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Shoe Carnival, Inc. (SCVL)

Q2 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon and welcome to Shoe Carnival's Second Quarter Fiscal 2018 Earnings Conference Call. Today's call is being recorded. It is also being broadcast via webcast. Any reproduction or rebroadcast of any portion of this call is expressly prohibited.

Management's remarks may contain forward-looking statements that involve a number of risk factors. These risk factors could cause the company's actual results to be materially different from those projected in such statements. Forward-looking statements should be considered in conjunction with the discussion of risk factors included in the company's SEC filings and today's earnings press release.

Investors are cautioned not to place undue reliance on these forward-looking statements which speak only as of today's date. The company disclaims any obligation to update any of the risk factors or to publicly announce any revisions to the forward-looking statements discussed on today's conference call or contained in today's press release to reflect future events or developments.

I'll now turn the call over to Mr. Cliff Sifford, President and Chief Executive Officer of Shoe Carnival, for opening comments. Mr. Sifford, please go ahead.

Clifton E. Sifford

President, Chief Executive Officer & Director, Shoe Carnival, Inc.

Thank you and welcome to the Shoe Carnival's second quarter 2018 earnings conference call. Joining me on the call today is Kerry Jackson, Senior Executive Vice President, Chief Operating and Financial Officer.

On today's call, I'll provide a brief overview of our second quarter operating highlights and sales results, as well as a review of our updated fiscal 2018 outlook. Kerry will discuss the financial results in more detail, then we'll open up the call to take your questions.

Before I get started, I want to take this opportunity to personally announce the hiring of our newest Executive Vice President, Chief Strategy and Marketing Officer, Mark Worden. Mark has 23 years of brand and marketing experience and will bring to Shoe Carnival a fresh perspective on enhancing our overall brand value. Over the past year, we have undertaken a journey toward customer centricity where we have mapped our customers' journey and identified opportunities for improvement.

We have a special relationship with our most loyal shopper, who counts on us to offer a wide selection of the best brands available to the family footwear channel. Our challenge is to communicate the Shoe Carnival message of great brands and the latest styles at great value to new customers in both existing and new markets. We believe that Marc's branding experience makes him just the person to make that happen. Marc and his family have already moved to Evansville and we look forward to adding him to our executive team on September 10th.

Now, on to the call. Please remember that the 53rd week in fiscal 2017 resulted in a one-week shift of our fiscal 2018 calendar. Our fiscal 2018 second quarter ended one week later as compared to the second quarter last year. In fiscal 2018, all of our quarterly year-over-year sales comparisons may be impacted if there are seasonal influences near the respective quarter end dates. Comparable store sales for the second quarter are presented on a comparable 13-week basis.

Now, I'll review our operating performance. We are very pleased to report a 6.7% comparable store sales increase for the second quarter. As I mentioned on our first quarter call, we were pleased with the start of the second quarter as May's comparable store sales were exceeding our expectations. With the arrival of warmer seasonal weather, our women's non-athletic sales immediately accelerated posting a double-digit comparable store sales increase throughout the quarter.

The performance in women's non-athletic footwear was driven through key items and brands. Our performance for the quarter was broad-based as most major product categories produced mid-single digit comparable store sales increases. I'm excited to tell you that this trend has continued into the important back-to-school season, where for the month of August through yesterday we have generated a 7.6% comparable store sales increase on top of the 7% increase we reported for the month of August last year.

We also continue to see improved merchandise margins due to our focus on inventory management. Merchandise margins improved 20 basis points due primarily to the strong performance of our high-margin seasonal product categories. BD&O was down 200 basis points as a percentage of net sales, and we leveraged SG&A by 70 basis points due to the strong sales performance.

The result was a 132% increase in operating income which, when combined with the 36% increase in tax expense, produced EPS of \$0.76 per diluted share, an increase of 217% compared to the second quarter last year.

Traffic for the quarter declined low-single digits. Conversion was up high-single digit. And average dollars per transaction was flat to last year. Average units per transaction were up low-single digits, and we ended the quarter with inventory down 2% on a per store basis.

Focusing on our second quarter comparable store sales by department, women's non-athletic increased in the teens driven by the sandal and canvas categories. Our strategy of identifying key categories and offering a broad assortment in depth paid off for us. The sandal category alone drove comparable store sales increase in the high-

20s. The men's non-athletic department was up mid-single digit on a comparable basis. Again, we were pleased with the performance of men's sandals, which drove the double-digit comp store gain for the quarter.

Children's shoes were up mid-single digits on a comparable basis. This increase was driven primarily from the sandal and canvas categories. Adult athletic was also up mid-single digit on a comparable basis. Our buying team continues to offer our customers fresh new styles and colors from great brands that continue to drive the athletic and athleisure trend we have experienced over the past several years.

Now, I'd like to spend a few minutes to update you on our key initiatives for 2018. We continue to work at improving the performance of those stores that we originally slated to close this year. We continue to see some positive results through a combination of stronger sales and, in some cases, better terms from our landlords. With the improving metrics of those particular locations, we were able to reduce the number of rejected store closures from a range of 20 to 25, to a range of 15 to 17.

Our real estate strategy remains conservative as we complete the implementation of our CRM initiative and allow the real estate market in total to settle down. Our CRM initiative will help us identify our high-value customers who are driving a high percentage of our overall sales. For the remainder of this year, we'll open up approximately three new stores. We expect to realize improved operating income and EPS performance as a result of our store opening and closing strategy.

For fiscal 2019, we do not expect to continue the level of store closings we have experienced over the past several years. We believe better real estate opportunities are ahead of us as we look to benefit from the evolving specialty retail landscape, including retail consolidation and store closures.

We ended the second quarter with 402 stores in 35 states and Puerto Rico. During the quarter, we closed three stores and we had no new store openings. Our CRM initiative is moving forward nicely and we expect our initial implementation to be complete by the end of the calendar year. This strategy is a key element in understanding who our customer is and creating a one-to-one relationship with them. Although a large part of customer data comes from our loyalty program, it is not just about loyalty.

By identifying our high value customers and where they live, we will improve site selection and real estate. By understanding how they shop along with the brands and categories they prefer, our merchant team can improve the merchandise selection on a store-to-store basis. And by understanding the pain points in our customers' journey, we can improve the operations in our brick and mortar stores and online. We believe this holistic approach to CRM will give us a clear runway for growing Shoe Carnival now and in the future.

I'm happy to announce that Shoe Perks GOLD, our newest version of our loyalty program was launched just prior to back-to-school. This new program offers our high-value customers a new tier of rewards that is designed to incentivize them to make Shoe Carnival their store of choice for all their family footwear purchases. Even though this program was launched in July, we have already seen some encouraging signs that our customers are embracing the new program. Since the re-launch, we have added 200,000 new GOLD members to the program. Our GOLD members spend on average 30% more per transaction than basic Shoe Perks members, and 60% more per transaction than non-members.

We are also pleased to announce that we launched our e-commerce vendor drop ship program. This enhancement allows us to offer a broader, online assortment of styles not currently carried in a Shoe Carnival store. The advantage for us is we get to test out brands and expand sizes without the risk of inventory ownership. In order to stay relevant with the changing retail landscape and the ever evolving consumer, we must

continuously improve and innovate. The investments we are making in technology and customer engagement are incredibly important as we take Shoe Carnival to the next level of growth.

Finally, I'd like to give you an update on our financial expectations for fiscal 2018. As I said earlier, we have gotten off to a very nice start to the third quarter as our August sales are currently up 7.6%. We believe that the customer shops us at key time periods like back-to-school because they trust us to have the right styles and brands and depth at a compelling value. Once we get to the latter part of September and October, weather becomes an important element to fuel the sales of seasonal categories.

As you will remember last year, we reduced our dependence on low priced promotional boots. This year our bootie sales will be driven by great styles and not purely by low price. We are excited about the selection of boots and booties we have to offer our customers this fall and winter. The acceleration of sales in the boot category is weather dependent, therefore we are being cautious in our forward-looking guidance. Based on these factors, we expect a comparable store sales increase for the fiscal year of approximately 3%. As a result of our revised sales guidance, we are raising our earnings per share expectation from \$1.90 to \$2.05 to a range of \$2.05 to \$2.15.

That concludes my overview. I would now like to turn the call over to Kerry.

W. Kerry Jackson

Senior Executive Vice President - Chief Operating and Financial Officer and Treasurer, Shoe Carnival, Inc.

Thank you, Cliff. Our net sales for the second quarter ended August 4, 2018, increased \$33.3 million, \$268.4 million compared to \$235.1 million for the second quarter ended July 29, 2017. Comparable store sales for the 13-week period ended August 4, 2018, increased 6.7% compared to the 13-week period ended August 5, 2017.

The increase in net sales was primarily due to an increase of \$37.9 million for stores included in our comparable store sales base, along with an increase of \$2.6 million from the 12 stores we have opened since the beginning of the second quarter of last year. These increases were partially offset by the loss of \$7.2 million in sales from the 27 stores closed since the beginning of the second quarter last year.

As discussed during our Q1 earnings call, due to last fiscal year being a 53-week year, Q1, Q2 and Q3 this year and one week later than last year. This calendar shift moves an important week of back-to-school that was included in Q3 last year into Q2 this year. The net effect of the week shift compared to last year increased sales in our comparable stores in Q2 this year by approximately \$19.7 million. Our gross profit margin for the quarter was 31.2% compared to 29.0% in the second quarter last year. This was driven by a 20 basis point increase in our merchandise margin and a 200 basis point decrease in buying, distribution and occupancy expenses as a percentage of sales. The reduction in buying, distribution and occupancy expenses as a percentage of sales was primarily a result of the lower occupancy expenses during the quarter and the leveraging effect of higher sales.

Occupancy expense for the quarter was lower than in Q2 last year due primarily to lower rents from stores we have closed or will close and a \$1 million lease terminations benefit for two stores in Puerto Rico where the landlord could not make contractually required repairs within the allotted time. Based on landlords' noncompliance in accordance with the lease terms, we canceled the two store leases.

SG&A expenses increased \$7.0 million in the second quarter of fiscal 2018 to \$68.9 million. As a percentage of sales these expenses decreased 0.7% to 25.6% compared to the second quarter last year. Significant changes in SG&A for the quarter included increases of \$4.8 million in incentive and stock-based compensation along with \$2.7 million increase in advertising expense. These increases were partially offset by a \$2.5 million decrease in expenses for stores that have closed or are closing net of new store expenses.

The calendar shift affected both advertising and incentive compensation expense for the quarter. The increase in advertising expense for the second quarter was to support back-to-school sales shift I discussed earlier. Given this was a shift in expense between quarters, we expect a corresponding decrease in advertising expense in Q3 this year. Incentive compensation expense of both Q1 and Q2 this year have been elevated due to the significant increases in sales and earnings. The calendar shift has concentrated our earnings growth over last year into the first half. Included in our annual guidance is the expectation that approximately 90% of the incentive compensation growth over last year is expensed in the first half of this year.

Store closing costs included in both cost of sales and SG&A were minimal in the second quarter this year, compared with store closing costs of \$821,000 in Q2 last year. Three stores were closed in Q2 this year compared to closing four stores in Q2 last year. There were no new store openings in Q2 compared to five store openings in Q2 last year. The effective income tax rate for the second quarter of fiscal 2018 was 21.6% compared to 37.9% for the same period last year. For the full year of fiscal 2018, we expect our tax rate to be approximately 24%. Our Q2 tax rate this year was below the expected annual rate due to favorable period adjustments recorded during the quarter.

As a reminder, in December 2017, the U.S. Tax Cuts and Jobs Act was enacted which reduced our corporate statutory tax rate from 35% to approximately 21%. Net earnings for the second quarter of fiscal 2018 were \$11.8 million or \$0.76 per diluted share. For the second quarter of 2017, we reported net earnings of \$3.9 million or \$0.24 per diluted share.

Now, turning to our cash position information affecting cash flow. In Q2 this year, we did not repurchase any of our common stock due to the accelerating stock price during the quarter. Based on our experience in Q2 and our optimistic viewpoint of the remainder the year, we are now projecting further repurchases this year in our earnings guidance. We now expect diluted weighted average shares outstanding for the fiscal year to be approximately \$15.7 million shares outstanding. This is an increase of about 500,000 shares over our previous guidance.

We currently have \$31.0 million available under our \$50 million share repurchase authorization. Depreciation expense was \$5.6 million in Q2. Depreciation expenses project to be approximately \$21 million for the full fiscal year. Capital expenditures for 2018 including actual expenditures during the second quarter are expected to be approximately \$10.5 million with a little more than half to be used for new stores relocation and remodels. Leasing centers are anticipated to be approximately \$500,000 to \$1 million for the year.

My final comment today will focus on adding a little color on our earnings expectations for the third quarter this year. While the calendar shift benefited Q sales by approximately \$20 million, we expect Q3 sales to be negatively impacted from the counter shift by about \$25 million. As a result, we expect Q3 net sales to decrease 7% to 8% compared to Q3 last year.

On a comparable week basis, we expect a low to mid-single digit increase in our comparable store sales in Q3. Our gross profit margin is expected to decline approximately 30 basis points due to the de-leveraging of our buying, distribution and occupancy costs from the expected lower sales. SG&A will also de-lever despite a low-single digit decrease in SG&A expense compared to Q3 last year. Our tax rate for the quarter is expected to be approximately 26%, compared to 40% in Q3 last year.

This concludes our financial review. Now, I'd like to open up the call for questions.

QUESTION AND ANSWER SECTION

Operator: Certainly. [Operator Instructions] Our first question will come from Mitch Kummetz with Pivotal Research. Please go ahead.

Mitch Kummetz

Analyst, Pivotal Research Group LLC

Q

Yeah. Thanks for taking my questions. Kerry, on the comp guide, I'm just trying to figure out how conservative you guys are being because you're running a 7.7% comp through three weeks. And those, I think, are the three biggest weeks of the month, so you're kind of a third in low, mid-single digit comp. What does that sort of imply for the rest of the quarter? And then again just the full year comp of 3%, you're running, I think, a 4% through the first half. Just trying to figure out kind of what you guys are thinking about in terms of Q4. I mean, are you looking at something like in the flat to plus 1% range somewhere in there?

W. Kerry Jackson

Senior Executive Vice President - Chief Operating and Financial Officer and Treasurer, Shoe Carnival, Inc.

A

It depends. September, we expect a low-single digit decline. And then, in October, we're actually expecting a small comp loss, primarily because we're going against the hurricane-affected stores where we saw some really nice rebounds, particularly when Puerto Rico started opening up again and then at the Houston area. So we are being cautious. We don't know how strong we're going to comp against those large comp numbers we saw last year from the rebound of that.

Mitch Kummetz

Analyst, Pivotal Research Group LLC

Q

And again, in Q4, you've got a tougher compare. Again, I'm still kind of trying to do the math to get to your expectations for the fourth quarter. But again, I'm guessing you're looking for a very, very slightly positive comp in Q4. Is that just a function of the tougher compare or just a lack of visibility into the boot category?

W. Kerry Jackson

Senior Executive Vice President - Chief Operating and Financial Officer and Treasurer, Shoe Carnival, Inc.

A

It is a low-single digit comp for the quarter. And we had strong boot sales last year and with the bootie sales also. And we are being cautious against that not knowing how it's going to respond and how the weather will be on a year-over-year basis.

Clifton E. Sifford

President, Chief Executive Officer & Director, Shoe Carnival, Inc.

A

Mitch, this is Cliff, our customer shops at need and we've proven that time and time again. And when the weather turns cool, our boot sales will accelerate. We're always somewhat cautious on this call because we obviously don't have any visibility to weather. We're very happy. I'll do have to say this, we're happy with the initial sales of our boot, especially our bootie category, which is trending very, very nicely right now, which bodes well for us once the weather does turn cool. So we are being cautious, but it is weather-dependent.

Mitch Kummetz

Analyst, Pivotal Research Group LLC

Q

Got it. And then last thing, Kerry, on the calendar shift, particularly on the gross margin, obviously it helped you in Q2, you leveraged BD&O by 200 bps. Could you say how much of that was just a function of the calendar shift versus the fact that you guys are closing stores and that obviously helped you on that line item. And then as far as the Q3 gross margin guide goes, I think you said down 30 bps. How are you thinking in terms of merch margins versus the negative impact on BD&O by losing that week of back-to-school?

W. Kerry Jackson

Senior Executive Vice President - Chief Operating and Financial Officer and Treasurer, Shoe Carnival, Inc.

A

So I'll target our Q2 first. So it was a combination. We actually incurred less occupancy expense for the quarter. Approximately half of it was due to stores we're closing or will close. And the other half was we received that lease termination benefit where those two Puerto Rico stores, the landlord was not able to turn them over to us in a contractual timeframe for us to rebuild, and therefore we just canceled the lease and we received about a \$1 million benefit in that number. So, overall, our BD&O was down on a year-over-year basis. You combine that with the 6.7% comp for the quarter, and that helped to leverage the BD&O very nicely.

Mitch Kummetz

Analyst, Pivotal Research Group LLC

Q

And on Q3, the 30 bps of pressure, how are you thinking about merch margin versus BD&O de-leverage?

W. Kerry Jackson

Senior Executive Vice President - Chief Operating and Financial Officer and Treasurer, Shoe Carnival, Inc.

A

So we're going to expect a merch margin increase, but it would be completely offset and more by the de-leveraging of our buying, distribution and occupancy costs. We don't expect to see the dollar. We expect to see lower buying, distribution and occupancy costs, primarily occupancy costs in the third quarter, but much more muted compared to the second quarter. And so, therefore, the lack of sales creates a pretty significant deleveraging effect on BD&O.

Mitch Kummetz

Analyst, Pivotal Research Group LLC

Q

Got it. All right. Thanks, guys. Good luck.

Operator: Thank you. Our next question will come from Chris Svezia with Wedbush. Please go ahead.

Christopher Svezia

Analyst, Wedbush Securities, Inc.

Q

Good afternoon, everyone. Thank you for taking my questions.

Clifton E. Sifford

President, Chief Executive Officer & Director, Shoe Carnival, Inc.

A

Hey, Chris.

Christopher Svezia

Analyst, Wedbush Securities, Inc.

Q

Congrats on the quarter and more importantly on August comp. So I'm just curious, for the August comp, what are some of the drivers to that year-over-year improvement? If you can add any color about what potential they are,

products, or just any clarification about that and/or how maybe the CRM activities might be helping that comp performance in August as well?

Clifton E. Sifford

President, Chief Executive Officer & Director, Shoe Carnival, Inc.

A

I'm going to address CRM activity first. It's really early in our CRM. In fact, we don't expect to get the full rollout of CRM until the end of the year. However, we did re-launch our loyalty program in July and we have seen some nice improvement and some nice reaction from our most – our highest value customer which we labeled as GOLD, and I'm really happy with where that is. From a back-to-school selling, it's always about athletic shoes, Chris, as you know. And our athletic business is comping up nicely, although I will tell you sandals continue to sell throughout August. We're very, very pleased with the opened up category – opened up sandal category.

Christopher Svezia

Analyst, Wedbush Securities, Inc.

Q

Okay. And how are you planning – just to clarify, how are you planning the boot business sort of back half just about – when you check about third quarter, fourth quarter comp, low to mid-single for Q3, but I'm assuming a slight increase in Q4. How do you think about the boot business and how that plays into that from a comp perspective?

Clifton E. Sifford

President, Chief Executive Officer & Director, Shoe Carnival, Inc.

A

We're planning our boot business basically flat. We want to be able to react to it. We think that placing a larger bet on the seasonal category that is so weather-dependent, it could be a little dangerous so we would rather react strongly toward a good trend than buy into it based on expectations, so we are planning our boot sales to be flat.

Christopher Svezia

Analyst, Wedbush Securities, Inc.

Q

Do you think by any chance as you go into that fourth quarter that your merchandize margin improvements in boots were very strong last year? I vaguely remember that you can comp improvement or will that be difficult to do?

Clifton E. Sifford

President, Chief Executive Officer & Director, Shoe Carnival, Inc.

A

We believe we can comp the improvement. Whether we can prove against it remains to be seen and it's definitely weather driven. I hate to keep saying weather driven, but the fact is if we get decent fall and winter weather, we'll sell the boots through at least the margin that we sold them through last year if not better. But if we go into the weather, as you know our customer does shop at need, and if we don't hit the weather then we'll have to react to that as well to keep the inventories clean.

Christopher Svezia

Analyst, Wedbush Securities, Inc.

Q

So just a couple quick questions for Kerry just on the model. Just so I understand and answering to Mitch's question, the comp trajectory you anticipate for Q3, did you say a negative low-single digit comp for September and October? Can just clarify that one more time?

W. Kerry Jackson

Senior Executive Vice President - Chief Operating and Financial Officer and Treasurer, Shoe Carnival, Inc.

A

No. We're looking at having a low-single digit positive comp at September and a slight negative in October, which will come out to a small comp increase for the combined September and October.

Christopher Svezia

Analyst, Wedbush Securities, Inc.

Q

Okay. And...

W. Kerry Jackson

Senior Executive Vice President - Chief Operating and Financial Officer and Treasurer, Shoe Carnival, Inc.

A

[indiscernible] (00:29:17).

Christopher Svezia

Analyst, Wedbush Securities, Inc.

Q

Okay. And then SG&A, you anticipated it to be down low-single in dollar but deleverage significantly, is that correct?

W. Kerry Jackson

Senior Executive Vice President - Chief Operating and Financial Officer and Treasurer, Shoe Carnival, Inc.

A

That's correct.

Christopher Svezia

Analyst, Wedbush Securities, Inc.

Q

Okay. So just to walk through it for one second. Mathematically, I'm getting a low \$0.60 we'll call it earnings number for Q3 ballpark, that would imply to get to the pioneer guidance that Q4 is roughly a loss of a \$0.10, ballpark. I'm curious, given the fact you're closing a lot fewer stores, there's a lot of savings related to those stores in terms of not doing the accelerated closings and markdowns, there's no expense related to those closings, how does that play into your thought process around Q4 and profitability?

W. Kerry Jackson

Senior Executive Vice President - Chief Operating and Financial Officer and Treasurer, Shoe Carnival, Inc.

A

Well, we haven't given guidance. I'm hesitating a little bit on Q4...

[indiscernible] (00:30:25).

W. Kerry Jackson

Senior Executive Vice President - Chief Operating and Financial Officer and Treasurer, Shoe Carnival, Inc.

A

You can extrapolate it off of the guidance. We're looking for a flattish earnings quarter in Q4 or a flattish EPS being close to zero on the quarter if that's what your question was, so once you're back into the Q3 number.

Christopher Svezia

Analyst, Wedbush Securities, Inc.

Q

Okay. Okay. Okay. It looks like you're being somewhat conservative. Like what I'm saying is just mathematically for Q3 and getting to like a low \$0.60 number. If Q4 is flat and you're above your guidance, maybe I'm missing something. I'll talk to you guys about it offline, then.

W. Kerry Jackson

Senior Executive Vice President - Chief Operating and Financial Officer and Treasurer, Shoe Carnival, Inc.

Okay.

Christopher Svezia

Analyst, Wedbush Securities, Inc.

Okay. That's pretty much all I have. Thank you, guys, and all the best.

Clifton E. Sifford

President, Chief Executive Officer & Director, Shoe Carnival, Inc.

Thanks, Chris.

Operator: Thank you. Our next question will come from Sam Poser with Susquehanna. Please go ahead.

Sam Poser

Analyst, Susquehanna Financial Group LLLP

Good afternoon. Just a couple – I just wanted to follow-up on that. You're still planning on – you're going to lose about \$25 million in Q3 and then you're going to lose another around \$16 million because of the extra week in Q4. Is that correct?

Clifton E. Sifford

President, Chief Executive Officer & Director, Shoe Carnival, Inc.

About \$15 million in Q4, yeah, because of the extra week.

Sam Poser

Analyst, Susquehanna Financial Group LLLP

And then I guess the question is, in 2016 when you had a negative 1%- 2% comp, you managed to earn \$0.07 from the fourth quarter. What are these – I assume this is an SG&A issue in the fourth quarter even on a low-single digit comp. Why would this go to zero earnings?

W. Kerry Jackson

Senior Executive Vice President - Chief Operating and Financial Officer and Treasurer, Shoe Carnival, Inc.

It's less of SG&A. There's two things that affect Q4. So we expect to have higher – on a year-over-year basis, higher incentive and equity compensation. That's one of the standout items of just – other than the natural growth in SG&A if we hit those numbers. Even though we frontloaded in the first half on a year-over-year comparison, Q4 has a difficult compare on that also and we're also looking at some merchandise margin pressure on the merchandise margin, and we will have some leverage. It'll be more difficult, obviously, to leverage our BD&O on a declining sales base. The one thing that creates opportunity with that extra week – it didn't create a lot of income though it decreased a little bit of EPS the extra week, but it does create a strong leverage of your expense structure for the quarter which we won't see coming out of this quarter in Q4 of 2018.

Sam Poser

Analyst, Susquehanna Financial Group LLLP

And...

Q

W. Kerry Jackson

Senior Executive Vice President - Chief Operating and Financial Officer and Treasurer, Shoe Carnival, Inc.

But the combination of some pressure on the merchandise margin and higher SG&A is the question.

A

Sam Poser

Analyst, Susquehanna Financial Group LLLP

And that merch margin pressure is just because last fourth quarter was so good you're not counting on it happening again?

Q

W. Kerry Jackson

Senior Executive Vice President - Chief Operating and Financial Officer and Treasurer, Shoe Carnival, Inc.

It's a combination of factors that, like Cliff talked about, there's consciousness around we had really good boot margins last year and if we have the right weather we can push against it. We also expect with the CRM initiative to see some pressure against some of the opportunities to drive customers in the store and you do that with coupons and discounts. So we expect some pressure from that standpoint also. And there's a mix shift, we're seeing a strong athletic shift and therefore with stronger athletic sales, you'll see a little margin pressure apparently, too. And also, closing stores. Like I said, there's a lot of things that are putting pressure on the fourth quarter, closing stores will be another item that we're anticipating seeing some pressure against on a year-over-year basis.

A

Sam Poser

Analyst, Susquehanna Financial Group LLLP

So if we wanted to see some leverage in the fourth quarter, what kind of comp would be needed, let's say BD&O and SG&A?

Q

W. Kerry Jackson

Senior Executive Vice President - Chief Operating and Financial Officer and Treasurer, Shoe Carnival, Inc.

I don't know, Sam. I haven't calculated like that. We really hadn't anticipated giving fourth quarter guidance right now.

A

Sam Poser

Analyst, Susquehanna Financial Group LLLP

Well, you're doing a very nice job of it.

Q

W. Kerry Jackson

Senior Executive Vice President - Chief Operating and Financial Officer and Treasurer, Shoe Carnival, Inc.

I didn't know I had a choice.

A

Sam Poser

Analyst, Susquehanna Financial Group LLLP

Q

I guess when you're looking at the comp last year, so you had like three good months. Could you walk through what the comps by month were in Q3 last year?

W. Kerry Jackson

Senior Executive Vice President - Chief Operating and Financial Officer and Treasurer, Shoe Carnival, Inc.

A

Well, last year we – August was by far the standout month. We were up 7%. In September we came back with a low-single digit comp and then October is basically just about flat.

Sam Poser

Analyst, Susquehanna Financial Group LLLP

Q

And that was with the help of that recovery from the hurricane?

W. Kerry Jackson

Senior Executive Vice President - Chief Operating and Financial Officer and Treasurer, Shoe Carnival, Inc.

A

Yes. In October.

Clifton E. Sifford

President, Chief Executive Officer & Director, Shoe Carnival, Inc.

A

In October.

Sam Poser

Analyst, Susquehanna Financial Group LLLP

Q

In October?

W. Kerry Jackson

Senior Executive Vice President - Chief Operating and Financial Officer and Treasurer, Shoe Carnival, Inc.

A

But after we saw the effect of the stores not being open also, so yes. And then, Puerto Rico was down longer. Then, Houston bounced back rather quickly, whereas Puerto Rico was down for a while.

Sam Poser

Analyst, Susquehanna Financial Group LLLP

Q

Okay. One last thing, Cliff, if you just look at the overall merchandise mix in the stores now compared to a year ago and the trends that are going with them, I mean, on a kind of scale of 1 to 10, how would you rank the mix this year versus last year? And then why should we expect such deceleration...

Clifton E. Sifford

President, Chief Executive Officer & Director, Shoe Carnival, Inc.

A

I was happy with the mix. I'm not going to give a scale, but I'm happy with the mix in the stores. I will tell you this that I'm really happy with the way our women's business is performing, but there is some concern on whether or not the athletic trend will continue at the current rate through the rest of the fall season. So that's part of the cautious outlook is that we see a strong women's trend continuing throughout the fall period, especially with boots and booties, but a little concerned on the athleisure trend.

Sam Poser

Analyst, Susquehanna Financial Group LLLP

Q

What's giving you pause there?

Clifton E. Sifford

President, Chief Executive Officer & Director, Shoe Carnival, Inc.

A

Just a streak of boot and bootie category. Athleisure, athletic has been strong now for the seventh straight year. I think it's judicious to get a little concerned as we enter into the – as we complete the seventh year of that trend. I think I'm right on the seven years.

Sam Poser

Analyst, Susquehanna Financial Group LLLP

Q

All right. Thanks very much, Cliff and Kerry. And good luck.

Clifton E. Sifford

President, Chief Executive Officer & Director, Shoe Carnival, Inc.

A

Thanks.

W. Kerry Jackson

Senior Executive Vice President - Chief Operating and Financial Officer and Treasurer, Shoe Carnival, Inc.

A

Thank you.

Operator: [Operator Instructions] We'll go next to Steven Martin with Slater. Please go ahead.

Steven L. Martin

President, Slater Capital Management LLC

Q

Yeah. Now that you've got a better visibility on Puerto Rico, can you talk about where that's going to end up when everything opens, closes, doesn't open? And second of all, you reduced the number of stores you were going to close. What are the implications of that vis-à-vis rent expense and closings going forward. Have you scared the landlords enough?

Clifton E. Sifford

President, Chief Executive Officer & Director, Shoe Carnival, Inc.

A

I'm not sure. I'm willing to say we've scared the landlords. What our real estate team has done a very good job of is setting out the landlords and working out a couple of year extensions, sometimes a three to four-year extension with some rent reduction or a kick-out that'll allow us to see if the current trend at the store will continue to accelerate.

So we want to save as many of these stories as we possibly can where it makes sense. So if we've seen with the current trend and our sales accelerating not only in our legacy stores, but in our new stores as well, we want to give them an opportunity to ramp-up. So it's a combination of working with the landlords, of increased sales, productivity in these stores, a myriad of reasons why we continue to reduce the number of store closures.

Steven L. Martin

President, Slater Capital Management LLC

Q

And what are the implications for that going out in 2019 and 2020?

Clifton E. Sifford

President, Chief Executive Officer & Director, Shoe Carnival, Inc.

A

Well, Kerry, correct me if I'm wrong, but we don't really announce store closures for as far out as 2020. Right now, we have not increased the number of store closings for 2019, and I don't anticipate doing that at this point. And we haven't released any numbers for 2020 or 2021.

W. Kerry Jackson

Senior Executive Vice President - Chief Operating and Financial Officer and Treasurer, Shoe Carnival, Inc.

A

Steve, it's too early to say. Just like we were able to find ways to get enough savings and performance in stores to take a lot of stores off of the closing list this year, we're still working on stores that are on our radar for next year. And we don't know where that's going to end up, so it's too early for us to give you guidance on that.

Steven L. Martin

President, Slater Capital Management LLC

Q

And I know you're not ready to give guidance for 2019, but are we going to reach a place where on a net basis possibly you don't close stores or you're plus or minus just a couple.

Clifton E. Sifford

President, Chief Executive Officer & Director, Shoe Carnival, Inc.

A

We anticipate to start opening stores again once we get our CRM program up and running and we have a better understanding of exactly who our customers are and where they live and how they shop. We've said that all year long. So that program was supposed to be up and running and which by the end of the year, we're learning new things every day. And at that point, we'll start to open up stores again. So, yes, I expect to see net growth of stores by 2020.

Steven L. Martin

President, Slater Capital Management LLC

Q

Okay. And Puerto Rico?

Clifton E. Sifford

President, Chief Executive Officer & Director, Shoe Carnival, Inc.

A

It's early on Puerto Rico yet. We've seen a really nice rebound in sales in Puerto Rico, a very nice rebound that continues in the six stores that we have open, and we're keeping a very close eye on the island to determine our long-term viability there. But we're very happy with the way Puerto Rico is performing right now.

Steven L. Martin

President, Slater Capital Management LLC

Q

Do you think that's a function of...

[indiscernible] (00:42:36).

Steven L. Martin

President, Slater Capital Management LLC

Q

Okay.

Clifton E. Sifford

President, Chief Executive Officer & Director, Shoe Carnival, Inc.

I'm sorry. Please.

A

Steven L. Martin

President, Slater Capital Management LLC

Do you think that's possibly a function of some competition maybe going away?

Q

Clifton E. Sifford

President, Chief Executive Officer & Director, Shoe Carnival, Inc.

I think it's a combination of several things. Competition has, there is less competition there today than it was before. I think there was a lot of FEMA money and a lot of insurance money that landed on the island that's why we're cautious. And I don't want to say that everything in Puerto Rico is fine and dandy and we're going to stay there because once the FEMA money and the insurance money runs out, we have to see how the island continues to progress.

A

Steven L. Martin

President, Slater Capital Management LLC

Thanks.

Q

Clifton E. Sifford

President, Chief Executive Officer & Director, Shoe Carnival, Inc.

Today, we only have six stores open and we have no plans to close any of those six stores this year.

A

Steven L. Martin

President, Slater Capital Management LLC

But is the market viable with six stores in the added expenses of shipping and transportation and travel to go down there?

Q

W. Kerry Jackson

Senior Executive Vice President - Chief Operating and Financial Officer and Treasurer, Shoe Carnival, Inc.

It's left to be seen where the sales level out at. So it's too early to say.

A

Steven L. Martin

President, Slater Capital Management LLC

Okay. Thanks.

Q

Clifton E. Sifford

President, Chief Executive Officer & Director, Shoe Carnival, Inc.

Thank you.

A

Operator: Thank you. We'll take a follow-up from Mitch Kummetz. Please go ahead.

Mitch Kummetz

Analyst, Pivotal Research Group LLC

Q

Yeah. Thanks. Yeah, I just got a few quick follow-ups, hopefully. So Cliff, when you look at the strength of the business this quarter, which is obviously continued into August, especially the strength that you're seeing in sandals, how much of that strength that you're seeing would you say is kind of a function of favorable weather and product trends, particularly in sandals versus maybe just a more buoyant consumer, is there any way to kind of disaggregate that?

Clifton E. Sifford

President, Chief Executive Officer & Director, Shoe Carnival, Inc.

A

I think it's both. I think the consumer does have more money in their pocket to spend and I think they're out spending it. But I believe that a good bit of what we're seeing has to do with the fact that we made a decision entering into this year that we were going to go after key categories and sandals, and a particular category of sandals we decided to – we wanted to own that category and it truly has driven the sandal sales all season and we see that continuing through back-to-school. We've taken the same philosophy for fall.

There are certain categories that I don't want to get into on the conference call, but certain categories we've decided to be the destination shop for it. And as long as our buyers have a lot of faith in them, have selected the right categories and they have definitely [indiscernible] (00:45:21) we're going to be successful. And I think that's one of the things that sets Shoe Carnival apart from our competitors that we do have large stores and we're not afraid to buy in depth on key categories and items.

Mitch Kummetz

Analyst, Pivotal Research Group LLC

Q

And then on sandals, you mentioned the commitment you made of this particular category and that you've seen momentum continue with goal, how long can you kind of chase that? I mean, you still have sort of enough inventory on hand to just let that go a little bit? Are you able to get more inventory at some point? Are you concerned [audio gap] (00:46:01) the season as the weather starts to change because you don't want to get kind of caught with too much to where you then have to get promotional? How are you sort of thinking about that, the opportunity to sort of leverage what you're seeing currently?

Clifton E. Sifford

President, Chief Executive Officer & Director, Shoe Carnival, Inc.

A

From that – yeah, from that category we have bought for the season so we're done. And we believe we have product that carry us into the warmer weeks of September and October and at that point I think it's time to transition. Actually, by the end of September, it's time to transition more to fall product and our boot categories, especially booties, and you'll see that as you go in our stores transition away from that sandal category and into the bootie category.

Mitch Kummetz

Analyst, Pivotal Research Group LLC

Q

And then lastly on the merch margins, I know [audio gap] (00:46:49) margin up in Q3. When I think about kind of where inventory, particularly sort of channel inventory stands, I would guess – and correct me if I'm wrong, but I would guess on the sandal side given the strength of the category things are probably pretty clean out there and maybe versus a more promotional environment a year ago that that would possibly provide a bit of a merch margin lift for you guys. And then also even on boots, as the boot category starts to kind of take off, I would guess

that maybe last year, there were maybe some more pack-aways that were being brought out that were already discounted that you don't have to deal with this year or that might help the merch margins. Is that a reasonable way to think about it kind of going transitioning into Q3?

Clifton E. Sifford

President, Chief Executive Officer & Director, Shoe Carnival, Inc.

A

It's a reasonable way to think about it but let me be really clear on one thing. We don't pack anything away and bring it back for next season.

Mitch Kummetz

Analyst, Pivotal Research Group LLC

Q

Yeah.

Clifton E. Sifford

President, Chief Executive Officer & Director, Shoe Carnival, Inc.

A

We're very, very focused on being clean of seasonal product at the end of the season.

Mitch Kummetz

Analyst, Pivotal Research Group LLC

Q

Got it. All right. Thanks again, guys.

Operator: Thank you. We'll take a follow-up from Sam Poser. Please go ahead.

Sam Poser

Analyst, Susquehanna Financial Group LLLP

Q

Kerry, can you walk through the decision not to buy back stock, and given this – I mean, what is going to trigger you to buy back stock or are you using those dollars for building out something else? I mean, can you talk about how you're allocating the capital in that regard?

W. Kerry Jackson

Senior Executive Vice President - Chief Operating and Financial Officer and Treasurer, Shoe Carnival, Inc.

A

Well, from that point of view, we're not foregoing – haven't foregone anything in the past that we need to invest in our business so that we can buy back stock. We always just used excess capital that didn't have a higher better use at that point in time. So we're not redeploying it. If we don't spend it on share repurchases, we'll let it accumulate on our balance sheet a little bit higher than what we've had in the past few years. We really don't get into what our triggers are, but we do have to be cognizant of our flow, it's not as large as some of our competitors and we want to make sure that we're not impeding shareholder's trying to take a position on and the stock price is on an uplift basis and that's why we stayed out of the market in Q2.

If we see strength in the second half, we're concerned that we are going to see strength in the stock in the second half and that's why we thought it'd better to take those shares that we had previously guided that we were going to buy back and take them out, and you'll find it when you run your models raising that share count through the years. It took about \$0.02 out of our guidance by raising that 500,000 shares that we have planned on repurchasing. We may go ahead if we – if we see the right opportunity we might – we're not saying we won't, we're just saying it's more likely than not if we have a strong stock price we weren't and it would be better to take it out of the guidance at this point in time and be opportunistic if we do find the opportunity to buy the stock.

Sam Poser

Analyst, Susquehanna Financial Group LLLP

All right. Well, thanks very much.

Q

Clifton E. Sifford

President, Chief Executive Officer & Director, Shoe Carnival, Inc.

Thank you.

A

Operator: Thank you, ladies and gentlemen. That will conclude our question-and-answer session for today. Mr. Sifford, I will turn the call back over to you for any additional or closing comments.

Clifton E. Sifford

President, Chief Executive Officer & Director, Shoe Carnival, Inc.

Thank you. I want to take this opportunity to thank our Shoe Carnival associates who dedicate themselves to making Shoe Carnival a unique, fun and exciting shoe shopping experience. I also want to thank you for participating in our call, and we look forward to announcing our third quarter results in November. Thank you.

Operator: That will conclude today's conference. Thank you all once again for joining and you may now disconnect.

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