Outlets Boost Sales at Vera Bradley, Michael Kors and Express

Top retailers tout the value sector as a highlight in Q1.

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Vera Bradley's Outlet Locations Drive Growth

Vera Bradley CEO John Wallstrom said recently that his company's customer base continues to grow, thanks to its outlet shops.

"The strongest driver has been the growth of our outlet business at our Vera Bradley Outlet locations where we see growth in total customer households in both retained and new customers," Wallstrom said during an earnings call. "We see the best growth in the new customer segment that we are targeting, the 'daymaker'."

Concurrently, made-for-factory items represented about 70 percent of the Vera Bradley Outlet merchandise in the first quarter.

"[It's] driving gross margin expansion," said CFO Kevin Sierks. "A year ago, made-for-factory started at about 25 percent in the beginning of Q1 and ended at about 40 percent. We expect a bit of gross margin benefit from made-for-factory product in Q2, and reducing thereafter, as we lap higher levels of MFO penetration."

Vera Bradley is in the third year of a multi-year turnaround. On the investor call, Wallstrom, reiterated the three main objectives for fiscal 2017: "Complete our brand transformation, drive core growth through optimizing our existing product portfolio and by strengthening our distribution channels, and begin to explore additional licensing and international growth opportunities.

"We launch our new brand positioning in September, and we believe this will lay the foundation for comparable sales growth in the second half of 2016 as we introduce our fall product assortment with our new logo, launch our comprehensive fall creative campaign, open our SoHo flagship store, begin to update key full-line stores incorporated in our new logo and modern visual package, and launch our new digital flagship."

Wallstrom added that Vera Bradley is enjoying a rise in its average dollar sale (ADS).

"Also, conversion is generally improving across the channels," Wallstrom said. "We had a slight softening in full-line stores in the first quarter, but generally, we've seen conversion continue to increase."

Store traffic adversely impacted sales across all Vera Bradley channels in Q1, and reduced promotional activity penalized ecommerce sales as well.

"We experienced a traffic slowdown, quarter over quarter, from Q4 to Q1, which we didn't expect, hence the slippage on comparable store sales," Wallstrom said. "Q1 traffic was a bit lighter across the board and remained very weak in many of the malls that house our full-line stores."

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Despite a modest $1 million sales shortfall in its fiscal Q1, Vera Bradley beat the Q1 EPS CapIQ consensus estimate of $0.05, reporting $0.06 versus a $0.10 loss per share in the year ago period, as a greater proportion of made for factory ("MFO") product supported 220 basis points of gross margin expansion.

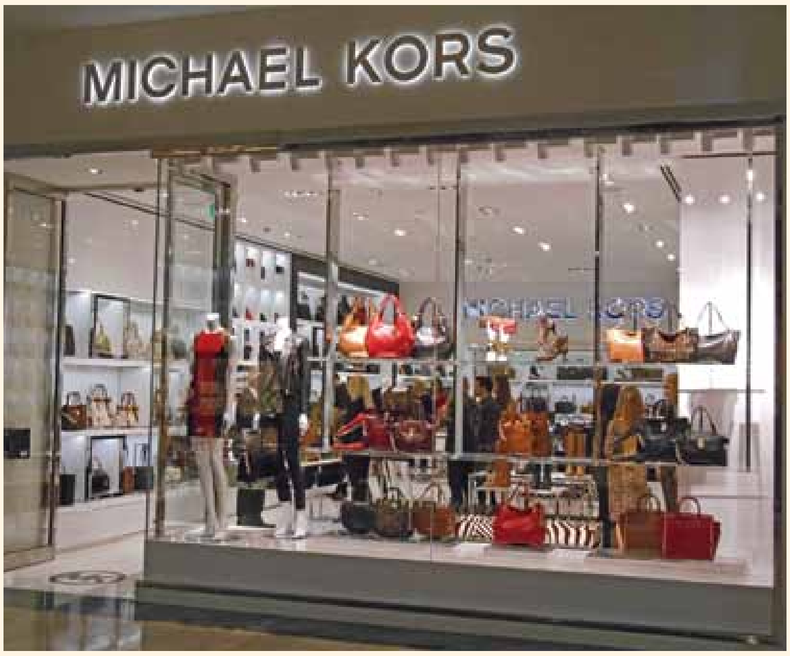
Q1 sales increased 4 percent to $105.2 million; direct retail segment sales rose 3.6 percent to $70.4 million as new store growth (11 full-line and seven Vera Bradley stores opened in the past 12 months) offset negative same store sales, or comps. Comp store sales declined 6.7 percent in Q1, down 3.8 percent in stores and down 11 percent in the ecommerce channel. Indirect wholesale revenues rose 5.1 percent to $32.2 million, reflecting sales to independent retailers and timing of a product launch.

Operating income rose four-fold to $3.9 million from $900,000 and represented 3.7 percent of sales versus 0.9 percent of sales last year. Gross profit margin of 56.7 percent of sales expanded 220 basis points reflecting sourcing and operational efficiencies as well as the increased penetration of made-for-factory product in the merchandise mix. The SG&A expense rate declined 90 basis points to 53.6 percent of sales with expense management.

The company maintained 2016 guidance of $510 million to $520 million net revenues; gross profit margin expansion of 110 to 160 basis points to 57.7 to 58.2 percent, and EPS of $0.90 to $0.98, up from $0.82. Store expansion includes four full-line and six Vera Bradley Outlet locations, supported by a $20 million capital budget.

The Vera Bradley store fleet consists of approximately 111 Vera Bradley full-line stores and 41 Vera Bradley Outlet shops.

Made-for-factory represented about 70 percent of the Vera Bradley Outlet merchandise in the first quarter, up from about 40 percent in Q1 2015.



John Idol, CEO, recently said that that brand has been able to mitigate traffic erosion by selling exclusive products in stores that are not sold online.

Online Strategy Helps Michael Kors Outlet Stores

Michael Kors' Outlet stores did not experience the same traffic downturn during its Q4 as the company's other locations, according to CEO John Idol.

"Traffic in outlets, while down, is down a very small amount, as opposed to our full-priced stores," Idol said. "We believe that this reflects our strategy not to offer our outlet products online. Unlike many of our competitors who still offer a reduced level of flash website sales, basically an outlet store online. We do not do that.

"We think we have been able to mitigate traffic erosion by maintaining channel exclusivity."

Idol added that the Michael Kors Outlet customer is attracted to its end-of-season product, or the merchandise it produces for the outlets.

"We do believe the outlet channel is experiencing traffic issues and it has to be acknowledged by others as well," Idol added.

Michael Kors saw a slight decline in North American comps on a constant currency basis in Q4, European comps increased in the mid-single digits, and comps in Japan rose in the strong double digits. Mall traffic in North America continued to decline during the quarter.

"However, we once again saw a significant increase in conversion rates in our own retail stores as customers responded favorably to our new product offerings," Kors said.

Regarding department stores, Idol elaborated, "In North America, the department store channel remained challenged. However, our new spring collection was well received, with strong sell-through in Q4. We believe the North America retail environment remains highly promotional, which is impacting the long-term brand equity of Michael Kors. We plan to decrease our exposure to the wholesale channel by reducing inventory levels and to focus on a higher level of full-priced sell-through and a lower level of markdowns.

"While this strategy is expected to result in a meaningful decrease in wholesale net sales in fiscal 2017, we believe that it is the right strategy for the overall health of our business long term as we protect our margins and brand equity."

Idol reiterated multiple growth opportunities: digital, men's, international market expansion, and the launch of the Michael Kors ACCESS wearable technology line.

Idol addressed store expansion, saying, "We expanded a handful of stores and they really haven't provided a great return for us. So that effort is over. There will be a handful of select locations where we will expand and there will be more flagship-type locations.

"Regarding outlets in North America, we are basically done at this

(Continued on page 20)

(Continued from page 19)

point. I think there is one or two more that we will open, likewise around the world, there will be a handful of Michael Kors Outlet locations that we will open, but we are pretty much finished with that. Over the next two maybe three years, we will be finished with our global store expansion.

"We remain highly productive on a sales-per-square-foot basis. In most centers we are in the top 5, let's call it the top 10 in the world. Stores are extremely profitable for us, and we will continue to open them where they make sense."

Michael Kors enters fiscal 2017 with 668 stores: 492 full-price retail locations and 176 Michael Kors Outlet stores. By region, 390 stores are in North America, 177 in Europe and 101 in Asia.

Michael Kors closed its fiscal year with a return to double-digit sales growth as Q4 (ended April 2) sales rose 10.9 percent, or 11.7 percent on a constant currency basis, to $1.2 billion. Retail sales rose 22 percent (23.4 percent constant currency) to $573 million driven by ecommerce, 142 net new stores and a 0.3 percent comp store sales gain (a 1.5 percent comp gain excluding the negative impact of foreign currency translation). Wholesale revenues rose 3.5 percent to $591 million and licensing revenue decreased 13.6 percent to $36 million.

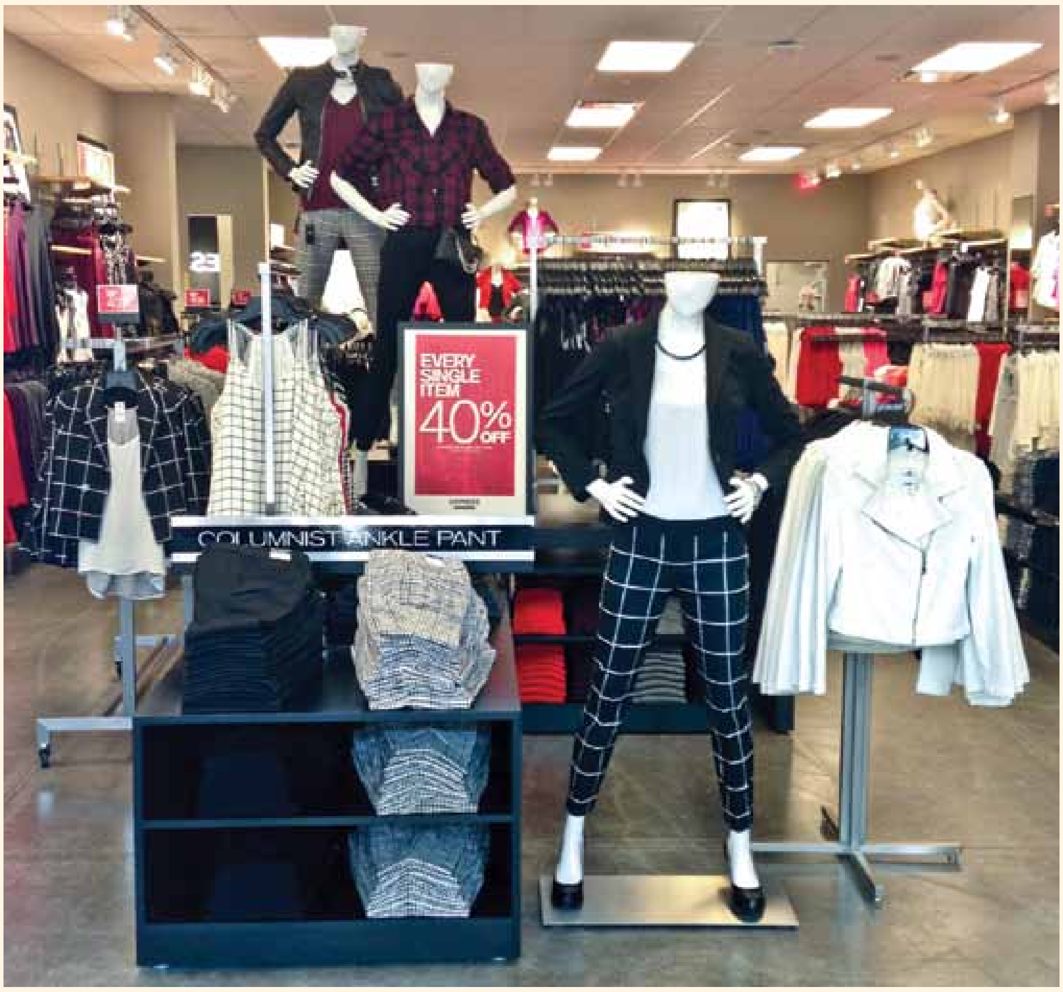
Gross margin declined a modest 20 basis points to 58.2 percent of sales while SG&A deleverage drove the 330 basis point contraction in operating margin, to 20.3 percent of sales. Net income declined 3 percent to $177 million, but EPS increased to $0.98 from $0.90, benefiting from 23 million fewer shares outstanding. Fiscal year 2016 sales were $4.5 billion, comps declined 0.9 percent constant currency and EPS were $4.44.

Guidance for fiscal 2017 (ending March 31, 2017) is for flat revenues at $4.5 billion, a low single digit comp store sales decline, an operating margin of 21.5 percent of sales, down from 24.9 percent and EPS in the range of $4.56 to $4.64.

Express Factory Outlets Expansion Planned Following "Pleasing" Performance

"Pleasing" is the common word used by Express executives when describing the performance of its 85 Factory Outlet stores.

Responding to a question during a recent earnings call, CEO David Kornberg said, "We are very pleased with the performance of Express Factory Outlets. The comp at our outlets decelerated simultaneously with the comp deceleration we experienced in our frontline retail stores, but it came off the higher base at Express Factory Outlet stores. [We're] generally very pleased."



By year end, Express will have 104 factory outlet locations and expects to reach 150 factory outlet locations within the next few years.

Similarly, CFO Periclis Pericleous said Express Factory Outlets had another good quarter, "and we continue to be pleased with the channel. During the second quarter, we will be opening six additional Express Factory Outlet stores and converting three full-price existing retail stores. We currently expect to end 2016 with 104 Express Factory Outlet locations, and we still expect to reach our target number of 140 to 150 stores within the next few years." Since the fiscal year began (January 31, 2016), Express closed 41 stores and plans to shutter another nine as part of its fleet rationalization initiative. The company intends to add 23 Express Factory Outlets during the current fiscal year, a combination of 20 new stores and three conversions, and end the year with 104 Express Factory Outlet locations.

> "We are very pleased with the performance of Express Factory Outlets."
> **David Kornberg, CEO**

The company said that relocation of its fulfillment center reduced ecommerce sales during Q1, and with the transition now complete, online business has begun to accelerate.

Pericleous addressed inventory levels, which increased 6 percent to $281 million versus the same time last year, stating, "Inventory at the quarter-end includes approximately $59 million of Express Factory Outlet inventory, a significant portion of which is related to new stores. In the aggregate, retail inventory decreased 3.4 percent and Express is working on additional inventory optimization projects to bring further efficiencies to this important area."

Express enters Q2 with 643 store locations; 541 full price Express stores in the US, 85 US-based Express Factory Outlet stores, and 17 stores in Canada.

Despite flat Q1 sales of $503 million, adjusted Q1 EPS rose 14 percent to $0.25 from $0.22 reflecting a lower tax rate (down 260 basis points to 38 percent) and 6 percent fewer shares outstanding. Same store sales declined 3 percent, which includes a 1 percent decline in the ecommerce channel.

Gross margin expanded 30 basis points to 33.4 percent of sales as merchandise margin widened 20 basis points and buying and occupancy costs leveraged 10 basis points. Higher IT spending led to an increase in the SG&A expense ratio to 27 percent of sales, up 50 basis points year-over-year. Operating income declined $2.1 million to $31.8 million or 6.3 percent of sales.

Express updated fiscal 2016 guidance to a negative mid-to-low single digit comp, a 30 basis point reduction in the operating margin driven by modest merchandise margin contraction and buying and occupancy and SG&A deleverage, adjusted net income of $113 million to $123 million and adjusted EPS of $1.41 to $1.54, versus $1.45. (Net income and EPS are adjusted for an amendment to the Times Square flagship store lease.)