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Shoe Carnival, Inc. (SCVL)

Q1 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon, and welcome to Shoe Carnival's First Quarter 2021 Earnings Conference Call. Today's conference 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 also 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 conference over to Mr. Cliff Sifford, Vice Chairman and CEO of Shoe Carnival, for opening comments. Mr. Sifford, you may begin.

Clifton E. Sifford

Vice Chairman & Chief Executive Officer, Shoe Carnival, Inc.

Thank you, and welcome to Shoe Carnival's 2021 first quarter earnings conference call. Joining me on the call today are Mark Worden, President and incoming Chief Executive Officer; Carl Scibetta, Senior Executive Vice President, Chief Merchandising Officer; and Kerry Jackson, Senior Executive Vice President, Chief Financial and Administrative Officer.

On today's call, I'll provide a high-level review of our fiscal first quarter 2021 results as well as an update on our business operations. Mark will then provide an update on our strategic initiatives, followed by Carl who will provide an overview of our business trends. And finally, Kerry will discuss the quarter's financial results in more detail. We'll then open the call for your questions.

I could not be more thrilled with our fiscal first quarter results. The team delivered a record-breaking quarter with the highest quarterly sales, margin and EPS in company's history. In fact, our first quarter sales of \$328 million eclipsed the previous record first quarter set in 2016 by 26.1%. But more importantly, our EPS of \$3.02 beat our highest reported annual EPS of \$2.92 which we reported in fiscal year 2019.

The first quarter of 2021 started out relatively slow due to a combination of colder weather, weather in February versus last year, and a delay in tax refunds. However, as new spring product arrived, weather became more seasonal, tax refunds and stimulus payments began to reach our customers, and sales took off. Sales were further bolstered by the successful rollout of COVID-19 vaccinations and the decrease in the number of COVID-19 cases. The combination of both these events gave our customers confidence to shop brick-and-mortar stores again.

E-commerce sales were up double-digits and our brick-and-mortar stores posted triple-digit comparable store sales growth for the quarter. The decisions we made early in the pandemic to support our employees while redirecting their focus to e-commerce sales and fulfillment enabled Shoe Carnival to reopen faster than many of our competitors, allowing us to welcome back our customers and give new customers an opportunity to experience our concept for the first time.

Much of the credit goes to our CRM initiative, which allowed us to nurture the bond we have with our existing loyal customers. We also took the opportunity with new first time customers to sign them up for Shoe Perks membership to turn them into long-term loyal shoppers. We truly believe that is what set us up for such great success over the last 12 months and will serve us well into the future. Our loyal shoppers continue to trust Shoe Carnival to have the latest trends and the best brands to make their shopping experience simple and enjoyable.

Our merchandising team's execution continue to be impeccable for the first quarter. Our merchants and partnership with our vendors kept our inventories flowing and in line with our key trends and brands, despite the ongoing supply chain issues the retail industry is facing. I believe the relationship we have with our key vendors is the definition of true partnership. Additionally, we eliminated all low-margin global promotional events, including BOGO half for the quarter.

Customers remain focused on certain categories and brands and they had faith Shoe Carnival would deliver those brands and categories with the breadth and depth we have always been known for. Our team's recognition that our customers were focused on these items and brands, along with our desire to make Shoe Carnival the retail headquarters for this product, led to the decision to eliminate global promotions. That key decision led to record product margins, which were up 910 basis points compared to last year.

Our strategic investments in technology also continue to serve us well. E-commerce sales continue to increase at double-digit rates as it grows toward our goal of 20% of overall sales. I'm also very happy to report that our Shoe Perks loyalty program grew significantly during the quarter and active members who achieved Gold status increased in the low-20s.

This is a critical metric as Gold Members drive a higher average ticket and shop more often than those members who are not yet active Gold Members. I am confident that our Shoe Perks loyalty program, along with our

industry-leading CRM initiative, helped drive our positive sales trends throughout the pandemic. Carl will dive deeper into business trends and category performance, but looking at comparable store sales by department for the quarter, our major departments posted very strong comparable store sales increases led by athletics and seasonal categories.

As I mentioned earlier, we are still seeing supply chain issues across the board. All retailers, not just the footwear segment, are having issues getting products from factories. And then once product is through the factories, there are significant delays at all ports. However, we are in constant communication with our vendors to ensure a steady stream of product for our stores and we are confident that we will have sufficient inventory for the back-to-school season and beyond.

Based on our conversations with our vendor partners, we are expecting the supply chain issues to normalize during the second half of the calendar year. We continue to prioritize our financial strength and flexibility as our discipline in this area has proven to be invaluable over the last 14 months. Our solid balance sheet, combined with our strategic investments and exceptional execution, has allowed us to make incredible progress on our long-term goals, despite these ever-changing market conditions.

We are excited about the remainder of this quarter and are looking forward to having a more normal back-to-school season. Many of our markets have not yet posted their plans for back-to-school, which makes it difficult to provide guidance for that particular time period. However, as vaccines continue to roll out to more and more of the populations, schools should begin to announce a more normalized opening plan. I believe we are well-positioned to continue our historic leadership position as the back-to-school headquarters from footwear and the markets we serve.

Kerry will provide more color on our financial expectations in his prepared remarks. But now, I'd like to turn the call over to Mark Worden to provide an update on our strategic initiatives. Mark?

Mark J. Worden

President & Chief Customer Officer, Shoe Carnival, Inc.

Thank you, Cliff, and good afternoon, everyone. Today, the Shoe Carnival brand is stronger than ever. Our strategic plans to deliver the preferred consumer shopping experience and grow shareholder value are outpacing our internal expectations. Consumers are once again resoundingly choosing Shoe Carnival for their family footwear needs. And as a result, our sales and profits in Q1 far exceeded any prior quarterly records.

In fact, as Cliff shared, the value we provided to shareholders during Q1 surpassed any full-year total earnings per share achieved in our company's history. Total company's quarterly comp sales grew 125.8% with store sales up 161%. This record setting growth level spanned across the Shoe Carnival geographic footprint, with all store divisions growing 140% or more for Q1.

Our e-commerce sales grew by low-double digits in the first quarter, successfully comping the 160% growth achieved in Q1 2020. We are thrilled with the positive trajectory of our e-commerce business over the past year. We believe the triple-digit growth experienced in online sales in 2020 has begun to plateau. And we will move into more normalized growth rates as the year progresses.

So far in 2021, Shoe Carnival consumers are resoundingly reengaging with live shopping experiences as COVID-19 restrictions continue to ease. We anticipate this trend will continue and our brick-and-mortar store sales growth will outpace e-commerce growth for 2021 as consumers continue to seek in-person experiences and family

activities outside the home. As a result, we expect online sales for 2021 to deliver triple-digit sales growth versus 2019 and moderate single-digit year-over-year decline versus 2020.

Over the next two to three years, e-commerce sales will be a key strategic driver of new customer acquisition and profitable sales growth for us. For example, looking at 2022 and 2023, we're planning low-double digit e-commerce sales growth to be our new norm, assuming that COVID-19 does not disrupt in-store shopping again. As part of our go-forward strategy, we are transforming the way we think about promotions to best meet consumer needs, to drive margin growth and to accelerate shareholder value.

During the first quarter, we continued to successfully shift away from deep discount chain-wide promotions. And we eliminated BOGO half promotions for the entire quarter. Results have been exceptional. We saw merchandise margins grow over 1,000 basis points. Conversion growth was explosive, up over 500 basis points and our average transaction increased mid-single digits. Building on the momentum from Q1 and the promising results we've seen to-date in Q2, we've eliminated BOGO half promotions for all of Q2 and we anticipate doing so for the rest of 2021.

The strategy to drive transformational margin improvement fuels stronger brand building and loyalty building investments. We continue to be pleased with our strategic investments in digital marketing and CRM with results climbing to new records. Loyalty members exceeded 27 million during Q1, posting a double-digit gain. We expect to see growth continue as we strategically invest to enhance our digital marketing, analytics and CRM capabilities.

New customer acquisition is accelerating, achieving double-digit growth during Q1. Our customer insights and analytics are growing rapidly and enabling enhanced personalization efforts, resulting in converting more new customers into repeat buyers. And energized for our team's progress, our customers' response and see a significant continued growth runway for the strategy ahead.

As we discussed last quarter, a major driver of our strategic plan includes modernizing over two-thirds of our store fleet in the next three to five years. Shoe Carnival's already known for providing family footwear consumers a unique in-store and online shopping experience. We remain at the forefront of the industry, continuously innovating to bring consumers into our stores for an enticing in-store experience. We are moving rapidly on this work and are on targets that completed the first 100 stores within our fleet modernization plan at this time next year.

So far, the consumer response to our enhanced Shoe Carnival store experience has been overwhelmingly positive. Consumers love our athletics shop-in-shops, the robust athletic assortment from the leading brands, the convenience of shopping multiple categories, and the modern shopping experience.

Thanks to our disciplined capital management approach, we're in our strongest financial position ever, with no debt, and \$175 million in cash and cash equivalents. The strength of our balance sheet and transformative margin strategy is enabling us to make investments in our brand, technology, people, and our stores. I'm excited for the continued progress we'll make throughout the rest of the year.

There are still many unknowns in fiscal 2021, including the ongoing impact of COVID-19, particularly as it relates to back-to-school and the broader global supply chain disruptions. However, I'm confident in Shoe Carnival team and our ability to continue making headway on our strategic priorities while growing profitability and accelerating shareholder value.

I'll now turn it over to Carl Scibetta for an update on our product performance and inventory position.

Carl N. Scibetta

Chief Merchandising Officer & Senior Executive Vice President, Shoe Carnival, Inc.

Thank you, Mark. This quarter, as you have heard, we continue our reduced global promotion strategy and focused promotion on key categories and items throughout the period. This has served us well so far, delivering record sales and margin. We continue to monitor key metrics that give us insight into our customers' behavior and will adjust if we see changes in their shopping habits. In addition to our reduced promotional strategy, the strength of our outstanding merchandise organization and our strong vendor relationships were key to our outstanding first quarter results. We were able to secure additional inventory and key demand product categories when we needed it most. And we continue to work very closely with our vendors to ensure this continues and to help mitigate any impact from the global supply chain constraints.

As you heard from Cliff and Mark, first quarter comparable store sales increased 125% versus 2020. All merchandising categories were up ranging from 90% to 160% versus the same period last year. To further illustrate the strength of our performance in Q1, comparable store sales increased over 31% versus 2019. Product margins were up over 900 basis points versus Q1 2019. Turning to comparable store sales by department for the quarter versus 2019, adult athletics continued to perform. Adult athletics comped up in the mid-20s as we continue to grow our leadership position in this category. Both men's and women's athletic had strong performances with sales driven by the basketball, skate and running categories.

Sales in our women's non-athletic categories were up in the high-20s for the quarter. Women's sport and seasonal drove the category but as communities begin to reopen, the demand for additional product categories like dress shoes have increased. Sales in women's dress shoes were down single-digits compared to the first quarter of 2019, however up triple-digits when compared to 2020. We expect this trend to continue throughout the year. Sales in men's non-athletic categories were up in the middle-20s. Increases were driven by men's casuals, seasonals, and all foot categories.

Kids comparable store sales versus 2019 were up over 50% for the quarter, with every major category doing well. Sales in both kids athletic and non-athletic were very strong and we were particularly pleased with results in kids sandals and instant shoes. Sales in non-athletic were driven by casual and seasonal products as families began to get out of the house for travel and entertainment. Both girls and boys athletics also performed very well consistent with what we have seen over the last several quarters.

We ended the quarter with inventory down 8.6% on a per door basis. As I mentioned, we continue to work closely with our vendor partners to replenish key categories and are diligently monitoring our supply chain. I believe we will be well-positioned that the product our customers will be looking for as we approach back-to-school.

With that, let me now turn the call over to Kerry Jackson to provide more insight into our financial performance for the quarter and the full year.

W. Kerry Jackson

Senior Executive Vice President & Chief Financial & Administrative Officer & Treasurer, Shoe Carnival, Inc.

Thank you, Carl. We achieved record net sales of \$328.5 million during the first quarter of fiscal 2021, an increase of nearly \$181 million or 123% compared to the first quarter of fiscal 2020. This record sales number represents a 29.4% increase compared to the first quarter of fiscal 2019. Recall that last year our stores were closed for the second half of the first quarter due to the pandemic. As such, in certain circumstances, we will compare the first quarter of fiscal 2021 to the first quarter of fiscal 2019.

Comparable store sales increased to 125.8% in the first quarter of fiscal 2021 compared to the first quarter of fiscal 2020. Compared to the first quarter of fiscal 2019, comparable store sales increased 31.6%. E-commerce sales represented nearly 12% of total merchandise sales during the first quarter of fiscal 2021.

As Cliff and Mark noted, we generated a low-double digit increase in e-commerce sales for the first quarter of 2021 on top of 160% increase in e-commerce sales in the first quarter fiscal 2020. Our total brick-and-mortar comparable store sales were up 161% in the first quarter of fiscal 2021, reflecting the consumers' desire to shop in our stores again.

First quarter 2021 gross profit margin of 39.6% was a record high for Shoe Carnival and represents an increase of 18.3% over the first quarter of fiscal 2020. Our merchandise margins increased 10% and buying, distribution and occupancy expenses decreased 8.3% as a percentage of sales. Our decision to eliminate low-margin promotional activity during the quarter had a significant effect on margins. To drive the point home a little further, our margins were also significantly above first quarter 2019, which is considered a more normal quarter.

First quarter 2021 gross profit margin increased 10% over the first quarter 2019. Merchandise margins increased 8.1% and buying, distribution and occupancy expense as a percentage of sales decreased 1.9%. This reflects tremendous improvement over 2019 when stores were open for the full quarter and there were significantly less disruptions in the marketplace. SG&A expenses increased \$17.8 million in the first quarter of fiscal 2021 to \$72.6 million.

As a percentage of net sales, SG&A expense in the first quarter of this year decreased to 22.1% compared to 37.1% in the first quarter of last year and further compared to 23.4% in the first quarter of fiscal 2019. Approximately 50% of the increase in SG&A expense were increases in compensation, credit card charges, and earnings on our nonqualified deferred compensation plan.

An additional 40% of the increase was for performance-based incentive compensation. Our record performance in the first quarter exceeded the annual performance target and consequently, virtually all annual performance-based compensation expense expected for the year was incurred in the first quarter of this year.

The effective income tax rate for the first quarter of fiscal 2021 was 24.8% compared to 30.3% in the first quarter of 2020. The higher tax rate in the prior year was primarily impacted by our first quarter implementation of the CARES Act and the deleveraging effect of lower pre-tax income on permanent differences. For the full year, we expect our effective tax rate to be comparable to the 25.8% tax rate recognized in fiscal 2020.

Net income for the first quarter of 2021 was \$43.2 million compared to a net loss of \$16.2 million last year. Diluted income per share for the first quarter of 2021 increased \$4.18 to \$3.02 per diluted share. Compared to the first quarter of 2019, diluted income per share increased \$2.11.

Now turning to information affecting cash flow. Depreciation and amortization expense was \$4.3 million in the first quarter of 2021, compared to \$3.8 million in the first quarter last year. We ended the quarter with inventory of \$269 million, which was down \$35 million compared to the prior year or 8.6% on a per store basis.

As Mark mentioned, we're aggressively working to modernize our store fleet. We expect capital expenditures in the range of \$30 million to \$35 million, with \$24 million to \$26 million of that to be used on remodels, relocations, and the planned new store. We expect to spend \$2 million to \$4 million on additional upgrades to our distribution center and e-commerce platform, with the remainder spent on various store improvements, technology investments, and global asset replacements.

Our planned expenditures remain subject to near-term changes associated with the pandemic and ongoing supply chain disruption. During the first quarter, we have spent approximately \$4.1 million on capital projects, with the majority of those on remodels. As of May 1, 2021, we had no outstanding debt and cash and cash equivalents of \$175 million. Our borrowing capacity was \$99.2 million at the end of the quarter, and we generated free cash flow of \$72.4 million.

My final comment today will be on our outlook for the second quarter. Our strong sales and merchandising margins have continued into May with our comps up in the mid-20s, the first two-and-a-half weeks of the second quarter. However, we expect the sales pace to moderate and turn negative in June when we start comping the strong sales we saw after reopening our stores last year. You may recall, our stores began opening last year in late April and almost all were opened by June 1. Our comp store sales increase in June last year was almost 40%.

Additionally, the strength of the back-to-school sales which typically drive sales in the last two weeks of the quarter were question at this time. Unlike in prior years, very few schools in the trade areas we serve have announced starting dates for their fall semester. While it appears likely most schools will have at least a part-time in-person learning, it is less understandable as to whether the traditional late July and early August school openings which benefit Q2 sales and earnings will resume as normal or commence at a later date. We have factored this into our guidance and this accounts for majority of the range of sales and diluted EPS expectations.

Now for the specific guidance, for the second quarter, we expect sales to range from \$268 million to \$278 million. And based on higher merchandise margin, diluted EPS to range from Q2 all-time high by \$1 to \$1.20. Implicit in our sales, the expectation, the comparable sales decreased of between high-single digits to very low-double digits. However, when compared Q2 2019 sales results, we are expecting a comp store sales increase of low- to mid-single digits. In Q2 last year, sales were at \$300.8 million and diluted EPS was \$0.71. In Q2 2019, sales were \$268.2 million and diluted EPS was \$0.80.

As Cliff and Mark both mentioned earlier, there's continued uncertainty in the business environment, including consumer spending behavior, ongoing supply chain disruption and the timing of in-person learning in the fall. Due to the uncertainties, we will only be giving directional guidance for the second half at this time.

Our second half results last year included a comparable store sales gain of 3.5% and record diluted EPS of \$1.55. We began aggressively reducing low-return promotions in the second half last year and instead, focused on the merchandise assortment and direct communications with our customers through our CRM. This change in focus, along with the government stimulus, resulted in a significant increase in our merchandise margin and drove our record diluted EPS performance.

Based on these significant increases in the second half of last year and the expectation of a decrease in government stimulus, we're anticipating this year's second half sales and merchandise margin to be flattish to slightly down. However, when compared to the results to the second half of 2019, we expect both sales and merchandise margin to increase in the second half of this year.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from Mitch Kummetz from Pivotal Research.

Mitch Kummetz

Analyst, Pivotal Research Group LLC

Q

Yes, congrats on the quarter, and thanks for taking my questions. Kerry, let me start with you, just some questions around the guidance. So let me start. I think you said that May today is up mid-20s. Was that a comp? Did I hear that correctly or is that sales?

W. Kerry Jackson

Senior Executive Vice President & Chief Financial & Administrative Officer & Treasurer, Shoe Carnival, Inc.

A

Comp.

Mitch Kummetz

Analyst, Pivotal Research Group LLC

Q

Okay. So comp's up mid-20s. Can you say what that is on a two-year basis or could you give the sales quarter to-date on a two-year basis?

W. Kerry Jackson

Senior Executive Vice President & Chief Financial & Administrative Officer & Treasurer, Shoe Carnival, Inc.

A

You know, Mitch, I don't have that in front of me. But the important part about that guidance was that, as we were opening up our stores last year, you're – we're going to be coming into tougher weeks as we progress and that's why I was putting a point that we're up now, have a positive sales trend. But we expect that to moderate as we progress in the quarter.

Mitch Kummetz

Analyst, Pivotal Research Group LLC

Q

Right. Yeah. I mean that's basically why I was asking for it on a two-year basis, just trying to normalize some of the noise in the business last year. Because when I look at your guide, your sales guide for the quarter, I think the high end of the guide is up 4% from two years ago. The quarter you guys just reported, it was up 29% from two years ago. And I guess I'm just trying to understand how is the business currently flowing because it sounds like you're being cautious on your back-to-school assumption and maybe cautious around some other things. So, that's kind of why I'm asking the question that way. So, I don't know if there's anything else you can add.

W. Kerry Jackson

Senior Executive Vice President & Chief Financial & Administrative Officer & Treasurer, Shoe Carnival, Inc.

A

No. I'll see if I can get that number for you though.

Mitch Kummetz

Analyst, Pivotal Research Group LLC

Q

Okay. That would be helpful if you could. You called out stimulus in your, guys, comments. Is there any way to quantify that? And I know that's difficult to do, but is there any way that you kind of do as you look at the trend in the business since sort of mid-March when all the stimulus started to hit? Is there any way you could sort of speak

to the trajectory or even – if maybe you talked about that May – May to date, do you still think there's stimulus in those numbers?

Clifton E. Sifford

Vice Chairman & Chief Executive Officer, Shoe Carnival, Inc.

A

You know, Mitch, it's very difficult in the first quarter to call out stimulus because in February, weather was not really conducive to doing the spring business and we had – as I've mentioned in my prepared remarks, we – February was not positive. However, both weather and stimulus hit at the same time. So it's tough for us to quantify whether it was the stimulus or it was weather or it was both. And we're just thankful that both happened with a bit and it helped us produce a record-breaking quarter.

Mitch Kummetz

Analyst, Pivotal Research Group LLC

Q

Cliff, do you think you're still seeing stimulus in – I mean, there are still, I think, some checks being cut, but the majority of the money went out [ph] to what we knew (00:32:09) a month-and-a-half ago.

Clifton E. Sifford

Vice Chairman & Chief Executive Officer, Shoe Carnival, Inc.

A

Yeah. The majority of the money is out, but we have the Children's Tax Credit that's still...

Mitch Kummetz

Analyst, Pivotal Research Group LLC

Q

Right.

Clifton E. Sifford

Vice Chairman & Chief Executive Officer, Shoe Carnival, Inc.

A

...to come, and then that will be – that hits our customer right where they live.

Mitch Kummetz

Analyst, Pivotal Research Group LLC

Q

And then, Kerry, on the merch margins, I think you said Q1 was up 810 basis points from two years ago. So is that kind of the number that we should think flowing through the year? I mean, do you think of that as being kind of a permanent number just given the elimination of the BOGOs and the – and also cutting back on other promotions? Is that a good way to think about that or do you expect to kind of give some of that up?

W. Kerry Jackson

Senior Executive Vice President & Chief Financial & Administrative Officer & Treasurer, Shoe Carnival, Inc.

A

Well, we'll see as we progress through it. Now we think we're going to achieving higher – permanently higher merchandise margins. This will be the third quarter – was the third quarter in a row that we've had significantly higher margins on a year-over-year basis. Obviously, the last year was affected by COVID shutdown. So the percentage point increases in Q1 were higher. We're expecting – we built in our guidance once again to have higher margins in Q2, though we probably will deleverage our BD&O which will take a little bit off of the nice increase we're expecting in our merchandise margins.

Mark J. Worden

President & Chief Customer Officer, Shoe Carnival, Inc.

A

Yeah. Hi, Mitch. It's Mark. Can I talk about that? We've started to significantly test and learn reducing promotion intensity in Q3 and Q4 during the pandemic, and we're about to lap into those as we get into back-to-school.

Mitch Kummetz

Analyst, Pivotal Research Group LLC

Right.

Mark J. Worden

President & Chief Customer Officer, Shoe Carnival, Inc.

As I said, we anticipate continuing to remain with the elimination of those low profits. If I were to think of a guide, the Q3, Q4 last year is a good benchmark of where we think gross margins have the potential of gravitating around.

Mitch Kummetz

Analyst, Pivotal Research Group LLC

Got it. I guess that's again why I asked the question on a two-year basis because I think Kerry in his prepared remarks called out merch margins up 810 bps from two years ago. So that would be – even when you get to the back half of this year, if you compare it to two years ago, that would be before you started the BOGO elimination. That's again why I'm trying to ask the question the way I did in order to kind of, again, normalize for some of those changes.

But – and I guess my last question maybe for Carl. Where are you seeing inflection across categories right now? You called out like the dress business was still down from two years ago but up triple-digits from last year. And I guess I'm just kind of – where on the margin are you seeing things just getting incrementally better or maybe even on the flip side slightly worse, and is it really around those categories that benefit as the market opens up and people are getting out and about and doing social things? Maybe you could just elaborate on that.

Carl N. Scibetta

Chief Merchandising Officer & Senior Executive Vice President, Shoe Carnival, Inc.

Sure, Mitch. We're continuing to see the categories that drove business during the peak of COVID, the categories we've been seeing all along. What has happened though as we got into late first quarter and early second quarter, we're seeing a much more diverse consumer coming out, buying product for different functions as that consumer is getting back out into their social life, going on vacation. There's a lot of weddings going on right now. And we're seeing a much greater expansion of the customers' wants into categories that were hurt severely during COVID. Not all back – not all the categories back, but we're definitely seeing that movement to buy goods that frankly he or she hadn't bought for 14 months.

Mitch Kummetz

Analyst, Pivotal Research Group LLC

Got it. Okay. All right. That's helpful. Thanks, guys.

Clifton E. Sifford

Vice Chairman & Chief Executive Officer, Shoe Carnival, Inc.

Thank you.

Operator: And your next question comes from Greg Pendy from Sidoti.

Gregory Pendy

Analyst, Sidoti & Co. LLC

Q

Hey, guys. Thanks for taking my questions. I just wanted to dig into the inventory. As Kerry, I think you mentioned in the results [indiscernible] (00:36:46) inventory was down 8.6% on a per door basis. But if I go back to 2019 based on an absolute basis, you're still down 7%. So just wondering if you could provide a little bit of color on inventory levels and then maybe within that context just any color on whether you were running a high stock out level during the quarter?

Clifton E. Sifford

Vice Chairman & Chief Executive Officer, Shoe Carnival, Inc.

A

Greg, the inventory levels on a – if you want to match it up on a per door basis to 2019 at the end of the first quarter 2021, 2019 were down 2.7%. And as I said, we were able to – you pick up 31% in the quarter and you're able to maintain 2.7% versus – and again, I'm talking versus 2019, we were able to get back into some critically important products for the timeframe and where a lot of the inventory is lower is frankly in categories that needed to be lower based on the consumers' response of the product during COVID.

Gregory Pendy

Analyst, Sidoti & Co. LLC

Q

Okay. That's very helpful. And then maybe could you just provide a little bit of color on where – I understand the eliminations – being less promotional is helping the merch margins. But just lower inventory when you mention the supply chain across the board, is that also having any impact on your merch margins? Do you think that maybe will start to wane in the second half? Just trying to work through your guidance a little bit.

W. Kerry Jackson

Senior Executive Vice President & Chief Financial & Administrative Officer & Treasurer, Shoe Carnival, Inc.

A

Greg, I do believe if the supply chain problems get better and continue to get better, there'll be more products out in the marketplace and as there's more products out in the marketplace, there's more choices. And it could have an effect on margin base to the same levels that we're running today.

Clifton E. Sifford

Vice Chairman & Chief Executive Officer, Shoe Carnival, Inc.

A

And I want to build on that. I want to build on that too if I can. The customer is – we talked about this on the last call. The customer is very, very focused on the categories and items that they want to buy. And what I mean by that is there are certain brands that are really performing very, very well, certain categories that are just over-performing.

And there's just – that allows us to not get promotional on those categories and I got to give the merchants incredible credit for the fact that they recognized that early and they said, if the customer is focused on buying that product, then we're going to do everything we can to maximize the margin we make on that product. And that's exactly what we did.

And that's the reason that our margins have [ph] climbed the way it has (00:39:31) and very proud of that. So, the promotion is one thing and that's probably the biggest issue, the biggest opportunity that we grabbed hold of and won with. But the fact that our merchants just went after the product categories that were selling and kept them in stock and get them promoted. That also was a factor.

Gregory Pendy

Analyst, Sidoti & Co. LLC

That's very helpful. Thanks a lot, and congratulations on the quarter.

Q

Clifton E. Sifford

Vice Chairman & Chief Executive Officer, Shoe Carnival, Inc.

Thank you.

A

Operator: [Operator Instructions] Your next question comes from Sam Poser from Williams Trading.

Sam Poser

Analyst, Williams Trading LLC

Hi. Good afternoon, everybody. Thanks for taking my questions. I've got a handful as you can imagine. I guess one thing and I'll start off with the silly stuff. I guess after all these years, it proved out that you did hire – [indiscernible] (00:40:15) you did hire is the [indiscernible] (00:40:28) merchants [indiscernible] (00:40:29).

Q

Clifton E. Sifford

Vice Chairman & Chief Executive Officer, Shoe Carnival, Inc.

You know what, Sam, I credit the merchants that we hired together, that we all reported.

A

Sam Poser

Analyst, Williams Trading LLC

[indiscernible] (00:40:41) Mark, congratulations. Anyway, a couple of things and nobody [indiscernible] (00:40:51) what we're talking about. Were any back-to – like did you see a back-to-school push in March when kids really – there was another move towards kids going in person around? Did you see any change in your business then or is that just hard to decipher with all the others?

Q

Clifton E. Sifford

Vice Chairman & Chief Executive Officer, Shoe Carnival, Inc.

It's tough to decipher because, as I think I said to Mitch or Greg, the weather turned, the stimulus checks and the tax refunds all happened at the same time. So when that began and you can almost pinpoint the day but our business just turned from what was a disappointing February into a great March and then continued through. Well, Kerry, has told you where we stand in this month, so it's just continued.

A

Sam Poser

Analyst, Williams Trading LLC

Got you. And then I'm just getting with a couple of little ones here. How many basis points did the inventory reserve – like any inventory reserve reversals helped your gross margin? Kerry, I know you'll be happy to answer that question.

Q

W. Kerry Jackson

Senior Executive Vice President & Chief Financial & Administrative Officer & Treasurer, Shoe Carnival, Inc.

Well, there is a question that we've never had before.

A

Clifton E. Sifford

Vice Chairman & Chief Executive Officer, Shoe Carnival, Inc.

Never, in fact.

A

W. Kerry Jackson

Senior Executive Vice President & Chief Financial & Administrative Officer & Treasurer, Shoe Carnival, Inc.

And it wasn't very material. So if you look at our merchandise margins in Q1, we're almost all driven by the product margin, the increase in that, all the – and then the other biggest item was we leveraged the shipping charges against the higher sales charge on our e-commerce business, even though the dollars were up, the overall sales were up substantially so we had deleveraged that last year because the stores were closed in Q1. That was the only other big item. Everything else kind of netted against each other.

A

Sam Poser

Analyst, Williams Trading LLC

Got you. Thank you. And then you talked – well, how much of back-to-school, I mean within your guidance right now, I mean there was no back-to-school at all last year. So how much have you – but can you give us some idea of what you put into your guidance, let's say, for versus 2019? I mean like are you – is it 20% of what happened in Q2 in 2019, you put into your guidance? Is it 50%? Can you give me some idea of what's going on there?

Q

W. Kerry Jackson

Senior Executive Vice President & Chief Financial & Administrative Officer & Treasurer, Shoe Carnival, Inc.

Well, in July last year, we were – our comps were down just into the teens. And we're looking at recovering most of that in July in our guidance. So having a comp increase in the very low-double digits.

A

Sam Poser

Analyst, Williams Trading LLC

Versus 2019?

Q

W. Kerry Jackson

Senior Executive Vice President & Chief Financial & Administrative Officer & Treasurer, Shoe Carnival, Inc.

Versus 2019.

A

Sam Poser

Analyst, Williams Trading LLC

And again...

[indiscernible] (00:43:56)

Q

W. Kerry Jackson

Senior Executive Vice President & Chief Financial & Administrative Officer & Treasurer, Shoe Carnival, Inc.

...versus 2020, Sam. I'm sorry.

A

Sam Poser

Analyst, Williams Trading LLC

Q

Oh, I see. Okay. So for this quarter, just walk us through the quarter again. So you're up 20% in May, that may or may not fall off in the next few weeks. And then June, you're up against the 40% and I assume you expect that to be down.

W. Kerry Jackson

Senior Executive Vice President & Chief Financial & Administrative Officer & Treasurer, Shoe Carnival, Inc.

A

We do.

[indiscernible] (00:44:16)

Sam Poser

Analyst, Williams Trading LLC

Q

So this – your comp expectation versus last year for Q2...

W. Kerry Jackson

Senior Executive Vice President & Chief Financial & Administrative Officer & Treasurer, Shoe Carnival, Inc.

A

We said high-single digits, and just in the low-double digits.

Sam Poser

Analyst, Williams Trading LLC

Q

Versus.

W. Kerry Jackson

Senior Executive Vice President & Chief Financial & Administrative Officer & Treasurer, Shoe Carnival, Inc.

A

The real issue is that just like I said in my speech we think that May, we're coming to get – as the stores open up, we get more comparable comps. So that the increase we're seeing from the comp's going to moderate in May. We do expect to have a pretty significant decline in comps in June going against the 40% – near 40% comp increase we had in June last year. That's obviously not sustainable and it was driven by the stores reopening and the big rebound we saw pent-up demand, et cetera. And then we had a weak July just because back-to-school didn't happen and we're looking at recovering most of that decline we had in July last year. It's still unknown to us right now because the schools have not committed to when they're actually going to go back. So we don't know...

Sam Poser

Analyst, Williams Trading LLC

Q

I understand. But I mean, you did \$300 million last year in Q2 and you're telling us you're going to do less than that this year on a positive comp?

W. Kerry Jackson

Senior Executive Vice President & Chief Financial & Administrative Officer & Treasurer, Shoe Carnival, Inc.

A

So what we're looking at, Sam, though is more typical against 2019. So, our guidance was \$268 million to \$278 million, and we did \$268 million in 2019. So that's I guess, the more normalized at the high end. We're expecting a nice growth on top of that.

Sam Poser

Analyst, Williams Trading LLC

Q

So this comp, you're talking about the comp increase of mid – in the low-double digits is against 2019 you're going to be down. Your comp is going to be down versus last year.

W. Kerry Jackson

Senior Executive Vice President & Chief Financial & Administrative Officer & Treasurer, Shoe Carnival, Inc.

A

Against last year, but against 2019, we would be up...

Sam Poser

Analyst, Williams Trading LLC

Q

That's right – yeah. Yeah, okay. I'm just making sure I get it because you're going to be down sort of mid-singles versus your last year, if that's correct. I mean, that's sort of where I'm coming to.

W. Kerry Jackson

Senior Executive Vice President & Chief Financial & Administrative Officer & Treasurer, Shoe Carnival, Inc.

A

Well, our guidance was against just 2020 that we were – in Q2, we're going to be down high-single to low-double digits.

Sam Poser

Analyst, Williams Trading LLC

Q

All right.

W. Kerry Jackson

Senior Executive Vice President & Chief Financial & Administrative Officer & Treasurer, Shoe Carnival, Inc.

A

And really – it's really focused on the strength of June, which is a five-week period and has a big effect on the quarter with that kind of comp.

Sam Poser

Analyst, Williams Trading LLC

Q

Are you expecting your return rate which wasn't much of anything last year to go much higher this year?

W. Kerry Jackson

Senior Executive Vice President & Chief Financial & Administrative Officer & Treasurer, Shoe Carnival, Inc.

A

We haven't seen a material change in the percent of returns.

Sam Poser

Analyst, Williams Trading LLC

Q

And then, two other things. One, you said that the – Carl, how much have you narrowed the assort – how much more have you narrowed the assortment and gone deeper on these key items? And then this improvement in the CRM which is sort of probably for everybody, you keep working on it, it keeps attracting more customers. Isn't that besides whatever may or may not happen with back-to-school in July? Couldn't – might we – I mean, isn't that a profitable revenue driver as well?

Clifton E. Sifford

Vice Chairman & Chief Executive Officer, Shoe Carnival, Inc.

A

So Sam, on the assortment, we've been on this path for several years. I can tell you that we went into the spring season, planning [indiscernible] (00:48:02) that we planned it on lowering the assortment again, not as drastically

as we have been because we're in our third or fourth year of this. However, we did tighten it down even more as we got closer into it based on what the consumer wants were on COVID. We've significantly increased the key item strategy in every category that we have.

Carl N. Scibetta

Chief Merchandising Officer & Senior Executive Vice President, Shoe Carnival, Inc.

A

And then on CRM, let me take that one. Great question. Yes, it's going to enable tremendous growth in profitability, and is a key contributor to delivering over \$3 earnings in the past 13 weeks or Q1 more than any total year in our history. It's going to drive fuel and profitable growth in our guidance too for Q2 and we anticipate because of the strength of knowing our consumer, and now having 27 million of them that we can talk to, we will as Kerry delivered record Q2 expectations on our profitability on low-single digit comp sales growth versus normal 2019 or the declines we just talked about versus 2020.

So we're really excited about it. I'm most energized about our ability to get new customer acquisition as I said on the speech. And we are utilizing our personalization messages to convert those new consumers into Shoe Perks members and then ultimately into Gold Shoe Perks members, the most profitable ones. And last, we have a long growth way ahead on this journey. We think we have significant ongoing value to create for shareholders based on our CRM in the years ahead.

Sam Poser

Analyst, Williams Trading LLC

Q

Great. Thank you very much and continued success.

Carl N. Scibetta

Chief Merchandising Officer & Senior Executive Vice President, Shoe Carnival, Inc.

A

Thank you, Sam.

Clifton E. Sifford

Vice Chairman & Chief Executive Officer, Shoe Carnival, Inc.

A

Thanks, Sam.

Operator: Your next question comes from Mitch Kummetz from Pivotal Research.

Mitch Kummetz

Analyst, Pivotal Research Group LLC

Q

Yeah. Thanks. Just had a few, hopefully, quick follow-ups. I think you guys have mentioned that store comp was up triple-digits in the quarter. I would imagine it was nearly non-existent last year. But could you say what the store comp is on a two-year?

Clifton E. Sifford

Vice Chairman & Chief Executive Officer, Shoe Carnival, Inc.

A

Yeah. Go ahead.

W. Kerry Jackson

Senior Executive Vice President & Chief Financial & Administrative Officer & Treasurer, Shoe Carnival, Inc.

A

Yeah, Mitch. We were up comp, 2019, 31.6%.

Mitch Kummetz

Analyst, Pivotal Research Group LLC

Q

Okay. I think you said that. All right. Great. And then maybe, Carl, just on – I think Q2 that's your biggest sandal quarter. Can you remind us how important sandals are in the second quarter and kind of what your outlook is there versus – I don't think sandals were great last year. I don't know that they were terrible, but it sounds like they're trending well. Now, I think some of that having to do with some good early weather. But how are you thinking about sandals in the second quarter?

Carl N. Scibetta

Chief Merchandising Officer & Senior Executive Vice President, Shoe Carnival, Inc.

A

We're looking – we think sandals are going to be strong in the second quarter. Mitch, we think there's going to be a tremendous vacation season this year as people are going to go to the beach and get out for the first time. We did see some of that around spring break in the first quarter. So, we do anticipate that continuing into the second quarter and just like we've experienced a longer seasonal selling period on seasonal categories. So we are – we feel good there.

Mitch Kummetz

Analyst, Pivotal Research Group LLC

Q

Okay. And then Nike, you talked about their scaled-back wholesale distribution. Can you tell me when that really kicks in and benefits you guys? Have you kind of thought through that?

Clifton E. Sifford

Vice Chairman & Chief Executive Officer, Shoe Carnival, Inc.

A

Go ahead.

Carl N. Scibetta

Chief Merchandising Officer & Senior Executive Vice President, Shoe Carnival, Inc.

A

Okay. The Nike – the latest round of Nike adjustments that we have heard take place in what Nike would consider holiday, 2000 – their 2022, which is a typical fiscal 2021, which will take place October deliveries forward.

Mitch Kummetz

Analyst, Pivotal Research Group LLC

Q

Okay. That's great. And then maybe lastly, just noticed you guys have a lot of cash on the balance sheet. I know you've got some remodels and things like that, and I think you want to ramp up the unit growth next year. But just – can you just kind of remind us how you think about capital allocation and your priorities there, especially just given the size of the cash balance as it stands today?

W. Kerry Jackson

Senior Executive Vice President & Chief Financial & Administrative Officer & Treasurer, Shoe Carnival, Inc.

A

Well, always – our first investment always with our cash is going to be for growth, and that is going to be through modernizing our stores, and that's where we're putting a lot of our CapEx this year. While we – and the other piece of it is dividends and buybacks as when we – the buybacks will come from the excess capital as we have it. Now one of the things that we wanted to do is carry a higher level of cash...

Mitch Kummetz

Analyst, Pivotal Research Group LLC

[ph] Oh right. You mentioned that last time (00:52:56). Yeah.

Q

W. Kerry Jackson

Senior Executive Vice President & Chief Financial & Administrative Officer & Treasurer, Shoe Carnival, Inc.

Right. So I think you have to take that into account that in order to more fortify our balance sheet during these unusual times we're in that, that will be an important piece of it also.

A

Mitch Kummetz

Analyst, Pivotal Research Group LLC

Okay. All right. Thanks, again.

Q

Clifton E. Sifford

Vice Chairman & Chief Executive Officer, Shoe Carnival, Inc.

Thank you.

A

Operator: Your next question comes from Greg Pendy from Sidoti.

Gregory Pendy

Analyst, Sidoti & Co. LLC

Hey. Just one quick follow-up. Just wanted to get any color on the trend store closings, if there was anything kind of on trend with those. Was that better lease terms or is it just business overall? What changed?

Q

Mark J. Worden

President & Chief Customer Officer, Shoe Carnival, Inc.

Hi. Those were the planned closings we've been talking about that are natural lease expirations during this year. And we're down to two more remaining for this year and one more store opening, so no unexpected changes on that topic.

A

Gregory Pendy

Analyst, Sidoti & Co. LLC

Okay. Okay. Got it. Thanks a lot.

Q

Clifton E. Sifford

Vice Chairman & Chief Executive Officer, Shoe Carnival, Inc.

Thank you.

A

Operator: There are no further questions at this time. I will turn the call back over to the presenters.

Clifton E. Sifford

Vice Chairman & Chief Executive Officer, Shoe Carnival, Inc.

I appreciate – I really do appreciate everyone joining us today, and now we look forward to talking to you in August. Thank you, again.

Operator: This concludes today's conference call. Thank you for participating. You may now disconnect.

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