Caleres, Inc.

Second Quarter 2024 Earnings Conference Call

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Mitch Kummetz, *Seaport Global Securities*

Josh Herrity, *Telsey Advisory Group*

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PRESENTATION

Operator

Good morning, and welcome to the Caleres Second Quarter 2024 Earnings Call.

My name is Rob, and I'll be your conference coordinator.

At this time, all participants are in listen-only mode. A question-and-answer session will follow the formal presentation. If anyone should require Operator assistance during the conference, please press star, zero from your telephone keypad.

As a reminder, this conference is being recorded.

At this time, I'll turn the call over to Liz Dunn, Senior Vice President, Corporate Development and Strategic Communications. Please go ahead.

Liz Dunn

Thank you, Rob. Good morning. I'd like to thank you for joining our Second Quarter 2024 Earnings Call and Webcast.

A press release with detailed financial tables, as well as our quarterly slide presentation, are available at caleres.com.

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

In discussing the results of our operations, we will be providing, and referring to, certain non-GAAP financial measures. You can find additional information regarding these non-GAAP financial measures, as well as others used, in today's earnings release and our presentation on the Investors section of our website.

The Company undertakes no obligation to update any information discussed in this call at any time.

Joining me on the call today is Jay Schmidt, President and CEO, and Jack Calandra, Senior Vice President and CFO. We will begin this morning's call with our prepared remarks and, thereafter, we will be happy to take your questions.

I would now like to turn the call over to Jay. Jay?

Jay Schmidt

Thank you, and good morning, everyone.

Earlier today, we reported sales and earnings that were below our expectations. While our brands and our products continue to resonate with consumers and we remain committed to, and confident in, our long-term vision, our second quarter results fell short in both segments and do not reflect our true potential. Our ERP upgrade during the quarter was a significant part of the problem, but not the entire problem. Lack of visibility caused execution issues that prevented us from delivering our expected results.

In total, for the second quarter, we achieved earnings per share of $0.85. Our second quarter sales declined 1.8% year-over-year and the sales miss drove the bottom line miss. We generated strong gross margin rates of 30 basis points, driven by the Brand Portfolio.

Now, let me delve into the issues faced with regard to our ERP system upgrade and what we have done to course correct.

As you are aware, we upgraded our SAP enterprise system to the new cloud-based version. This was a necessary upgrade that our teams have been working on for the past year, resulting in a common platform to leverage across our Brand Portfolio. Mid-quarter, we were down for a few days, as we planned. When our systems came back online, we initially saw signs of a successful implementation, with e-commerce and order shipping on track. However, as we progressed through the quarter, several key operational reports were delayed, causing a lack of visibility to the tools we rely on to drive our business day-in and day-out.

Additionally, there were issues related to size reporting that initially made it difficult for us to service dropship and replenishment orders.

Finally, we experienced late shipments and carrier failures that, while not related to the ERP implementation, contributed to the sales decline.

It is important to note that about 45% of our Brand Portfolio business is dynamic, including direct-to-consumer, replenishment, dropship and advancing newness, and without the tools and the reports to monitor these areas, we could not see all the issues until it was too late to fully recover.

In response, we took several actions.

- First, we immediately replaced one of our integration partners who handled reporting.
- Second, we pulled experienced order management professionals from elsewhere in our Company and enlisted them to help ship out as many orders as possible.
- Third, we've gone function-by-function to shore up reporting and develop workarounds, until the automated solutions are fully online.

Importantly, we are now operational in all areas that caused the ERP disruption and we have addressed the issues that temporarily impacted visibility. That said, we do not expect to recover all the missed sales with respect to seasonal categories, dropship and other direct-to-consumer purchases. This is factored into our updated guidance, that Jack will share with you momentarily.

We have also accelerated cost-reduction initiatives to mitigate the impact on profitability. To that end, today, we announced a restructuring that will save us approximately $7.5 million on an annualized basis and $2 million in this fiscal year. These moves will make our teams more efficient and effective. Additionally, we are reducing other SG&A items for the back half to align with our forecast.

Now, let's turn to our operating segments.

The Brand Portfolio sales declined 5.1%, with the issues related to our ASP upgrade impacting all brands, as well as weakness in seasonal categories. Wholesale and dropship were down, and our owned e-commerce was flat, but below our expectations.

We continued to see strong growth in demand for new products and momentum in fashion sneakers. In fact, sneakers and sport represented 28% of retail selling for the quarter, up six points, versus the prior year. Seasonal product continued to underperform, with sandals down high-single-digits, versus last year. We are well positioned in sneakers going forward and have aligned our inventory with consumer demand for this trending category.

Higher initial margin rates and a favorable channel mix resulted in a 140-basis-point improvement in segment gross margin. This demonstrates the health of our business, overall. Our 8.3% return on sales for the Brand Portfolio was down to last year due to deleveraging of expenses. Inventory is in good shape, about flat to last year, with a reduction in aged inventory.

Our four lead brands, which include Sam Edelman, Allen Edmonds, Naturalizer and Vionic, represented more than half of the Brand Portfolio sales in the quarter. While sales were down for the lead brands, in total, they outperformed the other brands in our portfolio.

A few highlights from the quarter demonstrate that our growth vectors are still on track.

On the international front, we are very pleased with Sam Edelman's momentum. What we are seeing in Asia is giving us increased conviction in our strategy there.

In terms of new channels of distribution, Allen Edmonds' wholesale door count is up 30% year-over-year, and we continue to see a strong response at Norstrom and other strategic specialty accounts.

We also continued to attract new consumers to our brands, like Naturalizer. There, I hope you noticed that we are moving forward with Deepica Mutyala and Lauren Chan as our first inclusivity ambassadors, starting with a campaign centered around our sizing initiatives and wide shaft boots. We are already seeing a strong reaction in early fall toward tall boots, especially in wide shaft.

Finally, at Vionic, the Uptown Mock franchise continues to introduce the brand to new consumers, with more modern and relevant fashion that embodies wearable wellbeing.

Overall, the Brand Portfolio had a difficult quarter. However, we have full confidence in our growth vectors. Our retail sell-throughs in the quarter were strong, we are well positioned from an inventory perspective in sneakers, and many of our brands have growth and receipt plans for the back half to support our guidance. This was a moment that is not indicative of our future potential.

Moving on to Famous Footwear, total sales were up 1.5% during the second quarter, while comp sales declined 2.9%. Despite sales that were lower than anticipated, we delivered sequential improvement in each month of the quarter. We saw our athletic trends build in July as the back-to-school season began and we aligned our assortment with trending categories and brands.

Notably, our strategically important Kids category once again grew in the quarter and Kids outpaced the total business. Our Kids business has now outperformed the rest of the chain for 14 consecutive quarters. Its penetration of the total Famous business was 21% in the quarter and we gained 0.5 points of market share of Kids in shoe chains, according to Circana data. Also, in the second quarter, Famous Footwear's market share was flat to the total footwear market, overall, and gained 0.5 points in shoe chains, according to Circana.

We were also pleased with the performance of our owned brands at Famous. Penetration of our Caleres brands was once again up in the quarter. Our owned portfolio provides Famous with greater access to fashion products and, at an enterprise level, Caleres capture a higher gross margin on brands sold vertically. Our Famous.com business was solid in the quarter, up 10% year-over-year, with much of the business fulfilled through our stores.

Finally, we continue to further our efforts to enhance the consumer experience at Famous. At the end of Q2, we had 31 FLAIR locations in total. We experienced a five-point sales lift versus the rest of the chain in our fall 2023 and spring 2024 FLAIR stores. Those of you that shop there may notice an expanded assortment of brands, like New Balance and Brooks. FLAIR is helping us attract these and other more elevated brands and products, and our Famous consumer is responding. We are on track to remodel 12 additional FLAIR stores in the back half of this year.

As for the back-to-school business, it came late, but it has come in strongly and we are pleased with where the season ended up. Early in the year, we saw a stronger athletic business materializing and worked hard to align our inventory investment with emerging trends for back-to-school. In mid-July, we launched new marketing messages and shifted our marketing mix to channels that were driving the most traffic. We also shifted our promotional strategy to BOGO from Buy More, Save More, after conducting a test that showed BOGO was margin dollar accretive.

In August, we experienced a high-single-digit positive comp store sales gain. As a result, through August, Famous Footwear comp sales are now about flat for the full year to date. The athletic trend continued to build and turned positive, with strength in Nike and Adidas, amongst others. Furthermore, we are seeing strength in Men's and Women's, alongside continued outperformance in Kids. While we see these trends normalizing, now that the back-to-school season is over, our results suggest our product, marketing and promotional messages are resonating with the Millennial family.

The strength of Kids, our FLAIR results and our trend in August lead us to a place of cautious optimism at Famous. We believe Famous' inherent competitive advantages, namely, its leadership position with the Millennial family, especially Kids, coupled with its clear avenues for growth and support from the Caleres structure, position the business to gain additional market share in shoe chains, generate robust levels of cash, and increase profitability over the long term.

As we look ahead, we are confident in our ability to get back on track and deliver earnings per share in line with our revised guidance. Longer term, we believe we are exceptionally well positioned to execute our strategic plan, invest to fuel our growth initiatives and drive sustained value for our shareholders.

With that, I will now hand it over to Jack for a more detailed view of our financial performance and our outlook. Jack?

Jack Calandra

Thanks, Jay, and good morning, everyone.

During today's call, I'll provide additional details on our second quarter performance, share our outlook for the third quarter, and discuss our revised guidance for the full year. While there were no adjustments to the second quarter this year, please note my comparisons to last year will be on an adjusted basis.

For the second quarter, sales were $683 million, down 1.8%, which included a $23 million benefit in Famous due to the retail calendar shift that pulled a peak back-to-school week into the quarter.

As Jay mentioned, our ERP upgrade, weak sandal demand and a late back-to-school lift resulted in a shortfall to expectations. Brand Portfolio sales were down 5.1%. Based on our analysis, we believe the system issue resulted in about $10 million to $15 million of lost sales in the quarter, or as much as five percentage points of growth.

Famous sales were up 1.5%. Comparable sales, which adjusts for the calendar shift, were down 2.9%. Encouragingly, we saw sequential improvement in each month of the quarter, and that improvement continued with a strong performance in August.

Consolidated gross margin was 45.5%, a 30-basis-point increase, versus last year, and was driven by higher margin in Brand Portfolio, partially offset by a lower margin in Famous.

Brand Portfolio gross margin was 42.7%, up 140 basis points, versus last year, as a result of higher initial margins and a favorable channel mix.

Famous gross margin was 45%, down 120 basis points, versus last year, due to more days on promotion and the pull-forward of our BOGO 50 offer, as well as higher clearance activity. While we utilized the BOGO 50 offer earlier than planned, we believe we maximized gross profit given the initial tepid response to our Buy More, Save More promotion.

SG&A expense was $268 million, or 39.3% of sales, and included planned investments in marketing behind our lead brands, the expansion of our international business and the SAP upgrade.

Operating earnings were $42.5 million and operating margin was 6.2%. Operating margin was 8.2% at Brand Portfolio and 8.3% at Famous.

Net interest expense was $3.3 million, down about $2 million from last year. The reduction was driven by lower borrowings, as our weighted average borrowing rate was similar to last year.

Earnings per diluted share were $0.85, versus $0.98 last year, and EBITDA was $57 million, or 8.4% of sales.

Turning now to the balance sheet and cash flow, we ended the second quarter with $147 million in borrowings, down about $98 million from Q2 2023, and no long-term debt.

I would note that one of our vendors had issues receiving payment later in the quarter, which resulted in a planned payment of $49 million being pushed into August.

Inventory at quarter end was $661 million, flat to last year. Inventory was up slightly in Famous and down slightly in Brand Portfolio.

Regarding cash flow from operations, we generated $80 million, which included the favorable impact of the deferred vendor payment.

Now, turning to our outlook, we are updating our full year 2024 guidance to reflect the shortfall we experienced in Q2, our strong August results at Famous, and the restructuring actions we announced today. Specifically, we now expect sales to be down a low-single-digit percent, versus last year. This comparison includes the impact of the 53rd week in 2023. Excluding the 53rd week, sales to be flat to down 2%, and earnings per diluted share of $3.94 to $4.09, and adjusted earnings per diluted share of $4.00 to $4.15, which includes about $2 million of savings and excludes $3 million of one-time costs associated with the restructuring. Additionally, we now expect the following for 2024. Consolidated operating margin of 7% to 7.1% and capital expenditures of $50 million to $55 million. Given the continued strength of e-commerce, relative to stores and Famous, we will close an additional 10 stores this year and expect to end the year with 850 stores, versus 860 last year. Lastly, we still expect an effective tax rate of about 24%.

We are also providing the following guidance for Q3. We expect consolidated net sales to be flat to down 2%, a cash restructuring charge of $3 million, and earnings per diluted of $1.24 to $1.34, and adjusted earnings per diluted share of $1.30 to $1.40.

We have provided a table in our earnings release and slides that summarizes our previous and revised guidance.

With that, I'd like to turn the call over to the Operator for questions. Operator?

Operator

Thank you. We'll now be conducting a question-and-answer session. If you'd like to ask a question today, you may press star, one from your telephone keypad, and a confirmation tone will indicate your line is in the question queue. You may press star, two if you'd like to withdraw your question from the queue. For participants that may be using speaker equipment, you may have to lift the handset before pressing the star key. One moment, please, while we poll for questions. Thank you.

Thank you, and our first question is from the line of Laura Champine with Loop Capital Markets. Please proceed with your questions.

Laura Champine

Thanks for taking my question this morning. Jay, just hearing all the things that you've done to fix the ERP implementation issues, should we consider it an immaterial impact on the back half of the year?

Jay Schmidt

I would say that's accurate, Laura. We have really triaged this during the second quarter and we feel confident that we have all systems go, and where we don't, we have the accurate backups in place until we do, that we really feel are very confident in.

Laura Champine

Got it, and then on this August rebound, and I think this would probably be tough to tell, but do you have a sense that that was driven by the macro, or could it be that your promotions, which were stepping up in that time period, are what drove the improved results?

Jay Schmidt

I think it starts with the fact—we were looking here this morning—a lot of our athletic brands are trending extremely well, so we were much in position with key athletic brands. It's representing well north of 50% of our athletic—or our total Famous business. So, getting those key brands in place and the Kids inventory in place was the first part. The second part was, as you alluded to, this was the first time that we saw such a high demand on the BOGO versus the Buy More, Save More, that it became margin accretive, and that was a different place for us that we haven't seen prior to that, so while not more days in the pure back-to-school business, we do see we got a much higher traffic lift from it. Then, finally, our marketing was really all focused on Kids during the back-to-school and the key athletic shoes, and others, that they really drove through. So, you're right, it's hard to get one impact on it, but I think those three things in tandem probably drove it through. That would be where I think we wound up.

Laura Champine

Got it. Thank you.

Operator

Our next question is from the line of Mitch Kummetz with Seaport Global Securities. Please proceed with your questions.

Mr. Kummetz, your line is live for questions.

Mitch Kummetz

Yes, sorry, I was muted. Yes, I've got a few questions. On the ERP situation, Jay, it sounds like you said all systems go. I am curious, though. You mentioned that with Brand Portfolio that you're seeing growth in your receipt plans. Is there any concern about fallout to those plans, maybe just as some of these issues might have negatively impacted some confidence in your business from your wholesale partners?

Jay Schmidt

No, and it was really, in many cases, Mitch, we did ship second quarter later, but it was within a customer's shipping window, so we haven't seen any lack of confidence from our retail partners, and in some cases, again, very nominal. What we are seeing, though, is some real strength out of fall, and it's early days, for sure, but we are seeing some really nice reaction to some key trending categories on the brand side, and those include sneakers, as we've mentioned, continue to grow. We've seen some great result in some early flats and mocs coming through, and, then, sport-inspired casuals is another great example. Finally, we've seen some interest in high shaft boots, particularly at Naturalizer and Sam

Edelman. So, it seems like the consumer is interested in new fall and is out shopping, and we're in a position to address that.

Mitch Kummetz

Just on the boot piece, can you remind me us how big a part of your business that is in the back half of the year, and what kind of performance you're lapping there from a year ago?

Jay Schmidt

Yes, it's a good question. Obviously, we haven't—we've had boot seasons that were disappointing in the last two. Our best information right now tells us it's about 28% of our Brand Portfolio sales in the back half, and what we see about that, from what I can see today, is tall boots will be up slightly, and then short boots will be down, but, again, a manageable amount. Over on the Famous side, boots are obviously a much smaller penetration, about 14% of the fall season, and over there, the only thing to report is that we are seeing some good results in actually some cozy-type of products selling early, which is good to see.

Mitch Kummetz

Then, on your third quarter outlook, I think, Jay, you said that Famous Footwear comp up 8%—I'm sorry, high-single-digits in August. What kind of comp assumption for the quarter is embedded in your outlook, what kind of Famous comp is in that sales range that you provided?

Jay Schmidt

Yes, I'll let Jack pick up for the comp reporting here. Jack?

Jack Calandra

Yes, hi, Mitch. Yes, we expect what I'll describe as a modest positive comp in Q3 for Famous, which obviously drafts off of the strength of August, but I will say, though, that the total reported sales for Famous in the quarter will be down mid-single-digits as a result of this shift in the calendar, with the back-to-school weeks and what we're anniversarying last year, so what you'll see is, I think, a modestly positive comp in Q3 for Famous, but total sales, reported sales that are probably down low- to mid-single-digits.

Mitch Kummetz

Okay. Then, how about Famous gross margin for the third quarter? Obviously, it was down pretty substantially in 2Q. Are you also expecting it to be down in 3Q, or do you expect it to be better?

Jack Calandra

No, we're anticipating the gross margin for Famous to be down in the third quarter, and what I would say is when we look at sort of the year, we're still looking for gross margin improvement at the consolidated level, which is really being driven by Brand Portfolio.

Mitch Kummetz

Then, one last one for me. Just in terms of the revision to the full year sales guidance—because, it sounds like in the quarter there were three main issues, there was ERP, there was back-to-school, there was seasonal. So, for the full year revision, does that basically take into effect kind of the $10 million to $15 million you lost on ERP, but for back-to-school, it's just kind—back-to-school is kind of a wash, right, because what you lost in 2Q you kind of pick up in 3Q, and then it's seasonal, and how much was the impact on seasonal, can you kind of parse that out?

Liz Dunn

We're just getting the number.

Mitch Kummetz

Okay. I thought maybe I lost you.

Jay Schmidt

No, we probably will have to pull it for you, but we did see sandals down on the Brand Portfolio piece of our business high-single-digits in the second quarter. In Famous, actually, sandals were flattish. We can pull the exact dollar amount as it relates to the miss there.

Mitch Kummetz

But, it's fair to say that back-to-school in terms of the full year guidance, that doesn't really reflect any changes to your thinking around back-to-school, because what you lost in 2Q you pick up in 3Q, or is your overall view of back-to-school worse than what it was when you last gave the guide?

Jay Schmidt

No, I think it was—actually, we were pleased with where we saw we came out in back-to-school, and I think, Mitch, the other thing is that a lot of the key brands and trends that were there, we do see a go-forward application of that and we're looking to fuel those all the way through as we continue to serve the family throughout the fall season. So, pretty pleased with what we saw. Obviously, a lot of these areas are things that we're very strong for and known for, so those actually will help us as we move forward.

Mitch Kummetz

Okay, thanks. Good luck.

Jay Schmidt

Thank you.

Jack Calandra

Thank you.

Operator

Our next question is from the line of Josh Herrity with Telsey Advisory Group. Please proceed with your questions.

Josh Herrity

Hey, Jay and Jack. I just wanted to follow up a little more on—you know, a lot of moving pieces here in the quarter from an inventory perspective. I think you mentioned a carrier delay, the ERP implementation, seasonal weakness. Could you talk a little bit more broadly about demand trends by category? Obviously, athletic is stronger, but dress seasonal, and what that means for your inventory composition heading into the back half of the year relative to the overall promotional environment, and what it could mean for the gross margin in the back half of the year?

Jay Schmidt

I'll start with the brand piece, Josh. We obviously see a lot of these key trends continuing here. The pivot to sneakers was done in the season, so we've already seen in the first couple weeks of August that come through. I think we're reacting appropriately with the tall versus short dynamic in boots, and feel pretty good about the what I would call the casual footwear business in the fall season, and we've made the appropriate, I think, adjustments to our dress business. So, that feels pretty good to me.

Then, on Famous, again, we've seen some really strong brand results there. The Nike business, very strong. Adidas, powering through very nicely, New Balance, Converse, amongst many others, Birkenstock, so we have a very good feeling about continuing to pivot into those brands. Famous is continuing to work with all their key strategic brand partners to bring in the very best from all of them to get the business to continue to—all the learnings, to keep going through and get more of that inventory in that the consumer is demanding.

On our brand side, we're seeing our target of 30% of our business coming through speed on receipts will continue, so that will help us to continue to help us fuel all the good things that are working there, too, and it's part of our dynamic model.

Josh Herrity

Great, thanks, and then if I can just follow up with a second question on the ERP implementation. That was entirely on the Brand Portfolio side; is that correct?

Jack Calandra

It was the Brand Portfolio side, as well as our core financial systems.

Josh Herrity

Can you remind us where the ERP rollout or system stands for the Famous side, or if there's any other system implementations upcoming here?

Jay Schmidt

Yes, at this point, we've put everything on hold for the future, Josh, just to make sure that we're 100% on this. We'll update everyone on our progress as we pull the whole Company in. But, for sure, we want prioritize and get this to be—make sure that we're 100% right on this, and we'll announce more when we have more to say.

Josh Herrity

Thank you.

Jay Schmidt

Thank you.

Jack Calandra

Thanks.

Operator

Our next question is from the line of Ashley Owens with KeyBanc Capital Markets. Please proceed with your questions.

Chandana Madaka

Hi, everyone. This is Chandana Madaka on for Ashley today. Thanks for taking our questions. First, I just kind of wanted to dig in a little bit more—you've already spoken to trends quarter to date by month, but you mentioned back-to-school kind of started off a little bit late, I just wanted to ask why do you think that is, and then you've talked about how selling ticked up in August, and dynamics in marketing and promo bring you up and more in line with your expectations, but I just wanted to dig in further there?

Jay Schmidt

Yes, I think we did see the consumer at Famous and has been very aware now (inaudible), and so I'm not surprised that back-to-school opened up a little late. In terms of when they really needed to buy it, is when they came out and shopped. So, that was just one thing, I think, was consumer demand and people really prioritizing their spend in different ways and spending really when they needed it. The second thing we saw was—obviously, when we did go into full back-to-school and we did shift from last year's Buy More, Save More type of promotion into this, we did see a good piece of traffic come through, and then, finally, we really turned on all of our marketing through new digital channels, as well as well as standard channels, to really maximize the time of the this back-to-school period, which was primarily in August. So, I think it was a combination of three things at once, and then, obviously, we had the inventory aligned to really take advantage of the traffic that came through.

Chandana Madaka

Awesome, and then just as a follow-up, (inaudible) door count expansion at Allen Edmonds, just any early success there you can speak to, or any other door expansion that's planned for the other lead brands, and maybe what are you hearing from wholesale partners?

Jay Schmidt

Yes, I think that, for sure, we're seeing some growth plans come through for the back half from both Sam Edelman and Vionic, as well as what we discussed with Allen Edmonds. We're seeing all categories of growth, sneakers, tall boots off to a good early start, and then, also, I would say overarching within this on our Vionic brand, we're seeing continued interest in comfort-oriented brands that really have a great experience for the consumer gaining traction going forward. So, I would say everyone is going to face some cautious optimism. Similar to Famous, we're both a wholesaler and a retailer here, and I think we—we share their vision, but we're really focused on getting the best of the product back into the consumer's hands through the best possible means, and so far it seems like it's off to an optimistic start as we look at just early fall.

Operator

Thank you. At this time, I'll turn the floor back to Jay Schmidt for closing remarks.

Jay Schmidt

Okay, thank you. Before I close today, I would like to thank the Caleres team for their focus, hard work and dedication during this quarter. Our team worked extremely hard to deliver, while executing the future strategy that will continue to help us go forward. Despite this setback, we are confident in our long-term plans and growth opportunities. We look forward to a stronger finish to the year, and we will update you along the way. Thank you all for joining us this morning on the call, and thank you for your interest in Caleres. Have a good day.

Operator

This will conclude today's conference, you may disconnect your lines at this time, and thank you for your participation.