vaughn - *Genesco Inc. - SVP Finance and CFO*

So Mitch, just specifically around your question. In the first quarter, Lids stores, just given the headwinds Bob described, their comps weren't that different than the Locker Room stores. And as we said, we are very excited to be getting into baseball season because baseball is our number one league in the first quarter.

It's still our number one league in the second quarter; it becomes even bigger. And then the impact of baseball starts to trail off in the third quarter with the start of football season. So far, our Clubhouse business in particular has been on fire because the Yankees have been on fire. And so that's been a very nice tailwind that has been driving the Clubhouse business and really the Lids business overall.

Operator

Laurent Vasilescu, Macquarie.

Laurent Vasilescu - *Macquarie Research - Analyst*

Good morning and thanks for taking my question. And thank you, Mimi, for the color on the cadence of earnings between the first half and the second half of the year.

Regarding the shift of the important week from the third quarter into the second quarter, could you possibly quantify the shift in EPS for that week? And then secondly, any directional color on where gross margins could go for the second quarter would be great.

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

I will just make the one comment. We don't give a quarterly guidance because of all the moving parts that I just finished describing, particularly in the Lids business. This is just another example of moving parts.

And so with that said, let me hand it over to Mimi.

Mimi Vaughn - *Genesco Inc. - SVP Finance and CFO*

Yes, I know that it's a tricky week and it's tricky in particular because it's such a big back-to-school week. It might not be as impactful in other businesses.

So just on the basis of last year, Laurent, if you look at the dollar amount of business that we would end up shifting from the third quarter to the second quarter, if you shift about $20 million, that should take care of the shift. And then you can work whatever your flow-throughs are to be able to flow through the right amounts.

As I said, we feel like there is some positive opportunity for gross margin this year. We saw gross margin up 30 basis points in the first quarter. We also think that there is stronger opportunity in the back part of the year for that gross margin lift, only because we have more opportunity to do business than both with back-to-school and with holiday.

Operator

Pamela Quintiliano, SunTrust.

Pamela Quintiliano - *SunTrust Robinson Humphrey - Analyst*

Thanks for taking up my follow-up question. Just a quick one on the online business. Can you talk about if that trended above or below your expectations? And just any granularity by division during the quarter?

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

In general, we continue to deliver a double-digit gain. We are pleased with that. And it has sort of been in the ballpark of our expectations.

In terms of specific business units, Mimi?

Mimi Vaughn - *Genesco Inc. - SVP Finance and CFO*

Yes, so you know, Pam, we are not breaking out specific business units anymore just because online comps are just so integrated with store comps these days. But we were up 10% against really a phenomenal up. I think we were up close to 30% last year in the first quarter.

So a little bit of the lower comps this first quarter I think is against a very strong compare from last year. Journeys' business especially has been comping strongly on the direct side. Journeys, some of our other businesses are more penetrated and so there has been lots of opportunity for Journeys to grow quickly because of some of the investments they have been making.

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

And Pam, this is going to get over time a little trickier for us to discuss and for you to analyze in the sense that the world is blurring in terms of what's an online sale. If you have a person who comes online but is buying from you because they have the chance to pick it up in the store, you have to give credit in a way for both the digital and the existence of that store for having closed that sale.

So I think increasingly we and others in the retail space will be just talking about comps. And then try to give some color about how much digital is helping comp, but it won't be strictly defined to what the digital sale was, which we have heretofore defined as a sale that is made on somebody else's device.

Mimi Vaughn - *Genesco Inc. - SVP Finance and CFO*

And I would just remind you that we run our e-commerce businesses to be profitable. So we are happy to take e-commerce sales to the extent that the customer wants to make those sales.

But the other thing that we've been delighted about is the strength of the store business for both Journeys and Johnston & Murphy. Because the positive store comps and the cost reductions that we have implemented and a strong direct business, that makes for a good formula for profitability.

Operator

Erinn Murphy, Piper Jaffray.

Erinn Murphy - *Piper Jaffray & Co. - Analyst*

Great, thanks. Good morning, and I apologize; I have been bouncing around on calls. So hopefully these haven't been asked. But I guess firstly, back to Lids. Footlocker mentioned a week ago that their customers seem to be purchasing, sort of wearing less hats in general.

Could you just talk about from a trend perspective, A, how you feel your customers are? And then from a trend perspective, any visibility on potential headwear fashions yet?

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

We did cover that on the call. Just the main theme is there is a dearth of fashion excitement in the headwear space right now, which is hitting the category, hence Footlocker's comments.

And right now what we are doing is testing a lot of different things; working very closely with our vendors to create more excitement and explore possibilities for the next trend. But we are not having great predictive -- we are not predicting when the next trend is going to appear.

Operator

And with no further questions, I'd like to turn the call back over to management for any additional or closing remarks.

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

Thank you, everybody, for joining us. And we look forward to having a conversation with you at the end of the second quarter. Have a good day.

Operator

Once again, that does conclude our call for today. Thank you for your participation. You may now disconnect.