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EXPR - Q3 2016 Express Inc Earnings Call

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PRESENTATION

Operator

Greetings and welcome to the Express third quarter 2016 earnings conference call. At this time, all participants are in listen only mode. A brief question and answer session will follow the formal presentation. If anyone should require operator assistance during this call, please press *0 on your telephone keypad. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Ms. Allison Malkin of ICR. Thank you, Ms. Malkin, you may begin.

Allison Malkin *- ICR, Inc. - IR*

Thank you. 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 Allison. Good morning and thank you for joining us. Our third quarter results were in line with our guidance with comparable sales of negative 8% and diluted earnings per share of $0.15, which includes a net discrete tax benefit of $0.04 per share. We made progress on our initiatives to correct the issues we faced in the spring. Our ability to quickly assess and take action was instrumental in delivering a double-digit increase in e-commerce sales in the third quarter, but continued mall traffic headwinds and the additional time needed to fully correct our choice counts, impacted sales in stores.

I will begin my remarks with an update on the issues we discussed on our second quarter call, followed by an update on our third-quarter merchandise performance. Finally, I will highlight the progress we made on our key objectives.

Now turning to the issues identified in Q2. As you may recall, in addition to mall traffic headwinds, we mentioned there were three key issues that negatively impacted our performance this past spring.

Namely, we skewed too young in our projection both in our marketing and merchandising; we had a lack of clarity in our assortment caused by too many choices, and we reduced customer touch points compared to last year.

I am pleased to say we are making progress on all fronts.

We have taken steps to address the issues we identified in our merchandising and marketing projections. Our presentation of fall more closely aligned with our target demographic driving improvements in important brand metrics such as familiarity and purchase consideration.

We are on track with our objective to reduce choice counts in the fourth quarter and to be at optimal levels as we begin 2017. We believe the choices that make up our fourth quarter assortment clearly identify, curate and communicate the important trends. This will be further enhanced with spring delivery.

Going forward, we will continue to deliver frequent newness, but will tell fewer fashion stories in-store to ensure our offerings are clear and cohesive across lifestyles.

With respect to customer touch points, beginning in September, we brought our direct mail activity back in line with that of fall 2015.

In addition, we began to re-launch Express NEXT, our loyalty program. As we mentioned on our Q2 call, the goal of the initial phase of the re-launch was to make it easier for NEXT customers to become fully engaged with the program and utilize their rewards.

During October, we fully activated a portion of our loyalty member base that had not yet completed the registration process. During the first month of the relaunch, we drove a significant year-over-year increase in completed enrollments.

We will continue to prioritize NEXT sign ups as a productive way to build brand loyalty and drive frequency of visits and a higher spend over the long-term. As a reminder, fully enrolled NEXT customers spend approximately 2.5 times that of a non-fully enrolled member and 4 times more than non-loyalty customers. We remain on track for a full program refresh set to begin in February and continue through the second quarter of 2017.

We were pleased to see the initial traction of our corrective actions result in strengthened customer interest in Express and higher e-commerce sales, despite facing a challenging environment, which we believe impacted our overall performance.

Let me now turn to a review of product, beginning with women's.

In the third quarter, denim, dresses and shoes performed above our comp average while we saw tougher results in skirts and outerwear. As we mentioned last quarter, we also relaunched our studio pant business in September with newness in fabric, silhouette and rise.

In regards to sweaters, new fall deliveries began to arrive in late September with sales still down overall, but improving in trend.

In addition, our knit business responded well to a change in our promotional strategy.

On the men's side of the business, suits, woven tops, ties and accessories performed above our comp average with the men's business overall comping ahead of women's. In suits, we increased our offering in stores and online and also carried our cotton suits longer into the season, which resonated with our customers.

We also introduced new textures and fabrications in men's shirts, which performed well.

Turning to an update on our objectives, which are improving profitability through a balanced approach to growth, providing an exceptional brand and customer experience, transforming and upgrading our IT systems and processes, and investing in the growth and development of our people.

First, as it relates to improving profitability, we continue to take a balanced approach to growth with the goal of increasing sales productivity and profitability as we focus our resources on areas of the business that have the potential to generate a strong return on investment, including the growth of our ecommerce and outlet businesses and the optimization of our retail footprint.

Ecommerce was a bright spot in the quarter, delivering 15% growth as we capitalized on the increasing preference of our customer demographic towards this channel with a strong and clear marketing and merchandising message.

During the quarter, we launched several key initiatives, including Improved Navigation, as well as continued optimization across search and category pages.

We opened 5 new Express Factory Outlet locations during the quarter, bringing the total to 99.

During the fourth quarter, we will be opening four additional stores and will convert one existing retail store. We are on track to end 2016 with 104 Express Factory Outlet locations and are well on our way to reaching our target of 140 to 150 stores within the next few years.

We also continue to make progress on our retail fleet rationalization initiative. We have closed 42 stores since the beginning of 2015 and have one additional closure planned for the fourth quarter, leaving us seven shy of our target of 50.

We regularly assess our fleet from an overall profit contribution standpoint to determine if any additional closures are warranted. We are also keenly focused on ensuring we have the right balance of locations across channels so that we are providing our customers with the ability to shop when, where and how they prefer.

Finally, we have also made progress toward achieving the cost savings goals we outlined with you in August. We remain on track to achieve $9 million in savings this year and $20 million in incremental savings in 2017. We are also lowering our capital spending levels for 2017. Perry will discuss this in greater detail with you shortly.

Turning to our second objective, increasing our brand awareness and elevating our customer experience.

We are increasing 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 and continue to see a positive impact from our media distribution strategies across digital and social channels from an owned and paid perspective.

Total brand impressions across these efforts grew significantly in the third quarter, leading to meaningful increases in purchase intent and lifestyle fit.

In addition, our influencer programs continue to see strong momentum and reach.

Our Express Instagram channels continue to build in following and engagement. Our number of followers has now grown to more than 600,000 across the channels, and we continue to see solid growth and engagement each month.

In regards to brand ambassadors, we are looking forward to next spring's introduction of an assortment designed and curated in collaboration with Karlie Kloss.

On the men's side, we are proud of our association with Kris Bryant, the Cubs third baseman, World Series Champion, and National League MVP. Our Kris Bryant video campaign on YouTube alone drove over 2 million views, which is our best performing video campaign to date.

Express' ongoing mission is to partner with brand ambassadors who are inspiring, confident, and embody the spirit of our customers, and Karlie Kloss and Kris Bryant do just that.

For holiday, we continue to engage with our customers through our Express Life campaign, promoting the season and lifestyle end uses tied back to our product.

We are also partnering with millennials who excel in their fields of expertise, showcasing additional lifestyle content in our digital channels. We know that 'real' people resonate with our core demographic and we are excited to align the Express brand with "everyday achievers" who are making a difference.

Our third objective is investing in our IT systems and processes. On our last call, we discussed some important IT systems implementations that launched at the start of Q3, including new order management, retail management and enterprise planning systems.

During the third quarter we began working with these new systems and have been pleased with the progress made in our employees' use and understanding of our new tools. We have now modernized approximately 95% of our portfolio of systems over the past four years. With most of the investment and focus of these implementations behind us, we can now start to take advantage of using the new system capabilities heading into 2017, including the foundation for us to pursue omni-channel capabilities.

We now possess greater insight into our customers' shopping preferences, which will enable us to personalize and customize promotional offers in conjunction with our loyalty programs.

In addition, we are now able to see inventory across the total company, giving us a real advantage as we plan and allocate product in to 2017 and beyond.

Ultimately, 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. And the fourth objective is investing in our people. We are committed to ensuring that Express remains a great place to work, develop and grow professionally, and that we continue to attract outstanding talent to the brand. We offer a variety of unique associate development programs that have received national recognition by leading industry publications.

In summary, during the third quarter we refocused our merchandising and marketing projection while making progress on choice count rationalization. We saw increased customer engagement through our enhanced social media and brand ambassador associations, and we elevated our loyalty program, which will begin to assist us to drive more frequent purchases.

Finally, we began working with our new IT systems, which will give us more capabilities to meet our customers' needs as we head into 2017.

As you are aware, we just completed Black Friday week, which was disappointing and reflected an intensely promotional retail landscape. While the majority of the quarter is still in front of us and we believe we have the right assortment and marketing plan, we are taking a cautious stance, which is reflected in our guidance.

I remain confident that our corrective actions taken, along with the continued implementation of our key initiatives will move us toward our long-term double-digit operating margin goal in an ongoing effort to enhance value for our shareholders.

We have a unique position in the marketplace, driven by our ability to serve the many lifestyle needs of our core demographic, with a brand only distributed by us. And we are highly focused on delivering consistently strong fashion, along with a strong customer experience and value proposition so that Express becomes a top shopping destination for many more consumers in our target demographic. This is our goal and one that we believe is well within our reach.

I want to close by thanking everyone at Express for their dedication and relentless effort to prepare for the holiday season.

Additionally, as you may have seen in the 8-K that we filed this morning, Jeanne St. Pierre, our executive vice president of stores, has shared with me her plan to retire at the end of the calendar year. I have appreciated Jeanne's tremendous leadership throughout her years at Express and wish her all the very best. We have a strong and tenured stores team, and I'm confident in their continued, relentless focus on the business.

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 third quarter, I would like to reiterate our commitment to the key business objectives of improving profitability through a balanced approach to growth, providing an exceptional brand and customer experience, transforming and upgrading our IT systems and processes and investing in our people.

I will now turn to a review of our third-quarter results, beginning with the income statement.

Net sales were $506 million, a 7% decline from last year's third quarter. Comparable sales declined 8%, in-line with the negative high-single-digit to negative low-double-digit guidance we provided in August.

Merchandise margin contracted by 340 basis points, driven by increased promotional activity.

Buying and occupancy expenses decreased $2.4 million, but our B&O rate increased by 160 basis points as the sales comp decreased led to anticipated deleveraging of fixed costs. As a result, third-quarter gross margin rate contracted by 500 basis points to 30%.

We continue to aggressively focus on managing expenses. SG&A was $10 million below last year, at 27% of net sales. The SG&A dollar decline of 7% was a result of savings across many categories of expenses and the reduction in sales.

The net result was operating income of $15.1 million or 3.0% of net sales. The 510 basis point contraction to last year was in line with our expectations. Third quarter diluted earnings per share was $0.15 and includes a net discrete tax benefit of $0.04 per share.

Turning to our cost savings initiatives, We continue to plan for a total of $44 million to $54 million of annualized cost savings over the next few years.

For modeling purposes, we expect to achieve approximately 40 percent of the savings in Merchandise Margin, mainly driven by Supply Chain efforts as we expand our factory sourcing base. Approximately 10 percent of the savings will be realized through B&O from sustainability efforts in our stores, and half of the savings will come from SG&A as we continue to enhance the productivity of our existing resources to expand profitability.

Our 2016 guidance reflects $9 million of savings, most of which will be in SG&A. We expect $20 million in savings in 2017 and $15 million to $25 million thereafter, which will generally be in proportion with our total annualized savings breakout.

Our balance sheet remains very healthy. We ended the third quarter with $102 million of cash and cash equivalents, compared to $91 million last year.

Capital expenditures for the third quarter were $31 million and $81 million year to date.

Inventory at the end of the third quarter totaled $342 million, representing a 6 percent decrease over last year. Our retail business inventories decreased by 5 percent as we remained 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 fourth quarter and for fiscal 2016. For the fourth quarter of 2016, we currently expect comparable sales to be in the range of negative low-double-digits, net income in the range of $20 million to $23 million, and diluted earnings per share in the range of $0.26 to $0.30.

Based on the midpoint of our guidance, we expect our operating margin to contract by approximately 670 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 range of negative high-single digits, adjusted net income to range from $62 million to $65 million and adjusted diluted earnings per share to range from $0.78 to $0.82.

On a full-year basis for 2016, we now expect that at the midpoint of our guidance, operating margin will contract by approximately 420 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 $100 million to $105 million, driven by new outlet stores and our IT platform. This is a $10 million reduction versus our initial capital spending guidance at the beginning of the year.

We also plan to take aggressive steps to further lower our capital expenditures run rate next year. These actions are consistent with our laser focus on reducing spending in all facets of our business.

Overall, we are confident we have identified the right initiatives to improve our sales and profit trend. We are focused on implementing the corrective actions to drive profitable and sustainable growth.

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) Betty Chan, Mizuho Securities.

Betty Chen - *Mizuho Securities - Analyst*

I was wondering if you can talk a little bit about the e-commerce discrepancy versus the stores, David. It is encouraging, to your point, that the e-commerce sales grew very nicely, up 15% in the third quarter. Do you think that, by the fourth quarter or where we are today, the store better represents the online presentation, and where do you hope that to be by spring?

My second question, if I could, is also regarding the inventory planning. It sounds very exciting that the system is now in place where you can kind of better plan and allocate inventory units. How should we think about the Q4 inventory and perhaps spring purchase plans as a result of that? Thanks.

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

Okay. I have got three questions there, Betty. First of all, e-commerce performance versus stores. Secondly, stores and whether they represent the online presentation and what we expect to see by spring. And, thirdly, inventory planning.

Betty Chen - *Mizuho Securities - Analyst*

That's right.

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

Okay. If we begin with e-commerce versus stores, look, we recognize that our demographic spends much more time online, and we see a transformative environment with our consumers shifting online. This is what we call here as adaptive change. The world is changing, and the industry is changing in that way. We have to be ahead of it. I think that e-commerce benefited from being able to communicate a strong marketing and merchandising message throughout the third quarter.

I think that we will reach our optimal choice count target in the stores as we get into 2017 and that we are going to be at a point where we are really able to increase the depth per choice, and we will be able to increase the productivity per choice. So I feel good about where we are heading into spring. Obviously, I am delighted with the performance that we delivered online, but I would say again, this is about adaptive change, and when adaptive change happens, you have got to get out in front of it. And I think that we are doing everything that we should be.

I would like to say to you, Betty, and I think this is very important as a message to get across to all of you, is Express is a strong and enduring brand. It is a brand that is 36 years old. We have a sound balance sheet, we generate a lot of cash, and we have zero debt. I think that what you heard from Perry is that we are laser focused on reducing our expenses and our capital spend. And going into, really, a second and third part of the question, spring, we will be in a much, much better position. I feel very good about the assortment. We have good, warm weather reads that we have got over the last few weeks in the southern part of the country, and we will be at this point where we have an optimal choice count.

So I feel good about where it is. I think overall, in terms of inventory planning, the good news is that our inventory was down at the end of the quarter and down as far as it was. I think that we are very open and liquid in terms of the purchases that we can make at the back end of the first quarter and completely liquid as we look into the second quarter. So I feel very good about where we stand overall in terms of the inventory position. I hope that answers your question.

Operator

Adrienne Yih, Wolfe Research.

Adrienne Yih - *Wolfe Research - Analyst*

David, my question for you is, the fashion items or however you want to discuss them, but we always think about that pyramid, and then there is sort of the basics and then the foundation, and then you kind of build up to the fashion pieces. The fashion component, I agree with you, looks great, but I feel it gets stomped out really quickly. So can you give a little bit more color? I know you started to about spring, how you are distorting that, and how you think that the fashion apparel trends build for spring and then, more importantly, for fall of next year? Perry, really quickly, is

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your fourth-quarter guidance predicated on quarter to date trends for the macro backdrop and mall traffic being negative not improving in December, or did it call for a little bit of an improvement as people get closer to holiday? Thank you.

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

Look, I agree with you. We have sold out too quickly on our fashion, and that is why we have gone back and increased significantly the depth per choice so that we can be more productive. And I think that it is also important that you understand that, with that increased depth to choice, going into the spring, we will also see some very good IMU improvement as well, largely because we have spread our factory base in a better and a fuller way.

So we have gone back. We are buying more against the fashion styles and more depth. I feel good about the spring assortment. As I said in response to the first question, we have some very good warm weather reads, and I think that the trends, which I'm not going to go into detail here on the call for competitive reasons about, are solidly behind our brand as we go into the spring season.

Adrienne Yih - *Wolfe Research - Analyst*

Okay. I agree there.

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

And then, to the second part of your question, the guidance reflects what we saw in the month of November and Black Friday week, and that is not assuming improving trends in the balance of the quarter.

Adrienne Yih - *Wolfe Research - Analyst*

Okay. Thank you very much and best of luck.

Operator

Neely Tamminga, Piper Jaffray.

Neely Tamminga - *Piper Jaffray - Analyst*

For David or Perry, you guys are cutting the CapEx guidance, which I think is prudent for this year and getting that focus into next year as well. Could you us give a little bit more as to what is behind the reduction? Are you canceling some programs? Are you delaying some programs? Are you kind of changing direction? Just, more strategically, what programs are getting readjusted through that? Thank you.

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

Okay. So overall, clearly in terms of CapEx, the opportunity is in terms of our real estate and our IT systems. I want to emphasize that, while we are looking at a CapEx reduction of somewhere in the region of 25% in 2017, we are not going to do anything that is going to harm the business in any way, shape or form. There are certain IT initiatives that we will delay, and then, when you look at some of the reverbs of stores, we are going to push back some of those as well. But, overall, it is absolutely the right thing for us to be doing going into 2017.

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

The good news, also, is the fact that, over the past three years, we have done an enormous amount of system implementations, touching the vast majority of our systems. All of that investment is now behind us. We still have a little bit of system investments going forward, but to a much lesser extent. So we now have made the investment in the systems. Now we get to enjoy the benefits over time.

Neely Tamminga - *Piper Jaffray - Analyst*

Thanks, Matt. Thanks, David.

Operator

Richard Jaffe, Stifel.

Richard Jaffe - *Stifel Nicolaus - Analyst*

Given the success of e-commerce or the strength in the growth there, are you looking at real estate with a different eye? Is there an opportunity to reevaluate that and, perhaps, take a more aggressive stance than what you have been doing? And can you talk about 2017 in light of that possibility? Thank you.

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

Yes. We are constantly looking at our real estate and reevaluating our portfolio. As we announced earlier on the call, we are almost at the end of our 50-store closing program. But we are reassessing all of the deals, all of the leases, and there is nothing to report now. We are looking at it very closely, and you need to be aware of that.

Richard Jaffe - *Stifel Nicolaus - Analyst*

Thank you.

Operator

Roxanne Meyer, MKM Partners.

Roxanne Meyer - *MKM Partners - Analyst*

First, I am just wondering if you could talk to the differential between online and in stores and, really, what is driving the outperformance online? Where is the strengths online that maybe you are not seeing in stores?

And then, just in terms of the composition of your inventory, just wondering how carryover inventories look, ending the third quarter? Thanks a lot.

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

Okay. Really, the differential between online and stores, I think, is really the clarity of the message that we can communicate, the sharpness of the marketing that we can put behind it online, and really there is obviously no limit in terms of the time in which the store is open online and then in terms of the breadth and depth of the assortment that you're going to put online. So it enables us to have more choice, which is a very different model.

But I think, with the work that we have done in terms of clarifying the choice count, rationalizing the choice count, and clarifying the look and the feel of the stores, as we went through the third quarter, we made progress. And we made progress in our business as we went through the third quarter.

What we have seen is the business got choppier into November and through Black Friday weekend. So we believe that the corrective actions that we identified made a difference as we went through the third quarter. And, as we get into the first quarter, which I've talked about for a while now, I believe we will be at a point in store where we are the optimal choice count, and we have the right depth per choice.

The good news is, as I said, we have tested a significant amount of it, and we have seen very, very good responses to it.

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

Yes, just piggybacking on David's comments, from a choice count perspective, when you look at the choice count, it is easy to tell clear stories online with expanded choice counts. When you get to the store where we have talked about the fact that we have expanded choice count and taken inventory down, the combination of those two creates a significant drop in the depth of those fashion buys that we are making, and that is what we are correcting heading into the spring season where we will have tighter choices, a much clearer message in the store, which is hard to tell with broader choice counts, and more depth per fashion choice, which should all help the business significantly.

Roxanne Meyer - *MKM Partners - Analyst*

Okay. Great.

Operator

John Morris, BMO Capital Markets.

John Morris - *BMO Capital Markets - Analyst*

A couple quick questions here. on the SG&A reductions for next year -- and thank you for giving us that extra color -- the 50% of that $20 million that you are taking, is that really coming across all categories the way you have done it this year?

And then, David, maybe talk a little bit more about what you have seen? It sounds like in November, it sounds like the challenge has been sort of through the month. It doesn't wasn't just on Black Friday weekend. But I am wondering if that causes you to -- I am thinking that most of that is coming from competitive promotions around you and what you see out there. Are you anticipating or thinking about how you want to change up your promotional strategy to the extent that you might consider that at all, and, if so, in what direction you might do that, either through the balance of the season or next year at about this time? Thanks.

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

Okay. So let me talk about that question, first. I think, John, the most important thing to understand is that we made sequential improvement as we went through the third quarter. I think that, as you got into November, yes, we did see a change in the promotional environment. It was sharper. Look, we always know going into the holiday timeframe that it is going to be promotional, we are prepared for the promotions, and I think that the important message to understand is that our inventory is under control.

So I think that we are well-positioned for the balance of December to be able to hold our own and to be able to compete. So I think that is the most important message to come across from that.

Perry, do you want to answer the SG&A question?

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

Yes. And, John, from an SG&A standpoint, yes, we did speak about $20 million in savings in 2017. Approximately 50% of that comes from SG&A. And similar to this year, we expect that savings from an SG&A standpoint to be across the business as we continue to look at opportunities to reduce expenses. As we mentioned before, we have a zero-based budget, of course, approach to all the expenses, and we continue to scrutinize every line item.

John Morris - *BMO Capital Markets - Analyst*

Thanks, guys.

Operator

Paul Trussell, Deutsche Bank.

Paul Trussell - *Deutsche Bank - Analyst*

I just wanted to inquire about the performance of the outlet boxes in the quarter and what your assumptions are there going forward.

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

Paul, consistent with the Q2 performance, we saw a similar drop in the comps and the outlet business as we had seen in the overall retail business. But we don't get into specific comps between the retail stores and the outlet stores. The overall performance, if I were to look at the total stores, were down from a traffic standpoint, and that was the driver of the softness.

Paul Trussell - *Deutsche Bank - Analyst*

Thank you.

Operator

Simeon Siegel, Nomura Intl.

Gene Vladimirov - *Nomura Intl - Analyst*

This is Gene Vladimirov on for Simeon. First, would you mind sharing the comp metrics for the quarter? And, second, I was wondering how we should be thinking about SG&A expenses in 4Q and next year. If you could give some color on where we are in terms of getting the new systems fully into place and how the implementation has been going. And maybe, any updated thoughts on when we should see the benefits flow through? Thanks.

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

From a comps metric perspective for the quarter and I touched on that on the previous question, we saw traffic decline in the third quarter. We also saw ADS being down in the third quarter as evident by the merchandise margin performance.

As it relates to the SG&A expenses, I think that was the second part of your question. In Q4, we expect SG&A in Q4 to deleverage, obviously given the negative low double-digit guidance. When I look at the SG&A in terms of a percent reduction to last year, I would expect it to be in the same, but same percentage as Q3 was.

As it relates to next year from an SG&A standpoint, we have not provided guidance for 2017 in terms of SG&A. But a couple of things to keep in mind from a 2017 standpoint. One is we are going to have some of the $44 million to $54 million in annualized savings start showing up in 2017. That is part of the $20 million of savings.

Then, also, from a 2017 standpoint, what you have to keep in mind is that we are going to have increases in SG&A driven by the normal inflationary costs such as merit increases, such as minimum-wage increases, such as reintroducing the incentive compensation into the financial structure.

Just a rule of thumb, I would think a deleverage point on the low end of mid-single digits for leverage in SG&A expenses in 2017.

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

As to your question on the IT systems, as you are aware, the majority of the IT systems went live at the end of July. This was a significant effort with significant change management required across many functions within the business. The system implementation went smoothly. We are getting our feet under us from a process standpoint, and it should start to see some leverage in the beginning of 2017, and that will continue to expand into the back half of 2017 and into 2018 as well.

One final system we are implementing is an assortment planning tool, which will be implemented in 2017. That will provide additional benefits in 2018 as well as we can get even more granular with our planning.

Operator

Marni Schapiro, The Retail Tracker.

Marni Shapiro - *The Retail Tracker - Analyst*

The holiday dresses really do look fantastic. I just wanted to focus on two areas that had been very strong for Express over the last period of time, and that is One Eleven. And I was curious how that performed in light of some of the pressure on the knits and topsides. And if you could also talk a little bit about the Portofino shirt, for example, had been a pretty significant volume driver at one point. And I'm curious if you are still seeing good sales there, or has there been a replacement to that volume?

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

Okay, One Eleven. This has been an area -- specifically casualness has been an area that has been performing ahead of the rest of the business. And I think -- well, I feel very good about this going into the spring season. We have got a very good assortment, and we are well-positioned with the rates that we have had in the warmer climate. So I feel good about that. Portofino has been hard. It has been very, very tough, as have all the key items in dressy women tops. But we have been testing a lot of units, and I think we have a good strategy going into the spring season, and we have good key items in place to replace the ones that we have.

The issue that we have had is that Portofino was such a big part of the assortment and such a big part of the business, but we have had many years out of it. Many, many years success out of it. But I feel good about the newness being developed in that area.

Marni Shapiro - *The Retail Tracker - Analyst*

If you looked at the tops business ex the Portofino, because items like that do tend to come in lumps for a period of time and then they trend up and then they trend down. If you look at the tops business ex that Portofino, is the rest of the business relatively healthy?

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

Look, we have got some very good items. We have got some very good sweaters. The sweater business looks good. The casual knit top business looks good. The casual work shirt business looks good. I am not going to give the actual specifics in terms of category performance, but we have some very positive signs.

Marni Shapiro - *The Retail Tracker - Analyst*

Excellent. Thanks. Best of luck for the rest of the holiday.

Operator

Janet Kloppenburg, JJK Research.

Janet Kloppenburg - *JJK Research - Analyst*

I wanted to ask, the last time we chatted, you seemed to like -- it seemed like you thought that comps would improve in the fourth quarter because of some of the SKU reduction and more focused products. And I just wondering, is it just the (technical difficulty) or is it the fact that maybe some of the (inaudible) business (inaudible)?

Allison Malkin - *ICR, Inc. - IR*

Janet, it is really hard to hear you. Can you repeat your question, please?

Janet Kloppenburg - *JJK Research - Analyst*

Sure. I will try again. Can you hear me?

Allison Malkin - *ICR, Inc. - IR*

Yes.

Janet Kloppenburg - *JJK Research - Analyst*

So I was saying, the last time we chatted, I think your guidance indicated that you thought, because of some of the assortment repositioning and SKU reduction, that comps would actually improve somewhat in the fourth quarter. And I just wondering if you did speak to the promotional environment, David, and how choppy it was, but maybe you could talk a little bit more about the deterrence the comps improving here in the fourth quarter. Was it just the competitive environment, was it warmer weather than expected, or are there some assortment issues that continue to need to be refined? Thank you.

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

Look, I think it is a combination of all of those factors. I think, yes, it was warmer weather. Yes, it was an intensely promotional environment. I think that the important message to come across is, as I said at the beginning, we made very good improvement as we went through the third quarter, and it has gotten tougher as we have gone into November and into Black Friday weekend. I think that the important message going into spring is that we will be at this position of having our optimal choice count. We will have more depth per choice on both our key items and also our fashion items. And we have a significant amount of it that has been tested. So, yes, clearly, I did say that comps would improve as we went to the fourth quarter.

Janet Kloppenburg - *JJK Research - Analyst*

What were they that you thought they were? I mean, yes.

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

And we saw comps improving as we went through the third quarter. What we were responding to is in terms of what we have seen in November so far.

Janet Kloppenburg - *JJK Research - Analyst*

Right. Okay. And so then (multiple speakers). Do you hold the same amount of confidence in the first quarter, or do you think the environment could just remain choppy?

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

Well, I think we have got to be prepared for everything, and I think that we reflected that in terms of our guidance for the fourth quarter. I feel good about our assortment going into the first quarter. (multiple speakers)

Janet Kloppenburg - *JJK Research - Analyst*

Okay. Just one last question, David. In terms of the comparisons with Portofino, when do they start to ease?

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

I think the comparisons on Portofino will start to ease as we get into the back end of the second quarter.

Janet Kloppenburg - *JJK Research - Analyst*

Okay. Great. Thanks so much, and lots of luck for the season.

Operator

(Operator Instructions) Rebecca Duval, BlueFin Research Partners.

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

I was wondering if I could just get a little bit more color on some of the trends that you are seeing in November. Was it mainly due to the traffic just being really weak? Because it seems like -- or were you missing out of the conversion? Was the conversion weaker than expected? It seemed like your sweaters were selling. You were getting good sell-through, especially on those letters. And the last time we had talked, you guys were chasing into that category. It sounds like you would be in good position for it. And so I'm just wondering if I could get a little bit more color there. And I am also wondering, when you had the glitch in the e-commerce business on Black Friday, was there any way to quantify any lost sales there? And do you feel like that glitch has now been corrected on a go forward basis? Thank you.

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

Yes. Look, if I can talk first of all about the e-commerce glitch. That we had on Black Friday. I think that the important message here is that we made up the volume over the weekend, and it is all fixed, and we feel very good about the way in which the system is operating. The team got onto it very, very quickly. And we are in a much, much better place.

So I think that the important message is that we made up the volume over the weekend, and we want to ensure customer satisfaction so we extended the offer into Saturday and that worked very well.

In terms of your question about November, what we saw is in terms of those metrics, we saw a decline pretty much across the board. So we saw traffic decline. We saw our ADS decline as a result of the promotional activity, and the conversion, I think you asked about as well, we saw a slight decline in conversion as well.

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

And the sweaters, David? The sell-through on the sweaters, did you guys feel like you had enough of the right inventory? It seemed like you had some good sell-through on initial reads that you were chasing into that were in the stores for Black Friday and more coming (multiple speakers).

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

I think part of the issue that we face is that we carried over a lot of sweaters last year into the spring season. And -- but I feel very good in terms of the sell-throughs that we have seen on sweaters so far.

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

Okay. Thank you and best of luck.

Operator

There are no further questions at this time. I would like to turn the call back over to Mr. David Kornberg for closing remarks.

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

Thank you, all, again, for joining us. We wish you a happy and healthy holiday season and new year.

Operator

Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation, and have a wonderful day.