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Market Intelligence

Shoe Carnival, Inc.

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Earnings Call

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Call Participants

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Presentation

Operator

Good morning, and welcome to the Shoe Carnival's Second Quarter 2024 Earnings Conference Call. Today's conference call is being recorded and is also being broadcast via webcast. Any reproduction or rebroadcast of any portion of this call is expressly prohibited.

I would now like to turn or introduce Mr. Steve Alexander with Shoe Carnival Investor Relations. Mr. Alexander, please go ahead.

Steve R. Alexander

Investor Relations

Thank you, and good morning. Thanks for joining us today. Earlier this morning, we issued our earnings press release for the second quarter of 2024. If you need a copy of the release, it is available on our website in the Investors section.

Joining me on today's call are Mark Worden, President and Chief Executive Officer of Shoe Carnival; Carl Scibetta, Chief Merchandising Officer; and Patrick Edwards, Chief Financial Officer.

Management's remarks today 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.

Today's call will reference non-GAAP measures. The non-GAAP measures or adjusted results referenced exclude the purchase accounting, merger, integration and transaction costs related to the acquisition of Rogan Shoes. A reconciliation of GAAP to non-GAAP results is included in this morning's release.

And with that, I'll hand the call over to Mark.

Mark J. Worden

President, CEO & Director

Thank you, Steve, and good morning, everyone. I'd like to start today by congratulating our 6,000 team members on achieving a new sales record for the second quarter and on the comp sales growth delivered during our most important event of the year, the back-to-school season. Well done, team. Based on these strong results, today, we are raising our annual sales and EPS guidance ranges.

During the quarter, our digital-first marketing approach worked, and our brand-focused product assortment resonated with customers across our banners, geographies and demographics. This drove customer engagement to levels that exceeded our expectations and sales and EPS that exceeded our Q2 guidance. But once the back-to-school season was in full swing at the tail end of July, comp sales growth rapidly accelerated. We once again gained significant market share, and we achieved a net sales record in the quarter, exceeding all previous second quarter net sales in Shoe Carnival's history.

During the quarter, net sales grew 12.9% to \$332.7 million. Our sales growth surpassed our expectations for the quarter, and there are several key drivers that I would like to highlight. First, Shoe Station net sales continued to grow faster than planned, increasing double digits as we continued to grow share in our existing markets, bring new customers into our Shoe Perks CRM platform and drive growth in expansion markets. Shoe Station has continued to deliver profit-accretive results as our growth banner. And as I briefly mentioned last quarter, we've identified significant additional growth opportunities going forward

with our new banner switch strategy that we are in test markets with now. I'll cover this topic in more detail in a few moments.

Second, Shoe Carnival trends continued to strengthen with comparable store sales sequentially improving versus Q1 and turn into growth during the back-to-school season. Store traffic improved sequentially versus first quarter 2024, and both conversion rates and average transaction amounts remained strong.

Third, our digital-first go-to-market approach worked beyond my expectations. This was the first back-to-school season where we fully pivoted from a traditional marketing campaign heavily focused on TV to the digital-first targeted marketing approach we have been testing for the past year. This approach gives us increased flexibility to invest in real time behind the products that are resonating with our customers during the season versus the old school way of being locked into whatever bets on the hot product were made at the time of the TV shoot and media buys. This added flexibility allowed us to amp up messaging in real time for brands that our customers were responding to during the season.

The customer engagement with our social and influencer content was very exciting to see in Q2, and results spiked as we turned on the full weight of the investments during back-to-school. Bottom line, this new approach contributed to a record-setting Q2 sales and comparable sales growth during back-to-school without spending additional marketing dollars versus the prior year. The effectiveness of our spend and added flexibility to react immediately to the customer are exciting to me, but we intend to continue building our expertise in this area going forward.

And fourth, Rogan's, which we acquired during the middle of February 2024, delivered second quarter net sales in line with our expectation and continues to be on track to deliver approximately \$84 million in annual sales, as we expected when we announced the acquisition. The integration is progressing smoothly on the accelerated schedule previously discussed, and we continue to be on pace to deliver the increased synergies in fiscal 2025, as discussed in each of the last 2 quarters. We're now about 6 months post acquisition, and our team has become very efficient at identifying synergies, integrating rapidly and building the skill set internally to capture profit synergies. The capabilities that we are building set us up well for future M&A opportunities as they become available to expand shareholder value and gain market share.

We're still early into Q3, but nearly all of our markets have gone back to school now. So I'd like to share some color commentary on our August back-to-school sales and margin results. In the fiscal month of August, we achieved solid low-single-digit comparable sales growth, led by mid-to-high single-digit growth in children's and athletics. The back-to-school weeks before Labor Day are the largest weeks of the quarter for us in Q3 and where we focus much of our campaign investments. During this time frame, we achieved comparable sales growth at both Carnival and Station banners, strong product margins, customer traffic growth and transaction size increases versus prior year.

Overall, we are encouraged not only with back-to-school and the Q2 improvement in comparable store sales performance, but also our performance on a year-to-date basis. All are key drivers of our decision to raise our full year net sales guidance range to growth of 5% to 6% versus prior year, and our comparable store sales guidance range for the full year to down 1.5% to up 1% versus prior year. Implicit in this enhanced guidance is comparable sales growth for combined Q3 and Q4 in the range of flat to plus 5%. I currently anticipate the lower side of this range is the most likely outcome as I look at where we stand today and the shape of the year to go. But if we have a record-setting boot season and holiday, then the higher side of that range is a possible stretch outcome.

Moving now from our sales growth and back-to-school update to a few financial highlights in the quarter. We again delivered sustained margin performance in the quarter with gross profit margin expanding to 36.1%, representing the 14th consecutive quarter above 35%. I'm pleased with the gross profit margin expansion achieved this quarter versus Q2 last year, and at the same time, we delivered record high sales in the quarter.

Operating income in the quarter increased 22% versus prior year to \$30.1 million, demonstrating that our strategies to grow the business profitably are working. EPS in the quarter increased on the strong net sales performance and the higher gross profit margin. On an adjusted basis, EPS in the quarter increased

17%, totaling \$0.83 as compared to \$0.71 in second quarter 2023. And operating cash flow in the quarter totaled \$40.7 million, and we ended the quarter with over \$84 million of cash, cash equivalents and marketable securities.

Our vision is to be the nation's leading family footwear retailer, and one of the core strategies to executing on this vision is profitable M&A activity. As I mentioned earlier, Rogan's, which we acquired in February 2024, is delivering results in line with our expectations, and we're on track with the integration and synergy delivery for fiscal 2025.

Along with profitable M&A, another core strategy is to grow our existing business by leveraging our advanced customer analytics capabilities. As I mentioned on our call last quarter, one of the primary focus areas in this strategy is to evaluate data on community characteristics, purchasing trends, product assortment and mix at a store level. As part of that extensive analysis, we have gained valuable insights about our Shoe Station customer and have defined markets where Shoe Station can likely outperform. Specifically, we have identified existing Shoe Carnival locations where the customer and real estate characteristics are better aligned with Shoe Station. We've been in the test and learn process for several months now, and I'd like to share some of the early results from these test markets and our observations to date on this exciting growth opportunity.

Let me start by saying that it is currently only a small-scale test and only a few months of in-market results. But to say the early results to date have outperformed our objectives would be an understatement. So what have we done so far? We define the success criteria for our banner switch test markets at 3% to 5% annual sales growth, which is roughly the breakeven profit point for the investments required to close the existing Shoe Carnival store and open a new Shoe Station store in the market.

Our first in-market test included 3 store switches from Shoe Carnival to Shoe Station in the core Station markets of Alabama and Mississippi. Here, the Shoe Station brand is very strong with high customer awareness and decades of experience. Said differently, we expected the switch would succeed here. These 3 stores did more than succeed though. They performed exceptionally well, with sales for the 3 in total growing over 15% versus prior year, and each of the stores individually also grew over 15%. The growth achieved was widespread across athletic and non-athletic categories and men's and women's, again, each expanding over 15%. Even more encouraging is the profit growth of these 3 stores with each store growing profit over 20% versus prior year. The financial leverage gained from the more productive sales is driving solid profit leverage gains and flowing through. Based on these compelling early results, we're expanding the scope of our test and switching an additional 6 to 7 stores this fall to Shoe Station stores.

Our focus on the second round of testing is to further validate that switching in core markets is profit-accretive and better meets the local customer needs. But importantly, we're expanding the test into additional Southern states where Shoe Station is present or known but not the market leader. I'm sure you share my interest in learning what the store count potential is for this strategy over the years ahead. It is too early to say today if this strategy is a winner solely in core Southern markets, across most or all of our Southern markets, or possibly even further. We'll be working diligently over the fall and early into 2025 to answer these questions in the South with in-market live customer data to guide our strategic road map. I'll update you on how this encouraging test is progressing on our Q3 earnings call.

Now, shifting to thoughts on the balance of this year. As I discussed earlier, we're encouraged with the sales growth and profitability that we achieved year-to-date. Patrick will provide additional details in his remarks. But given the solid performance in both the quarter and year-to-date, today, we raised our full year guidance ranges for net sales, comparable store sales and EPS.

As we wrap up the back-to-school season, we're entering a non-event buying period until we get into the holidays. While we have experienced improving customer purchasing trends so far this year during non-event periods, we are not yet seeing category expansion during these periods. It remains unclear if customer caution levels will continue to improve as we head into the upcoming non-event months and the election cycle ahead. We'll continue to monitor customer buying behavior closely during this period before the holiday season starts and pivot accordingly.

Before handing it to Carl to discuss Q2 category-level performance, I'd like to share a few summary comments. We're encouraged by the results we achieved in the quarter, delivering record second quarter sales with operating profit and EPS higher than our guidance. Sales growth in the quarter was led by continued strength in our Shoe Station banner, improving Shoe Carnival trends, our new digital-first marketing approach and Rogan's acquisition. Trends accelerated sharply at our Shoe Carnival banner once back-to-school started. Our strategies to grow sales and increase profitability over the long term are working, and we have additional opportunities, including our new banner switch strategy that is currently in test markets, to drive additional growth going forward.

Our long-term vision is clear: to be the nation's leading family footwear retailer. And I believe we are very well positioned to continue advancing toward that ambition for the balance of this year and beyond.

And now, I'll hand it over to Carl. Carl?

Carl N. Scibetta

Senior EVP & Chief Merchandising Officer

Thank you, Mark. As you discussed, we achieved a record sales level for the quarter, which exceeded our expectations. Momentum accelerated across the business as the back-to-school season started late in the quarter, and that momentum continued in the fiscal month of August.

From a category perspective, women's boots, sandals and adult athletics performed very well in the quarter. And in the fiscal August, as back-to-school continued, we delivered mid-to-high single-digit growth in children's and athletics.

While competitive intensity remained high during the quarter, we delivered gross profit margin above 35% for the 14th consecutive quarter, and we remain committed to our long-term profit transformation and targeted CRM strategies to continue delivering sustained gross profit margin performance. Our merchandise margin in the quarter decreased by 50 basis points versus prior year, reflecting competitive intensity. On a year-to-date basis, our merchandise margin is about even with the prior year.

During the second quarter, we continued to further optimize our inventory levels. Inventory at the end of the quarter totaled \$425.5 million, an increase of \$16.1 million versus prior year, primarily reflecting impacts of the Rogan's acquisition in February 2024. Excluding the impacts from Rogan's, our merchandise inventory at the end of Q2 was lower by approximately 7% on a dollar basis than prior year. And on a unit basis, merchandise inventory was down approximately 10% versus prior year. Excluding the impacts of Rogan's inventory, we continue to expect fiscal 2024 year-ending inventory to be approximately \$20 million or 5% lower than fiscal 2023 year-end, while maintaining the freshest product assortment for our customers.

Now, moving to sales and categories for the quarter. Total comp sales were down 2.1%, which reflected a very strong start to the back-to-school season, combined with growth in sandals, women's boots and women's athletics.

From a category perspective, total adult athletics comp sales decreased very low-single digits in the quarter. Comp sales in women's adult athletics were up low-singles led by running, basketball and court. Comp sales in men's adult athletics were down low-singles with a decline in running, partially offset by strength in basketball and walking. Children's comp sales were down mid-single digits with athletic and non-athletic down mid-single digit. Children's non-athletic performance was primarily due to softness in casuals and sandals. In the fiscal month of August, children's athletic comp sales accelerated to mid-single-digit growth during the back-to-school season.

Second quarter comp sales in women's non-athletic footwear were down low-single digit. Dress was down high-teens and casual was down low-double digit. Sport was down low-single digit. Sandals were strong in the quarter, growing mid-single digit, and boots delivered [low-single digit] growth. Men's non-athletic comp sales were down mid-single digit. Dress was down mid-teens. Casual was down mid-single digit, and boots were down low-singles. Sandals delivered a strong performance, growing high-teens in the quarter.

Coming out of the quarter, our inventory content is clean and in good position. We are excited about the fresh new products coming into our stores for the balance of 2024, and we are in a strong position to continue providing the product assortment, mix and values that our customers want.

And with that, I will turn the call over to Patrick for a review of our financials. Patrick?

Patrick C. Edwards

Senior VP, CFO, Secretary & Treasurer

Thanks, Carl. Moving on to our financial results, starting with top line growth, our net sales in Q2 were \$332.7 million, an increase of 12.9% versus prior year and were a record second quarter for us. Continued growth from Shoe Station and e-commerce, combined with continued strengthening trends at Shoe Carnival stores and the success of our digital-first go-to-market approach were key drivers to this strong performance. Sales from Rogan's in the quarter were in line with our expectations.

Going into a little more detail on our top line, Shoe Station total net sales performed very well with a mid-teen increase versus prior year, driven by sales from new stores and a comparable store sale increase. Shoe Carnival total net sales came in at a mid-single-digit increase with comparable store sales sequentially improving from Q1 and turning to growth versus prior year as the first important back-to-school weekend started. In fiscal August, as back-to-school continued, we saw Shoe Carnival comparable store sales increase to low-single digits, led by children's and athletics. Rogan's sales in the quarter approximated \$22 million. As you will recall, we completed the Rogan's acquisition in mid-February of this year. And consistent with previous guidance, we continue to expect full year 2024 net sales for Rogan's to approximate \$84 million.

As a result of the 53rd week in fiscal 2023 that will not recur in fiscal 2024, the calendar weeks each quarter shift in 2024 as compared to prior year, which we have discussed previously. On a comparable store sale basis, which excludes the impact of this calendar shift, Rogan's sales and other new store growth, net sales declined 2.1% for second quarter, representing an improvement versus 2023 and first quarter 2024. The strengthening trend of total company comparable store sales accelerated into August with back-to-school, as comparable store sales for fiscal August were also up low-single digits. This performance provides us confidence to increase certain guidance ranges for the full year, which I will more fully discuss in a moment.

Q2 gross profit margin expanded to 36.1%. And compared to Q2 2023, gross profit margin increased approximately 30 basis points, primarily due to leveraging our buying, distribution and occupancy costs. These BD&O costs were higher in the quarter, primarily due to operating Rogan's and occupancy costs associated with other new stores. Despite these higher overall costs in the quarter, BD&O leveraged on the higher sales versus prior year.

For the quarter, our merchandise margins were down a small amount compared to the prior year's second quarter and were generally flat compared to the prior year on a year-to-date basis. As a percentage of net sales, our SG&A was 27.1%, reflecting 30 basis points of leverage on the higher sales in the quarter.

SG&A expense in Q2 was \$89.9 million, representing an increase of \$9.1 million versus Q2 2023, primarily related to the addition of Rogan's. We continue to expect synergies from the Rogan's acquisition in fiscal 2025, and we expect those synergies to lower our SG&A as a percentage of sales as they are achieved.

Operating income in the quarter totaled \$30.1 million, an increase of 22% versus prior year on a GAAP basis and 23.7% on an adjusted basis. On a GAAP basis, operating income included approximately \$400,000 of merger and integration expenses related to the Rogan's acquisition, of which approximately \$300,000 was in cost of sales and \$100,000 was in SG&A.

Our income tax rate in the quarter was 26.3%, resulting in a headwind to EPS of approximately \$0.04 per share versus the prior year second quarter rate of 22.3%. This higher rate primarily reflected discrete benefits from share settled equity awards and a state deferred tax benefit that favorably impacted the prior year and did not recur in 2024.

On a GAAP basis, net income for second quarter 2024 was \$22.6 million or \$0.82 per diluted share. On a non-GAAP basis, excluding the Rogan's acquisition-related costs, adjusted net income for the second quarter was \$22.9 million or \$0.83 per diluted share.

At the end of the quarter, we had total cash, cash equivalents and marketable securities of approximately \$84.5 million. Cash and cash equivalents increased over \$37 million versus second quarter 2023, and cash flow from operations in the quarter increased approximately \$18 million versus the prior year.

2023 fiscal year-end marked the 19th consecutive year the company ended a year with no debt. And through the second quarter of 2024, we have continued to fund our operations and growth investments from operating cash flow and without debt. As of the end of August, our cash and cash equivalents, and marketable securities were more than \$120 million.

During the quarter, we did not repurchase any shares and have \$50 million available under our current share repurchase program. Inventory at the end of the quarter totaled \$425.5 million, an increase of approximately \$16 million versus the prior year. The increase reflected Rogan's acquired inventory, partially offset by continued efficiencies in Shoe Carnival and Shoe Station from our ongoing inventory optimization improvement plan. As Carl discussed, we continue to expect inventory will be lower by approximately \$20 million on our business, excluding Rogan's, by the end of the year.

Moving on to our 2024 outlook. Based on second quarter and year-to-date results, inclusive of a strong back-to-school performance and comp positive results in fiscal August, today, we increased guidance ranges for full year 2024 net sales, comparable store sales and EPS. We now expect full year 2024 net sales in a range of \$1.23 billion to \$1.25 billion, reflecting growth of 5% to 6% versus 2023. We now expect full year comparable store sales in a range of down 1.5% to up 1%. And we now expect GAAP EPS in a range of \$2.55 to \$2.70 and adjusted EPS in a range of \$2.60 to \$2.75.

Going into a little more detail on our revised guidance and what it means for the back half of our fiscal year. To achieve these increased full year sales guidance ranges, we estimate a range of comparable store sales in the back half of the year of flat to up 5%, which includes the fiscal August low-singles comp sales increase. While we see a path to achieving the 5% high side comp sales increase, we anticipate the more likely outcome is the lower end of the range unless, as Mark pointed out, we have a record boot season and holiday to close out fiscal 2024.

With respect to Q3, we currently expect total net sales for the third quarter to approximate \$320 million. Our expectation for third quarter sales includes the impact of the retail calendar shift, which resulted in approximately \$20 million in net sales moving primarily out of the third quarter of 2024 and into the second quarter as compared to the prior year. We expect the combined total of Q2 and Q3 sales growth in 2024 versus prior year to be on the high side of our full year sales growth outlook with sales growth at or perhaps just ahead of 6% over this 6-month period. We currently expect GAAP EPS of about \$0.70 in the third quarter 2024 with an income tax rate of approximately 25% of pretax income.

With respect to thoughts on the fourth quarter. In Q4 2024, the loss of the 53rd week and the retail calendar shift will result in the loss of approximately \$20 million in net sales compared to the prior year. As a result, our sales growth in the fourth quarter is expected to be less than our full year guidance range with a likely outcome of flat to up 3% compared to the prior year. Further, we estimate the calendar shift and the loss of the 53rd week will be a headwind to EPS of approximately \$0.10 in the quarter compared to the prior year fourth quarter when we earned EPS of \$0.57. Our increased fiscal 2024 EPS guidance range of \$2.55 to \$2.70 reflects this \$0.10 fourth quarter headwind, as well as some deleverage in SG&A as a percent of net sales from Rogan's until synergized in fiscal 2025.

To close, in the second quarter, we were thrilled to deliver a record level of net sales and growth of 12.9% versus the prior year and operating income growth of nearly 24% on an adjusted basis. Trends across our business continue to be favorable, and Rogan's is performing in line with our expectations. We have seen those favorable trends on the base business accelerate into the peak August back-to-school season. And we are excited to update guidance ranges for the back half of the year that include comp positive growth at the midpoint.

This concludes our financial review.

Operator

I'd now like to hand back the floor to Mr. Steve Alexander.

Steve R. Alexander

Investor Relations

Thank you, operator, and thanks again to everyone for joining us today. I wanted to let the audience know that due to an unforeseen personal matter, our CFO, Patrick Edwards, is unable to participate in today's Q&A session. Thanks for your understanding.

And now, I will ask the operator to open up the call for questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Mr. Mitch Kummetz from Seaport Research.

Mitchel John Kummetz
Seaport Research Partners

I've got maybe a handful. Let me start on the second quarter. Your same-store sales were down [2.1%]. I think you said maybe in the press release, June was flat. Can you give us the comp by month in 2Q?

Mark J. Worden
President, CEO & Director

Mitch, it's Mark. The months didn't vary greatly. We're not going to break out the exact numbers, but I'd say the months didn't have wild swings within them. What we did see that was encouraging was 2 things. We talked last time about non-event periods and are concerned with them being down like they were last year in the mid-to-high singles. We didn't see that occur again this time. We saw in that June, early July period that the non-events were slow, the category contracted, but we were not seeing wild swings. Second, once back-to-school kicked in at the very tail end, it turned -- July, towards the end, turned into comp growth. But the core message is, there weren't wild differences between the months away from the overall quarter down [to 2%].

Mitchel John Kummetz
Seaport Research Partners

Okay. And then, on the third quarter, you guys are -- well, actually, let me start with August. So August has a positive low-single-digit comp. Can you say what percent of the third quarter is August? I assume it's your largest month. Is it like half the month -- or half the quarter?

Mark J. Worden
President, CEO & Director

I don't have that exact number in front of us, but it's not half. It's not more than half. So it's less than half.

Mitchel John Kummetz
Seaport Research Partners

And again, on 3Q, you're giving the sales range, but not comp. It sounds like your comp was strong in August. Can you talk about kind of what's the comp expectation for the quarter? And what do you need in September and October to get to your expectations for 3Q?

Mark J. Worden
President, CEO & Director

Right. So, we're guiding to about \$320 million in Q3, and that already has baked into it, the low-single-digit achieved in the fiscal month of August. We're giving the second half of the year as comp positive. Flattish to up 5% would be what we're guiding for, for the back half of the year. We do anticipate, as I said in my speech, that this period between back-to-school ending now and holiday starting on Thanksgiving, we're not expecting comp growth meaningfully during that period of time or category expansion is implicit in this guidance.

But as I said, we anticipate -- if I look at the shape of things right now today, I would expect the back half of the year has flat to mid-single increases, which should be a really nice pivot from where we've been for many quarters and another sequential improvement. If, however, as I said in my remarks, we have a great boot season and a healthy holiday season, we can see the higher end of that range with mid-singles up to the 5%. But we do see that as a stretchy ambition at this point.

Mitchel John Kummetz*Seaport Research Partners*

Okay. And on that note, can you remind us what percentage of the business is boots in the back half? If I'm not mistaken, boots were a tough category last year. Can you just kind of remind us what happened with boots last year? And kind of what are -- maybe, Carl, what are the early reads on boots so far and kind of how are you planning that category for the back half?

Carl N. Scibetta*Senior EVP & Chief Merchandising Officer*

Sure, Mitch. Boots in the back half of the year in our women's non-athletic business, kids' non-athletic business, which is roughly half, it's about 40%, accelerates -- it's about 25% in the third quarter. It accelerates in the fourth quarter to around 50%. Boots last year were down high-singles. We're planning boots, this fall, up low-singles with -- in a position to react if needed to drive that number towards the higher range of our guidance.

Mitchel John Kummetz*Seaport Research Partners*

And any early reads on boots so far? I know it's early, but what...

Carl N. Scibetta*Senior EVP & Chief Merchandising Officer*

The only early reads -- the early reads we have, which [really where] second quarter and into third quarter is, [Western] is performing very well. Traditionally, with us, that slows down as you get into mid and late third quarter. The boots that would be early reads that we feel would continue through holiday, they're just being delivered, and there's really not a lot of data there.

Mitchel John Kummetz*Seaport Research Partners*

And then, maybe my last question, on the guide, if I'm not mistaken, for margins, you're previously guiding, I think, around for gross margin, 35.8%; and SG&A, I think 28.2%. Are we still looking at kind of those rates for the year, or has any of that changed?

Steve R. Alexander*Investor Relations*

Yes, Mitch, this is Steve. You're spot on in thinking about the gross margin -- gross margin percentage for the year. What we guided to was flat to last year. Last year was 35.8%. And then, on the SG&A, that's around -- we guided up 40 bps versus last year, [built in] that low-28% range. I'd certainly -- as you think about that full year guide on SG&A, I would think about where we are to date on our -- you'll see we've got some leverage in the first part of the year, so probably fair to expect some deleverage on that SG&A, year-to-date SG&A number, principally in Q4 of this year.

Operator

Our next question comes from Jim Chartier from Monness, Crespi.

James Andrew Chartier*Monness, Crespi, Hardt & Co., Inc., Research Division*

So, it sounds like the most likely outcome you said for second half sales is the low end of guidance. Should we infer that EPS also then trends towards the low end of guidance?

Mark J. Worden*President, CEO & Director*

Jim, it's Mark. Yes, I think that's a good assumption to be thinking through. Again, with the upside potential clear, as I called out, for the great boot season and holiday, the mid-to-high end is possible. But with a normalized season, I would say that mid-to-low side is what we should anticipate.

James Andrew Chartier

Monness, Crespi, Hardt & Co., Inc., Research Division

Okay. And then, any change to kind of your marketing spend in second half, and I guess, particularly now holiday, given how well it performed for the spring season and then back-to-school?

Mark J. Worden

President, CEO & Director

Yes. We were very pleased with the way it worked out, our first year through of trying this new approach, and it delivered comp sales right out of the gate, and we spent no more money than we did last year. So, as I said in my speech, I'm so excited about the efficiency and the flexibility our new digital-first approach are driving. The back half of the year builds in that continued approach. We're going to continue to do that through the holiday season and amp up what winning products Carl and his team bring and what message is working. In terms of the specific cost, no, you shouldn't anticipate increased cost as we're getting better efficiency on the same level of spend.

James Andrew Chartier

Monness, Crespi, Hardt & Co., Inc., Research Division

Okay. And then, on the store switch strategy, can you just give us a little more color on what's driving the improved sales? Is it coming primarily from existing customers? Or are you attracting new customers?

Mark J. Worden

President, CEO & Director

This is probably the most exciting part of it. We are capturing the new customers in these 3 test markets that did not previously shop at Shoe Carnival. And our insights and our data showed there were a variety of customers north of \$50,000 household income. That's Shoe Carnival, which skews largely below \$50,000 household income that we were not capturing. And what's specifically they're liking? The Shoe Station product assortment is better meeting their needs, high-end performance running, fashion women's and a variety of the must-have brands throughout America. Shoe Station has them, the customer is coming in, and we're capturing new customers like I've never seen before at a Shoe Carnival store. For us to have delivered sales growth above 15% in all 3 of the test stores and across every single category of athletics, women's, men's, I couldn't be more excited. So I'd say it's product that is largely doing it. But the whole aesthetic is different too. The whole shopping experience of this, it's really -- our store design, our look, our feel is geared towards that more affluent, higher-end customer, and they're coming in and saying, wow, this is a great place.

James Andrew Chartier

Monness, Crespi, Hardt & Co., Inc., Research Division

Great. And are you retaining existing customers, too?

Mark J. Worden

President, CEO & Director

We are. Yes, we've been really pleased. Carl and his team are working really hard to ensure the things we're great at, we're still doing. And an example would be our children's business. Shoe Carnival has been growing back-to-school in kids' for decades. One of the things we've -- and that's not the same for Shoe Station. It's not a core kids' business. But throughout this test and learn, we've been ensuring we keep the right assortment to capture the former Shoe Carnival back-to-school kids shopper during back-to-school. And coming out of this back-to-school, we were very pleased that these test stores performed strong in the kids' categories very well.

James Andrew Chartier

Monness, Crespi, Hardt & Co., Inc., Research Division

And I guess, is there an opportunity to just, without switching banners, take some of these learnings and then some of the assortment changes and bring that to some of your better performing Shoe Carnival stores?

Mark J. Worden

President, CEO & Director

I don't think so. I think they are 2 completely different banners with, as I said, different aesthetics, different [service], different product, and an overall different communication message. And we sell a very different tier of product in the Shoe Station business at a much higher average ticket price, particularly in athletics and women's non-athletics than Shoe Carnival. So I really don't think it's as simple as that. We think it's -- the brand Shoe Station is resonating, and the brand Shoe Station is what we're very excited about, continuing with this double-digit growth. I have a lot more to learn, though. Like I said in my remarks, we're only 3 test stores in and a few months in, and it's wildly exceeded our success criteria. And we're going to expand to 6 or 7 more in the next couple of months. We're going to learn a ton more, and we'll be able to update folks on the [legs] of this strategic idea in our November call when we talk to you next.

Operator

Our next question comes from Sam Poser from Williams Trading.

Samuel Marc Poser

Williams Trading, LLC, Research Division

I have a handful of questions. Hello, can you hear me?

Mark J. Worden

President, CEO & Director

Yes, Sam.

Samuel Marc Poser

Williams Trading, LLC, Research Division

Okay. I guess, just some housekeeping. You mentioned, Steve, on the digital -- sorry, on the SG&A that you saw -- expected more of a headwind in Q4 than Q3, but you're losing a similar amount of sales in both quarters. Why won't you feel some SG&A pressure in the third quarter as well?

Steve R. Alexander

Investor Relations

We will, Sam, [except you] have to keep in mind that the advertising moves around a bit based on the way the business is running. So we'll see some pressure on SG&A in Q3, but it won't be as apparent, as in Q4 is where I think you'll see it principally in terms of the pressure on the SG&A. Back to that full year guide, 28.2% as a percent of sales, if you look at where we are year-to-date, I think our guide implies some deleverage, which again, I think, you'll principally see in Q4.

Samuel Marc Poser

Williams Trading, LLC, Research Division

Got you. Okay. And then, Carl, to what degree is your overall assortments narrower? Or are they narrower this year and deeper than they were? How has that evolved over the last few years?

Carl N. Scibetta

Senior EVP & Chief Merchandising Officer

I would -- Sam, I would say our assortments are narrower than they have been. The improvement in supply chain has enabled us to really jump into big items like we have in the past. In addition, based on

owning the product right, we've been able to tighten it down a bit, be more meaningful and shed tertiary products and brands.

Samuel Marc Poser

Williams Trading, LLC, Research Division

And then, Mark, you talked about the non-event periods being -- things tend to drop off during the non-event periods. But you've also talked about how good your digital marketing is and how that's working. So how do you activate -- how are you going about activating that digital, more personalized targeted marketing during the non-event periods to better engage your customers?

Mark J. Worden

President, CEO & Director

June would be a good example, where -- in the last call, we spoke about the lack of vision we could share at that point in time. And throughout June and then into early July, we did just -- as you said, we ran our social and digital program, and it worked really well. It got towards flattish during that time frame before -- I would be transparent, July was less than that as -- before we got into back-to-school. So we're going to take those learnings, and we're going to apply them now to September, October and early November to ensure we're getting that digital message out there, we're engaging with them, and we're trying to drive them in. But historically, the volumes and units go down significantly as soon as the back-to-school season, which is very strong, ends. We find our -- particularly, Shoe Carnival, the lower end customer has spent most of their discretionary income for Q3 once we get past Labor Day, and we find those volume numbers are small.

Samuel Marc Poser

Williams Trading, LLC, Research Division

Right. But that also means that any incremental could be large. And you're up -- and you have some competitors out there that are -- that work with exactly the same consumers. So how long -- I guess, the question is more predictability. How long will it take for you to be able to really be confident in measuring the impact of the work? You had success early in June and early July. But how -- as this evolves, how long until you have confidence that you might be able to take some of the moderate customers from some other retailers with whom you compete and turn them into Shoe Carnival customers during those -- during both the event and non-event periods?

Mark J. Worden

President, CEO & Director

Yes. Our confidence is high, Sam, and that's why we're raising our guidance today and saying we'll be flat to up 5% comp for the back half of the year. Implicit of that is absolutely taking market share throughout Q3 and Q4. It's also balanced and pragmatic, right? We were down 2%, and now to get to flat to plus 5% in the back half of the year, we think, is absolutely achievable from the strength of the plan, strength of the product, gathering market share. But we think that's probably the upper end of it also at this point in time.

Samuel Marc Poser

Williams Trading, LLC, Research Division

And then lastly, when we think about -- could we assume that you're expecting Q4, from a comp perspective, to be significantly better than Q3? Is that an accurate way to think about it?

Mark J. Worden

President, CEO & Director

No, I wouldn't say that. Again, Q3 is low-single digit fiscal August, and then the balance to achieve is 0% or up to 5%. And so, I think the right way to think about it is, we're -- looking at the shape of the business right now is, I would think that midpoint to the lower side is the right way to think about that. From flat to 2.5% for the back half of the year is the most likely outcome. But as I said, we had a tough boot season last year. I'm really excited about the product that Carl's organization has, and we're ready

to go. So with a strong boot season and our campaigns working for the holiday season, the higher side is absolutely possible. But we should think about...

Samuel Marc Poser

Williams Trading, LLC, Research Division

That wasn't my question. My question is, regardless of what it is, do we -- like, for instance, let's just say 2.5% as the midpoint, would we expect -- let's say you did 2.5%. Would we expect 2.5% in Q3 and 2.5% in Q4? Or might -- or would that more look like flat in Q3 and up 5% in Q4? I'm trying to understand a balance regardless of what the number is.

Mark J. Worden

President, CEO & Director

Got you. Good clarification. I'd assume the same Q3, Q4, Sam. For a simple point, to use the midpoint, if we were going to say 2.5% for simplicity in Q3, same for Q4, with the downside to that being more likely than upside, equally in both quarters.

Operator

Our next question comes from Mitch Kummetz from Seaport Research.

Mitchel John Kummetz

Seaport Research Partners

Yes. Just a couple of quick follow-ups for me. One on the 3Q EPS guide, I think you said -- I think it's \$0.70, but that's a GAAP number. What is that on an adjusted basis?

Steve R. Alexander

Investor Relations

Yes. So, Mitch, it's Steve. You can see sort of what that GAAP to non-GAAP adjustment has been each of the first 2 quarters. And you can see what our full year guide was, right? It's \$0.05. So fair to think about that differential being about the same, call it, \$0.01, maybe \$0.015.

Mitchel John Kummetz

Seaport Research Partners

All right. I don't know, it seems like it would be easier to just give us an adjusted number, but I'm not going to push that. And then, again, on the third quarter, again, I just kind of want to be clear as to sort of how you expect the balance of the quarter to play out. You guys aren't giving comp on the quarter. You're giving sales. But August is running plus low-singles. Mark, it sounds like you expect September and October to kind of dip from that, since it's a non-event period. Are you looking for sort of flat to down comp in September and October to kind of get to your sales guide on the quarter? Is that how you're thinking about it?

Mark J. Worden

President, CEO & Director

Close. I'd say flat to very low-single digit for the balance of this quarter is how the numbers work out to get to the \$320 million, approximate. So, flat to a slight increase for the balance of this quarter.

Operator

As of right now, we don't have any pending questions. I'd now like to hand back over to the management for the final remarks.

Steve R. Alexander

Investor Relations

This is Steve. Thanks again for joining us today. We're available all day. If you have any follow-up questions, please let us know. Thank you very much.

Operator

Thank you for attending today's call. You may now disconnect. Have a wonderful day.

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