THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

EXPR - Q2 2016 Express Inc Earnings Call

EVENT DATE/TIME: AUGUST 24, 2016 / 1:00PM GMT

THOMSON REUTERS

CORPORATE PARTICIPANTS

Tom Filandro *Express, Inc. - IR*

David Kornberg *Express, Inc. - President & CEO*

Perry Pericleous *Express, Inc. - SVP, CFO & Treasurer*

Matt Moellering *Express, Inc. - EVP & COO*

CONFERENCE CALL PARTICIPANTS

Neely Tamminga *Piper Jaffray - Analyst*

Simeon Siegel *Nomura Securities - Analyst*

Adrienne Yih *Wolfe Research - Analyst*

Roxanne Meyer *MKM Partners - Analyst*

Betty Chen *Mizuho Securities - Analyst*

Susan Anderson *FBR Capital Markets - Analyst*

Michael Binetti *UBS - Analyst*

Richard Jaffe *Stifel Nicolaus - Analyst*

Rebecca Duval *BlueFin Research Partners, Inc. - Analyst*

Paul Trussell *Deutsche Bank - Analyst*

Pam Quintiliano *SunTrust Robinson Humphrey - Analyst*

Jay Sole *Morgan Stanley - Analyst*

Marni Shapiro *The Retail Tracker - Analyst*

Janet Kloppenburg *JJK Research - Analyst*

PRESENTATION

Operator

Greetings and welcome to Express, Inc.'s second-quarter 2016 earnings call.

At this time, all participants are in a listen-only mode. A question and answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press *0 on your telephone keypad. As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Mr. Tom Filandro. Thank you. You may begin.

Tom Filandro - *Express, Inc. - IR*

Thank you and good morning and welcome to our call.

I'd like to open by reminding you of the Company's Safe Harbor provisions. Any statements made during this conference call except those containing historical facts may be deemed to constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

Actual future results may differ materially from those suggested in forward-looking statements due to a number of risks and uncertainties, all of which are described in the Company's filings with the SEC, including today's press release. Express assumes no obligation to update any forward-looking statements or information except as otherwise required by law.

In addition, during this call, we will make reference to adjusted net income and adjusted earnings per diluted share, which are non-GAAP measures. Information necessary to reconcile these non-GAAP measures to reported net income and earnings per diluted share can be found in our press release.

With me today are David Kornberg, President and CEO, Matt Moellering, Executive Vice President and COO, and Perry Pericleous, Senior Vice President and CFO. I will now turn the call over to David.

David Kornberg - *Express, Inc. - President & CEO*

Thank you Tom. Good morning and thank you for joining us.

We are disappointed with our second quarter performance, which capped off a challenging first half for Express. Sales and earnings were below our guidance reflecting a decline in store traffic. We also attribute our performance to a lack of clarity in our assortment caused by too many choices, and this was compounded by skewing too young in our projection, especially in the latter part of the quarter.

As it relates to choice, based on our 2015 spring results we proactively increased choices, in higher productivity malls for spring this year to further drive sales at these doors. We found, however, that the increased choice count resulted in a lack of clarity across the store, particularly in women's, and ultimately led to lower sales and added markdown pressure. We believe we will be in a better position in terms of choice count as we enter the fourth quarter and closer to optimal choice count at the start of next year.

In an effort to acquire younger customers to our brand we expanded our merchandising reach and shifted our marketing projection. While our fashion attracted more customers at the lower end of our target demographic age group, this was more than offset by a decline at the upper end. We have corrected this balance and believe our assortment and marketing will appropriately reflect our target demographic as we move further into fall.

At the start of the year we shared with you our priorities, namely to present our customers with a strong assortment, to increase our brand awareness and elevate our brand experience, to drive customer acquisition and retention and finally to maintain discipline with regard to inventory and expenses. This strategy served us well in 2015 with four consecutive quarters of positive comps and a significant increase in earnings.

We also highlighted some important IT system implementations that would launch at the end of the second quarter that will lay the foundation for us to pursue omni-channel capabilities and enable us to manage the business with more precision over the long term, providing opportunities for additional topline growth and margin improvements. While our merchandising issues impacted our top and bottom line in Q2, we made strides in moving our priorities forward. We identified and are executing against $14 million in annualized expense reductions; our inventory level is in good shape; and we successfully launched several major IT systems in May and at the beginning of August. With the investment and focus of these implementations behind us, we can now start to take advantage of the new system capabilities as we head into 2017.

As it relates to topline growth, we are confident that we have identified the necessary actions to move past the issues we faced in the quarter. From a merchandise perspective, we have rationalized our choice counts so that we clearly identify, curate and communicate the important trends. This will be reflected in Q4 receipts and should be optimized by the beginning of 2017.

Beginning with the fall season we have adjusted the merchandising and marketing projection of the brand to be more closely aligned with our target customer demographic. Going forward, we will continue to deliver frequent newness but will tell fewer stories to ensure our offerings are clear and cohesive across lifestyles.

A great example of this is studio pants. We are re-launching pants for September with strong in-store navigation and marketing. As you know, women are very loyal to brands that offer superb fits in pants and we are pleased to be building upon our strength in this category with our new studio pant offering.

We expect newness in fabric, silhouette and rise to allow us to drive UPTs. And while we expect traffic to remain a headwind we anticipate our brand building and customer experience initiatives will gain traction throughout the balance of the year and help improve our trend, increase the speed with which we operate and most importantly move our sales and profit trends upward.

At the same time, we are applying even more rigor toward testing, inventory and expense management. While it was too early to see these benefits in Q2 we are making great progress on all fronts.

Let me now turn to an update on the opportunities we identified to improve our topline trend. We have already discussed steps we are taking to address our product offering.

As it relates to driving traffic and customer acquisition and retention we are focused on four areas: first, to increase our customer reach we are reinstating the number of direct customer touch points back to last year's levels along with elevating and placing more focus on our next loyalty program; second, to reach existing customers we are improving upon our email marketing efforts, delivering more targeted emails with increased personalization and segmentation; third, to reach new and existing customers we are continuing to advance our e-commerce and digital capabilities and are encouraged by the positive change in trend that we have seen in this channel in recent weeks; and we are redoubling our efforts in social media to further enhance our communication with our target demographic while continuing to communicate through influencers, bloggers and brand ambassadors.

I will provide some details on each. Our first initiative is to increase the total number of customers coming into the brand along with the shopping frequency of existing customers as we increase the number of direct customer touch points and better utilize and market our Express Next Program.

Last year, we conducted testing that showed we had room to reduce in-home mailings to certain customer segments and also reduce other marketing tactics such as customer bounce back programs. In isolation, each of these decisions looked to be appropriate, but in aggregate, touchpoints in some customer segments dropped significantly over the spring season. We are increasing these customer touch points back to last year's levels starting with the September in-home direct mailer and we will ensure we maintain optimal touches with each customer segment going forward. To be clear, we are not increasing the depth of our direct mail promotions. We are increasing the breadth of the audience.

As for the NEXT program our data shows that our fully enrolled Express Next customers shop with us four times more often than a non-NEXT customer. To maximize enrollment in our program we are set to re-launch Express Next in September with enhancements that make it easier for customers to activate and shop.

We will introduce the program in two phases with an initial marketing push to communicate the benefits of the program. These benefits will include enticing experiential events in our top 50 stores such as blow dry and styling bars for women among others. This will be followed by updated visual presentations of our NEXT loyalty program instore and online. We expect these events and our marketing push to increase sign-ups head of the all-important holiday season.

A second phase will begin Mid-January and will include integration into social media, with a full program refresh set to begin in the February to March timeframe.

Our second marketing initiative is taking a more strategic approach with email personalization and segmentation based on customer shopping preferences. We just went live with this initiative.

Third, on the ecommerce front, we have also been very active improving our product presentation and search capabilities on our site. We implemented a new search capability that provides visual recommendations immediately to users which is increasing conversion rates.

THOMSON REUTERS

In addition, the improvements we have made to our product pages are resulting in better product presentation, greater engagement in reviews and improvement in some of our core conversion metrics. Beginning in August, we rolled out substantial new improvements in how we help customers filter our product assortment by trends that we believe will connect our product better to customer needs. Finally, we recently launched the Edit, on our website, which will better showcase our content and storytelling to engage new customers in ways that connect their lives to our products. Our goal is to showcase our differentiated fashion with high emotional content to drive sales while creating loyalty through making the purchase experience as easy as possible.

Fourth, we are redoubling our efforts on social media while continuing to communicate through Influencers, Bloggers and Brand Ambassadors. We have been very pleased with the expanded efforts we have taken in this area. We have experienced tangible results with sales spiking when particular pieces are worn.

We also see positive impact on our social media engagement and our brand recognition.

Our new men's Instagram channel @expressmen continues to build a following and engagement. In fact, its number of followers has now grown to more than 25,000 since its launch three months ago.

We are thrilled to have Karlie Kloss return to Express, this time for a longer engagement as a brand ambassador for our core Express campaign. We are looking forward to her continuing association with us as a way to build and extend our brand reach as well as provide differentiation in our stores as we present an assortment curated in collaboration with Karlie next spring.

On the men's side, athletes have proven appeal to our core male demographic and we continue to be equally enthusiastic with the work we are doing with Kris Bryant, the Cubs third baseman and 2016 All-Star.

We are also launching an Express Life campaign where we engage with people doing meaningful work within their communities. We know that 'real' people resonate with our core demographic and we are more closely aligning Express with these consumers by working with influencers who have excelled in their fields of expertise. We will share more regarding this on our next call.

We believe these four marketing focus areas have the potential to bring more new customers into the brand as we move into the back half of the year.

Next I'm going to talk about our IT initiatives, as there was an enormous amount of work done on this front during Q2. We implemented a new order management system early in the second quarter. Subsequently, at the start of Q3, our new Retail Management and Enterprise Planning Systems went live.

The good news is that these complex implementations are behind us, all of the systems are up and running and we can now focus on leveraging our new capabilities.

Over time, these systems will allow us to quicken decision making, increase speed to market and conduct planning and allocation to a more precise level. This effort should enable us to have the right inventory across channels, leading to lower clearance and therefore driving more profitable sales. We have now modernized approximately 95% of our portfolio of systems over the past four years with most of the investment behind us.

As discussed in the past, we expect that benefits will accelerate over time and assist us in moving towards our double-digit operating margin goal.

Finally, we are ramping up our expense saving efforts. At the start of the year we shared with you that we identified $14 million of annual savings. During the second quarter we identified an additional $30 million to $40 million in net annual savings, bringing the total identified net savings to $44 million to $54 million. We expect to achieve these savings over the next few years, starting with this fall season. Perry will discuss the flow by year shortly.

Let me turn now to product and the performance of the women's and men's businesses.

In the second quarter our men's business slightly outperformed our women's, although both were negative throughout the period.

In terms of categories, on the women's side, knits tops, denim and dresses outperformed our comp average and we were pleased with the growth we achieved in active, swim, shoes and accessories. On the men's side, the strongest categories were suits and accessories. Also in men's, denim and woven tops outperformed our comp average, however, men's knits continued to be challenging.

Heading into fall, we feel good about our merchandise presentation. As many of you know, wear to work increases in importance in the third quarter and this has traditionally been a strength of ours.

As I mentioned we are re-launching our Studio pant business in September with new silhouettes, rises and fabrications. We are a market share leader in wear to work pants for our demographic and we expect to continue to build off of that trend with our latest styles. In addition, we have seen good selling in women's sweaters which has us optimistic as we head into holiday given that this is a key gifting category for us. The fall season will also see an update to our men's [wear to work] shirts with new fabrics and textures.

As it relates to our stores, we continue to optimize our real estate fleet making considerable progress toward our store closing initiative. In fact, by the end of the first half of 2016 we had closed 15 stores on top of the 27 stores closed in 2015 bringing us to 42 closures, 8 shy of our 50 store target. We continue to have regular real estate reviews to assess whether any incremental closures may be warranted. While we do not intend to go beyond 50 store closings at this point, we are continuing to add flexibility to our B and C level lease terms as renewals are negotiated.

We also continue to see opportunity to expand our Express Factory Outlets, broadening our reach to new customers at an attractive ROI. During the quarter we opened six new outlet locations and converted three existing stores into outlets. At quarter end we operated a total of 94 outlet stores. During the third quarter, we will open five additional outlets. We expect to end 2016 with 104 Express Factory Outlet locations, and are well on our way to reach our target of 140 to 150 stores within the next few years.

During the quarter we made a $10 million minority investment in Homage, a Columbus, Ohio based private apparel company that is in the early stages of growth, operating an ecommerce site and four retail locations. I want to assure you that we remain firmly focused on the Express brand. This minority investment simply allows us to participate in the potential growth that we believe lies ahead for Homage.

Looking forward, the constant is that product and execution remain at the heart of our business. We are committed to providing our customers with a curated collection of fashion that represents "what's now" along with a great customer experience.

The new initiatives that we have implemented in brand building and IT will enable us to increase our speed to market thereby allowing us to bring new trends to our customers more often. At the same time, we are continuously improving our go to market strategy, refining our sourcing and production practices and improving our systems to achieve greater efficiencies.

We believe we have identified the issues that impacted our first half results, are taking aggressive actions to improve our performance and believe our healthy balance sheet and ability to generate strong free cash flow leaves us well-positioned to drive future stockholder returns.

I want to close by thanking everyone at Express for their dedication and ongoing commitment to the brand. I'd now like to turn the call over to Perry.

Perry Pericleous - *Express, Inc. - SVP, CFO & Treasurer*

Thank you, David. Good morning everyone.

Before I review our financial results for the second quarter of 2016, I would like to highlight the following.

In 2015 we delivered four consecutive quarters of solid, comparable sales and profit growth anchored on product composition and new disciplines around product testing, inventory management and speed-to-market initiatives.

Unfortunately, the business turned more challenging in 2016. As David mentioned we have identified and have actions in place to improve our merchandise and marketing presentation across our demographic.

We are also intently focused on driving brand awareness, improving sales productivity, and increasing profitability through important Brand building and IT initiatives. We believe the brand building initiatives that David shared with you will enable us to improve our traffic and conversion trends and at the same time reduce markdowns as we begin to benefit from IT efficiencies.

So while we're managing through short term challenges, we firmly believe that our strategy is the right one that will enable us to improve sales activity and profitability as we enter 2017.

Now I will review our second quarter 2016 results beginning with the income statement.

Net sales were $505 million, a 6% contraction from last year's second quarter. Comparable sales declined 8%, below the negative mid-single-digit guidance we provided in May.

Merchandise margin contracted by 200 basis points, driven by increased markdowns on clearance items as we focused on positioning our inventory for the fall season.

Buying and occupancy expenses decreased by $2 million even as year-over-year store count increased by 11 stores to 648. Our B&O rate increased by 120 basis points as the sales comp decrease led to deleveraging of fixed costs. As a result, gross margin rate contracted by 320 basis points.

We continue to manage expenses well. SG&A dollars were $7.4 million below last year, at 26.4% of net sales.

Our marketing spend for the quarter was flat to last year, while we delivered decreases in other expense categories.

The net of which resulted in operating income of $17.9 million. On a rate basis, our operating margin came in at 3.5% of net sales and diluted earnings per share was $0.13.

Turning to expense savings initiatives, we announced $14 million of annualized savings on our Q1 call and have identified an additional $30 million to $40 million of annualized net savings, bringing our total annualized net savings to $44 million to $54 million. For modeling purposes, we expect to realize $9 million of savings in fall of 2016, approximately an incremental $20 million in 2017 and the remaining $15 million to $25 million thereafter. The $9 million of fall season savings is reflected in our guidance.

Our balance sheet remains very healthy. We ended the second quarter with $120 million of cash and cash equivalents compared to $156 million last year. This change reflects the use of $10 million for the minority investment in Homage and $120 million to repurchase common stock under our share repurchase program over the last 12 months, $41.5 million of which occurred during the first quarter and $10 million in the second quarter. We have approximately $20 million remaining under the current share repurchase program.

Capital expenditures for the second quarter were $32 million and for the first half of the year $50 million. Inventory at the end of the second quarter totaled $257 million, representing a 6% decrease over last year. This included approximately $49 million of Express Factory Outlet inventory, a significant portion of which relates to new stores.

With respect to our retail business, aggregate inventories decreased by 9% as we remained keenly focused on entering the fall season clean and conservatively positioned.

As David mentioned, we are working on additional inventory optimization process and flow projects to bring further efficiencies to this important area. We continue to be extremely focused on our open to buy processes to ensure that our level of inventory is appropriate for our sales trends.

The final topic I want to address is our guidance for the third quarter and for fiscal 2016.

For the third quarter of 2016, we currently expect comparable sales to be in the range of negative high single digits to negative low double digits; net income in the range of $7 million to $12 million and diluted earnings per share in the range of $0.09 to $0.15.

Based on the midpoint of our guidance, we expect our operating margin to contract by approximately 500 basis points. This will be driven by merchandise margin contraction along with B&O and SG&A deleverage associated with lower sales expectations.

Turning to fiscal 2016 we expect comparable sales to be in the negative high single digit range; adjusted net income to range from $79 million to $90 million and adjusted diluted earnings per share to range from $1.00 to $1.14.

On a full-year basis for 2016, we now expect that at the midpoint of our guidance operating margin will contract by approximately 250 basis points. This is driven by merchandise margin contraction along with B&O and SG&A deleverage.

Lastly, in terms of guidance our capital expenditures are now expected to range from $105 million to $110 million as we continue investing in new outlet stores and our IT platform.

Our 2016 guidance does not in any way change our objective of returning to full-year double-digit operating margins within the next few years.

Using 2015 as a base year, our multiyear path to double digit operating margin includes 50 to 100 basis points of merchandise margin expansion, 50 to 150 basis points of B&O leverage driven by our expense savings initiatives and leveraging our fixed costs and finally 50 to 100 basis points of SG&A leverage driven by our expense savings initiatives and a more normalized SG&A growth rate post-system implementations.

Overall, we are confident we have identified the right initiatives to improve our sales and profit trends. In the short term we are focused on presenting our customers with a clear fashion message, expanding our brand reach with marketing that connects more closely with our customer profile while reducing costs across our organization.

We look forward to the increasing benefits from our marketing and IT initiatives in 2017 and expect this, along with our continued expense and inventory discipline, to move us toward our sales productivity and operating profitability goals.

And now, I would like to turn the call over to the operator to begin the question and answer portion of the call.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Neely Tamminga, Piper Jaffray.

Neely Tamminga - *Piper Jaffray - Analyst*

Good morning. David, I was wondering if I could dig a little bit more into just rewinding a little bit back into the choice count decision. So was the original intent to just increase choices per delivery on the floor or was it really about increasing choice counts and then flowing more frequently? So we're trying to understand that dynamic a little bit.

And the latter seems actually like a very healthy decision in fashion retailing. So was it really just that it was mis-executed or is this a people problem or a process problem? Thanks.

David Kornberg - *Express, Inc. - President & CEO*

I think it was more of a process problem. We strategically increased our choice count to deliver more frequent newness and what we saw is with the drop-off in sales this compounded the issue. So as a result it led to a lack of clarity in the assortment and we did this purposefully in our A and B malls.

Neely Tamminga - *Piper Jaffray - Analyst*

Okay. I guess then switching gears a little bit, in terms of quarter-to-date commentary you made a reference in your prepared remarks that there has been a change in trend with e-commerce. I guess just to be really specific, are you talking about the e-commerce channel sales or just the traffic specifically?

And then any sort of broader commentary around quarter-to-date trends would be helpful. Thank you.

David Kornberg - *Express, Inc. - President & CEO*

In terms of e-commerce we've seen it in both the sales and in the traffic and also an improvement in the conversion. In terms of broader traffic it's really built into our guidance that we've given for the quarter, which we believe is appropriate.

Neely Tamminga - *Piper Jaffray - Analyst*

Okay. I will let someone else ask a question. Thanks.

Operator

Simeon Siegel, Nomura Securities.

Simeon Siegel - *Nomura Securities - Analyst*

Thanks, good morning. So what were the comp metrics over the quarter?

And then, Perry, what are you expecting 3Q and 4Q merch margins embedded within the guidance? Maybe you can quantify that at all, just particularly in light of the cleaner ending inventory and the comments around greater inventory visibility from systems.

Perry Pericleous - *Express, Inc. - SVP, CFO & Treasurer*

So, Simeon, to answer your question on the metrics for Q2 what we've seen is as we said in the prepared remarks traffic was down in Q2 in stores. We saw some conversion improvements but also we saw because of the clearance ADS to be down.

But as we look at it holistically traffic was the major component of the comp declines. You've asked this question around merchandise margin expectations for Q3 and Q4. Is that the question?

Simeon Siegel - *Nomura Securities - Analyst*

(multiple speakers)

Perry Pericleous - *Express, Inc. - SVP, CFO & Treasurer*

So from a merchandise margin standpoint for Q3 and Q4 right now what I would assume it's something in the tune of about 150 to 175 basis points decline in Q3 and a little bit less, maybe nearer the 100 basis points mark for Q4.

Simeon Siegel - *Nomura Securities - Analyst*

Great. And then if I can throw one last one in, what percent of sales right now are done through the Express Next customers? And then just in light of the marketing comments, what do you expect marketing to add net as a percent of sales this year?

Perry Pericleous - *Express, Inc. - SVP, CFO & Treasurer*

So on Express Next members, we don't disclose that. And then to your second question around the marketing we expect our marketing to be approximately 5% of net sales.

Simeon Siegel - *Nomura Securities - Analyst*

Great, thanks a lot, guys. Best of luck for the rest of the year.

Operator

Adrienne Yih, Wolfe Research.

Adrienne Yih - *Wolfe Research - Analyst*

Thank you. Good morning. David, can you talk about the aging to the younger target market, how much younger was the spring product going and when you do your testing phase, why do you think that the test did not capture the aging younger issue earlier?

Finally, do you think the fall assortment reflects the age back up to your core target market? And then for Perry, very quickly, on the gross margin pressure, it seems like it will be similar in total gross margin pressure to 2Q but the inventories are pretty clean.

So is that just because you've lowered the sales or the comp forecast? Thank you.

David Kornberg - *Express, Inc. - President & CEO*

Okay, so Adrienne, just to go back to your first questions. What we saw is we saw a substantial increase in purchase consideration from the customers in the 18 to 21 age group.

But having said that, we also saw a decrease in the 20 to 25 and also in the 26 to 30. And this is based on brand tracker information that we got. Our testing process really defines the winners and the losers in terms of the styles that we're going to go after.

It really doesn't give us any demographic information. And the way in which we look at it it's really, it's focused on understanding what the sell-throughs are and as I said which are the winning items that we need to chase after and what's going to drive the season.

So it's really not an age demographic testing process. It's really about what are the best sellers going to be.

So having said that, what we saw was we saw a very good increase in terms of our overall brand equity. So what we have to do as we go forward is continue to go after younger customers and get them into the brand but we have to ensure that the brand projection is safely around what the brand proposition is and the age group that we've defined as our edit point and our customer point.

Adrienne Yih - *Wolfe Research - Analyst*

Very helpful. And then Perry?

Perry Pericleous - *Express, Inc. - SVP, CFO & Treasurer*

So when it comes to the gross margin pressure for Q3, you're right we expect a similar pressure in Q3 as we've seen in Q2. And part of the reason is the merchandise margin pressure that I addressed with Simeon's question and then also from a B&O standpoint as we've lowered our expectation. If you look at the midpoint of the guidance on the B&O we're going to see more pressure given the fixed cost as sales decrease they are going to be deleveraging more.

Adrienne Yih - *Wolfe Research - Analyst*

Okay, thank you very much. Best of luck.

Operator

Roxanne Meyer, MKM Partners.

Roxanne Meyer - *MKM Partners - Analyst*

Great, good morning. My first question relates to your comments about increasing your touch points with the consumer and basically going back to last year's level. Does that signal that you're going to be a more promotional business going forward and is that already in your guidance and incorporated into your longer-term thinking?

David Kornberg - *Express, Inc. - President & CEO*

No, I think the answer to that is as I said on the call what we're looking to do is broaden the audience that we're reaching out to as opposed to the depths of the promotions so that we are getting more people into the brand.

Roxanne Meyer - *MKM Partners - Analyst*

Okay I guess I was just thinking that presumably if you have more people that are coming back to your store incrementally with some kind of bounce back that that might drive a more promotional business.

David Kornberg - *Express, Inc. - President & CEO*

No, that is absolutely not the aim.

Roxanne Meyer - *MKM Partners - Analyst*

Okay, great. Then -- sorry if I interrupted you.

Perry Pericleous - *Express, Inc. - SVP, CFO & Treasurer*

No I was going to say, Roxanne, you have asked if this increase of the customer touch points if those are in our guidance. To some extent they are in our guidance but when you look at from a sale standpoint the guidance that we provided does not assume that we are going to see just a change immediately. We are going to see an improvement over the fall season.

Roxanne Meyer - *MKM Partners - Analyst*

Okay, great. Then as it relates to the increase in choice count, I guess I'm just wondering was that done across all categories and were there certain categories where you disproportionately took that strategy? And just a little bit more color there.

David Kornberg - *Express, Inc. - President & CEO*

No, it happened pretty much across the board. I think that the biggest area that it affected was obviously the tops area and women's.

Roxanne Meyer - *MKM Partners - Analyst*

Okay, great. Thanks and best of luck.

Operator

Betty Chen, Mizuho Securities.

Betty Chen - *Mizuho Securities - Analyst*

Good morning. Thanks for taking my question.

I was wondering as we get into Q4 and then spring I think David you mentioned that we could start to see some of the changes in the choice count. How much of a change should we expect in the fourth quarter? And it sounds like it will be across all categories, but especially in regard to the women's tops business.

And then the second question really is around the sweaters read. It sounds like you've seen some encouraging reads for the women's sweaters business for the fall. Is there any more color you can give us on that front?

Lastly, in regard to the second-half unit buy, Perry, can you just remind us what were the unit buys and whether you were able to make some media adjustments for the first quarter or spring 2017? Thanks.

David Kornberg - *Express, Inc. - President & CEO*

Okay, Betty, good morning. Looking at choice counts we will get into a better position as we get towards the back end of Q3. Q4 we will have less choices in store than we had last year.

In response to your question on sweaters, we've seen some very good indications and some very good reads early on. And we're encouraged by what we're seeing.

I think that we have a strong fashion assortment and we are seeing as I said very good reaction. Perry?

Perry Pericleous - *Express, Inc. - SVP, CFO & Treasurer*

Betty, in terms of the unit buys right now the unit buys for the back half of the year are in line with our sales expectation. One thing that I would note is we are buying back into fast turning items and we expect those to come back in the back half of Q3.

Betty Chen - *Mizuho Securities - Analyst*

Can I add one last one? David, it seems like we've been hearing that there are some changes to fashion silhouette that could be particularly relevant for the Express customer whether it's denim or maybe a top like bodysuits.

Just curious and any thoughts around that or whether you're seeing some of those trends pick up in your business as well? Thanks.

David Kornberg - *Express, Inc. - President & CEO*

Yes, we are seeing it. We are seeing obviously a move to higher rises which we're seeing in denim, in particular.

We have higher rises coming in as we get further into fall in dress pants, as well. But the real strength of denim has been in the midrise, also in the high rise. And also particularly in terms of the leggings we are seeing a cleaner look and we're also seeing a more tucked-in look in terms of the way in which people are wearing their clothing.

So we see that going forward. In terms of other trends, I really don't want to go into too much detail based off of competitive information.

Betty Chen - *Mizuho Securities - Analyst*

Okay, great, thank you so much. Best of luck.

Operator

Susan Anderson, FBR & Company.

Susan Anderson - *FBR Capital Markets - Analyst*

Hi, good morning. Thanks for taking my question. I was wondering if you can give us some color on the outlets, particularly those that have been in place for over a year, holiday comping, are you guys seeing positive comps there?

And then second on the new systems, any issues around implementing those and now it sounds like they are in place? And how do you expect the benefits to flow through and have you seen any early reads from them? Thanks.

Perry Pericleous - *Express, Inc. - SVP, CFO & Treasurer*

Susan, from an outlet standpoint we have seen a similar decline in the outlet business as we've seen in the retail business from a store standpoint, mainly driven by traffic in the outlet locations. But overall we're still pleased with the outlet performance as a channel.

Matt Moellering - *Express, Inc. - EVP & COO*

This is Matt. As it relates to the IT initiatives that have gone live in the last few weeks. The heavy lifting of these is behind us and as with any large implementation of this nature there are still a few things we need to iron out with the systems, but for the most part they are working very well and we are pleased with the execution to date.

These systems will provide significant benefit to us over the long term. So we're now able to start to plan by channel, retail stores, e-comm outlet which we were not able to do well before with our 25-year-old systems. We have much more granular metrics and reporting available to us, better attribution capabilities, and these system implementations also lay the foundation for omni-channel capabilities moving forward.

So there are lots of things that this new system will do. There is significant process change attached to these new system implementations that everybody is getting used right now. And that's why we've talked about the benefits accruing over time.

Right now we're finalizing the stabilization of the systems, getting used to the new processes that are involved with the new systems. And we do think over the longer term there will be 50 to 100 basis points of margin opportunity in the out years and we will ramp that up over time. Some of it in 2017 and then additionally as we get into 2018 with really leveraging these capabilities.

Susan Anderson - *FBR Capital Markets - Analyst*

Great, that's helpful. And if I could just throw one more in on the inventory. It sounds like you continue to plan conservatively. Should we expect it to be down similar to second quarter and third quarter? And then if you could just make some comments on how you feel about inventory out there in the industry and the competitive and promotional environment.

David Kornberg - *Express, Inc. - President & CEO*

Overall I believe that our inventory levels are in very good shape. And when we look at the work that we've done on our inventory optimization project we are executing very well this year. I think as you look at our inventory going into the quarter our redline inventory is a little higher than it was last year, but as Perry said earlier, several reorders of fast turning items will be hitting the stores as we get into October.

So I'm encouraged by the ability of what that's going to give us. In addition, our open to buy is still very liquid as we look into the fall quarter. So I'm encouraged from that perspective.

In terms of looking at other people out there and looking at the mall I don't want to comment on what others are doing. I think we have to be totally focused on what we're doing and how we are driving the business forward.

Susan Anderson - *FBR Capital Markets - Analyst*

Great, thanks guys. Good luck next quarter.

Operator

Michael Binetti, UBS.

Michael Binetti - *UBS - Analyst*

Hey guys, good morning. Thanks for taking my question. It wanted to ask you about maybe on UPTs for a second and denim.

We've seen the denim on sale a lot. The product looks fine but do you think, and you called it out as a strong category, do you feel like the customer is coming in and picking up denim and just not adding anything else to the basket or maybe you could help us just with a little bit of directional commentary on what UPTs look like in the quarter?

Perry Pericleous - *Express, Inc. - SVP, CFO & Treasurer*

So for Q2 what we've seen overall from a UPT standpoint it was flat to last year. So we haven't really seen that the customer is coming in and not picking up any other units, especially as it relates to last year.

David Kornberg - *Express, Inc. - President & CEO*

I think also look at denim, denim is a driver of the business. And as you look competitively at the mall while we are not a back-to-school destination, I think that it is a driver of people's purchase consideration in the August time frame. So we need to be competitive with the mall.

Michael Binetti - *UBS - Analyst*

Okay. Can I ask you just about some of the components of the same-store sales guidance through the year? It sounds like you've got the guidance calibrated for similar levels of traffic and on a year-over-year basis in 3Q, but it doesn't look like the implied guidance for 4Q sees much of an improvement but obviously the same-store sales compares get easier. Do the dynamics of traffic versus ticket change much in the way you've modeled it out in fourth quarter versus third quarter?

Perry Pericleous - *Express, Inc. - SVP, CFO & Treasurer*

We do not assume that traffic is going to be improving as we look at the latter half of the year. We're assuming that what we've seen in overall during Q2 in terms of traffic pressures remains for the balance of the year.

Matt Moellering - *Express, Inc. - EVP & COO*

That being said we are taking the appropriate action to address a lot of these items. And we would hope that the business would improve over the next two quarters.

Michael Binetti - *UBS - Analyst*

All right. Thanks a lot, guys.

Operator

Richard Jaffe, Stifel.

Richard Jaffe - *Stifel Nicolaus - Analyst*

Thanks very much, guys. Two questions.

One is just a finance question. How did the cost savings breakout between SG&A and gross margin?

Perry Pericleous - *Express, Inc. - SVP, CFO & Treasurer*

So the expense savings for the back half of the year, the $9 million that both myself and David addressed, we would expect about 90% of that to be in the SG&A and the remaining to be in the gross margin. And as I mentioned in my prepared remarks, these savings are contemplated in our guidance.

Richard Jaffe - *Stifel Nicolaus - Analyst*

Very good. A question on the product mix.

You've been working on the Express One Eleven line and then certain stores were getting a much more high fashion or elevated assortment, as well. Are these initiatives turning out to be the source of the greater assortment than you had hoped for?

David Kornberg - *Express, Inc. - President & CEO*

No, I don't think that's the case. I think when we look at One Eleven some of our best-selling and best turning items have been within the One Eleven assortment. So it's been very good and additionally it was only in 27 stores, so it's not a major driver of the total business or of an assortment mix.

Richard Jaffe - *Stifel Nicolaus - Analyst*

So I guess the question was asked earlier but is really just an initiative internally to have more SKUs and that became over sorted in stores. Is that fair?

David Kornberg - *Express, Inc. - President & CEO*

Yes, we believe that that's the case, that by adding in the amount of choices that we did and the frequency of newness alongside that it led to a lack of clarity in the assortment.

Richard Jaffe - *Stifel Nicolaus - Analyst*

And could you quantify the difference year over year in terms of customer choices in the quarter?

David Kornberg - *Express, Inc. - President & CEO*

No, I can't go into the details.

Richard Jaffe - *Stifel Nicolaus - Analyst*

Thank you very much.

Operator

Rebecca Duval, BlueFin Research Partners.

Rebecca Duval - *BlueFin Research Partners, Inc. - Analyst*

Good morning, thanks for taking my call, my question. David, I just have a question on some clarification on the assumptions with traffic.

It seems like you're optimistic about some of the fall initiatives in place. You're seeing some green shoots in the early fall assortment. But is the guidance still reflective of similar traffic trends that you're seeing in the early Q3 with no assumption that it would improve based on some of these optimistic early reads?

David Kornberg - *Express, Inc. - President & CEO*

Well, the guidance has been based off of the business that we saw at the back end of Q2 and what we're seeing in terms of early Q3. That's how we build the guidance. Perry, do you want to add?

Perry Pericleous - *Express, Inc. - SVP, CFO & Treasurer*

And as it relates to traffic our expectation right now is that traffic is going to be constant, if you will, from a performance standpoint to LY as we've seen in Q2. And as mentioned earlier we do believe that the initiatives that we have in place will change the trend of the business but we feel that it is appropriate to have the guidance the way that we've set it.

Rebecca Duval - *BlueFin Research Partners, Inc. - Analyst*

Thank you. That's very helpful. Best of luck.

Operator

Paul Trussell, Deutsche Bank.

Paul Trussell - *Deutsche Bank - Analyst*

Yes, just going back in terms of category color, could you just speak a little bit more to the variance in business trends from casual to wear to work, accessories, men's and women's on the collections and just which of those areas should we expect to see the biggest changes in the fall? I know you mentioned a relaunch of the studio pants and men's shirts, but just a little bit more color on the updates that we should expect going forward. Thanks.

David Kornberg - *Express, Inc. - President & CEO*

I think that what we've seen the departments where we saw the strength in the second quarter of the departments that we should see continued growth in. My expectation is that we're going to see an improvement in our sweater business as well but as I said on the call, denim, dresses, knits and accessories performed above the average and we should see that continuing as we go further into the fall season. I'm excited about the pant offering that we have for September which is new and it also moves the rise forward and higher which is great news and that's obviously the direction that the customer is moving in.

In addition to that we've got an introduction of the skinny pant in women's dress pants which is an important silhouette and is also a very versatile pant for us. It works across multiple wearing occasions. So excited about what that is going to bring us, as well.

In men's as I said the performance above the average was largely within woven shirts and suits, which is good news for us because they are major drivers of our business and we should see that going forward. In addition to that, denim and dress pants were also relatively good and we need to ensure that we are fixing the men's knit business and we are getting the men's knit business back to where it was. And I'm confident with some of the work that's being done there and some of the newness that we're going to be delivering there that we have some very good ideas in place.

Paul Trussell - *Deutsche Bank - Analyst*

Thanks for that color. Just, thinking about those categories, are there still any major pockets of excess inventory in any of those areas that we should expect additional markdowns to clear?

David Kornberg - *Express, Inc. - President & CEO*

No. I think the issues that we have here as we talked about based on the sales that we saw in the second quarter our redline inventory is a little higher than it was last year. But we have several reorders of soft turning items which we will be getting back into as we get further into the quarter. And I believe that that has the ability to change the trend of the business.

Paul Trussell - *Deutsche Bank - Analyst*

Thank you. Good luck.

Operator

Pam Quintiliano, SunTrust Robinson Humphrey.

Pam Quintiliano - *SunTrust Robinson Humphrey - Analyst*

Hey guys, thank you for taking my questions. Just another one on choice count.

To further clarify, so you took up in A and B. I'm assuming that product was also available online. So was there a difference in the online performance of those SKUs versus what you saw in stores?

So essentially just trying to figure out if it was more product related, how it was presented in the stores or maybe a disparity widening on who is shopping online versus in stores currently.

David Kornberg - *Express, Inc. - President & CEO*

Very good question, Pam. That is exactly the case. I think it's the clarity of the assortment in the store versus the way in which it can be presented online made a big difference.

We saw a disparity in the performance of departments online to what we saw in the store, which was obviously positive to what we saw in the store. And as I said earlier on the call we're seeing some very good progress in terms of the selling that we're seeing online as we get into the fall season.

So in terms of talking about it I think that it's really it's a visual opportunity for us in terms of clarifying the assortment in store with fewer choices which are more meaningful that are able to drive the volume and able to get us to next. And I think that's where the opportunity lies.

Pam Quintiliano - *SunTrust Robinson Humphrey - Analyst*

That was very helpful. Thank you.

Just one follow-up to that, you had spoken about the age demographic earlier in the call. And are you seeing -- so is it the younger customers responding more online now and you're seeing a broader shift to who is shopping in the stores or is there anything to that as well?

David Kornberg - *Express, Inc. - President & CEO*

I think there's an element of that but we don't go into details in terms of the age demographic across channels. But at as I said earlier to another question, we saw the purchase consideration change in a very big way at the 18- to 21-year-old level as a positive turning point.

I think the good news with that is that it shows we have the ability to move the needle with the younger customer as well. But we have to get back to who our core customer is in terms of our overall projection and we have to get her back into the store. And I believe we have the ability to do that and we have the ability to get on with it in this quarter and in the next quarter.

Pam Quintiliano - *SunTrust Robinson Humphrey - Analyst*

We look forward to seeing it in the stores. Best of luck.

Operator

Jay Sole, Morgan Stanley.

Jay Sole - *Morgan Stanley - Analyst*

Great, thank you. My question is on the cost savings. Can you talk about the sources of the incremental cost savings that you're talking about this quarter versus last quarter?

And then secondly, can you talk about some of the variables that would determine whether you can reach the high-end of the total opportunity for cost savings versus the lower end? Thank you.

Perry Pericleous - *Express, Inc. - SVP, CFO & Treasurer*

So Jay, to answer your question overall, and I've mentioned that in the last call in May, we constantly evaluate our financial architecture. And as such we have identified additional savings across multiple areas of the business.

Right now as we've mentioned earlier we expect to gain about $9 million of savings in the back half of the year and then the remaining will come in 2017 and thereafter. As we look at the big buckets our expectation of these savings are through the zero-based budget process in our SG&A and B&O and then some savings within our overall sourcing and production.

Jay Sole - *Morgan Stanley - Analyst*

Okay. Is it fair to say that to get to the higher end of the guidance it would be those same buckets that can drive it? And when will you know whether you are going to reach the higher end or the lower end of the cost saving goal?

Perry Pericleous - *Express, Inc. - SVP, CFO & Treasurer*

It will be the same buckets to get us to the higher end of the guidance that we provided. We're going to know as we progress into 2017 as to our ability to achieve the higher of the range.

Jay Sole - *Morgan Stanley - Analyst*

Got it. Then maybe one more. As you think about 2017 can you directionally do you think CapEx will be similar to this year, above it or below?

Perry Pericleous - *Express, Inc. - SVP, CFO & Treasurer*

We revised our overall guidance for CapEx for 2016 down to $105 million to $110 million. And at this point for 2017 we've stated that our capital expenditures would be in the range of $100 million, slightly below the 2016 actuals.

Jay Sole - *Morgan Stanley - Analyst*

Okay great. Thank you. Good luck next quarter.

Operator

Marni Shapiro, Retail Tracker.

Marni Shapiro - *The Retail Tracker - Analyst*

Hey, everybody. So I guess a couple of quick questions.

The younger customer who is coming into the store now, this 18- to 21-year-old you said, is she entering through denim and One Eleven? And I guess is there an opportunity for you guys to consider maybe that could be almost a separate concept or a side-by-side or a pop-up so that there is a little bit more clarity or you can get back to clarity at the Express brand?

David Kornberg - *Express, Inc. - President & CEO*

We are considering anything and everything at this stage. I think that the biggest opportunity for us in the short term is improving the clarity within our stores as we've identified. We know that the wounds are self-inflicted.

The good news is that we've identified them and that we are taking action. Having said that, longer term I believe that there are multiple opportunities for us as a business, obviously with One Eleven and denim. But denim is a big part of the business and the brand across all of our wearing occasions.

So to split that off would be the wrong thing to do. Having said that, we're looking at everything and all opportunities as I said at the beginning of your question. But yes, it's a very fair question.

Marni Shapiro - *The Retail Tracker - Analyst*

And could I just follow up on this? This problem seems like it's very specific to the Express full-line stores.

Did it have the same effect in outlets? Because it sounds like it's really just your A, your biggest stores. Is that right?

David Kornberg - *Express, Inc. - President & CEO*

Yes, I think it is. It's more of a retail issue, what we have seen more recently as we've started to see the outlet business picking up a bit.

Marni Shapiro - *The Retail Tracker - Analyst*

Fantastic. Best of luck for back-to-school, guys.

Operator

Janet Kloppenburg, JJK Research.

Janet Kloppenburg - *JJK Research - Analyst*

Hi, everybody. Glad I got my question in.

David, I wondered if the lack of clarity that you talk about in the assortments currently had to do with maybe there not being a strong trend beyond denim that could carry the overall business and whether a lack of newness out there is constraining the performance of the business? Just your general thoughts there, because other people are saying that there are some pretty major trends going on that could lift overall apparel consumption.

And just one other question is I wondered if the systems that you recently implemented, the planning, forecasting, if those had been on board and you had had some history behind them whether or not, going forward whether some of this volatility could be taken out of the business? Thank you.

David Kornberg - *Express, Inc. - President & CEO*

Okay, to your first question yes, there are trends out there and there are some very good trends that we are seeing some very good results with. And we are buying into them in greater depth and I believe that that has the ability to change the trend of the business based off of what we have seen.

Second question, I think in terms of the systems, I think we've identified this as we said three issues, three issues: we skewed too young, we have got over-choiced which has led to a lack of clarity, and I think that the third one is also a major contributor which is we pulled back on the frequency of customer touch points whether it's DM, whether it's bounce back, whether it's fast cash. We pulled back on it last year and we had a terrific year. We believed that we could pull back further this year and that was the wrong decision.

So we are going to increase back to the levels of communication that we had last year with our customers in terms of these touch points. And our expectation is that based on the fact that we are on the right trend that our stores will look clearer and will look better that we will see the customer come back. And we will see a return to the positive levels of growth that we achieved in 2015 and I believe that we are capable of delivering that.

Janet Kloppenburg - *JJK Research - Analyst*

Of course you are. Lots of luck.

Operator

That does conclude our Q&A sessions. So at this time I will redirect the call back to Mr. David Kornberg for closing remarks.

David Kornberg - *Express, Inc. - President & CEO*

Thank you for joining us today. We appreciate your interest in Express and look forward to speaking with you when we report the Q3 results in December.

Operator

This concludes today's conference. Thank you for your participation. You may disconnect your lines at this time.
