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PRESENTATION

Operator

Greetings and welcome to the Express, Inc., first-quarter 2016 earnings conference call. (Operator Instructions) As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Marisa Jacobs, Vice President of Investor Relations for Express. Please go ahead.

Marisa Jacobs - *Express, Inc - VP 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'm now going to turn the call over to David; he will be followed by Perry, and then we'll turn to our Q&A.

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

Thank you, Marisa. Good morning and thank you for joining us.

The first quarter began on a positive note; however, from mid-March through the back half of the quarter, traffic declined unexpectedly in each of our channels and impacted our quarterly results. Throughout the quarter, our disciplined approach to inventories, promotions, and expense management served us well. This is evidenced by our merchandise margin, which grew by 20 basis points, and our gross margin which increased by 30 basis points.

Net sales for the quarter were flat, and our comparable sales declined by 3%, both of which were below our expectations. Our diluted earnings per share grew by 7% to $0.16. Adjusted diluted earnings per share rose by 14%, and at $0.25 was within the guidance range provided in March.

Despite this, we were not satisfied with our performance, and we continue to have a laserlike focus on execution and on controlling the controllables. Throughout 2015, we fundamentally changed the way we operate the business. During the first quarter, we improved our business processes, and we continued to invest our time and energy into driving profitable growth.

Specifically, we remain focused on delivering the right product and selling it at prices that protect our brand equity across our different channels.

We are accelerating projects focused on improving our sourcing and inventory optimization and shortening our product lead-times.

We have implemented a new order management system that will ultimately enable us to introduce new channel capability to our customers.

We are introducing new marketing and brand-building activities designed to elevate our brand, drive incremental traffic, introduce new customers to Express, and aid in our customer retention.

Finally, we are maintaining a maniacal focus on financial discipline and expense management, which limited the flow-through of the top line shortfall in Q1.

As we move through the second quarter, we will continue to focus on our key business initiatives, while looking for opportunities to positively impact the trend of the business. Let me review our business initiatives with you at this time.

First is store productivity. Positive comps early in the quarter were overshadowed by the slowdown that began in mid-March. Despite the downturn, we worked to ensure that the in-store experience was positive.

Throughout the quarter, we continued to flow in newness and highlight new looks. This kept the shopping experience interesting, and I believe that our stores remain fresh and inviting.

We also made important progress throughout the first quarter in terms of our fleet rationalization work. Shortly after the quarter began, we closed 14 retail stores. At this point, we have closed 41 stores, marking significant progress since we first announced our 50-store closing initiative.

In addition, 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 in time, we're continuing to add flexibility to our B and C level lease terms as renewals are negotiated.

Express Factory Outlets had another good quarter, and we continue to be pleased with this channel. We opened four new stores during the quarter, bringing our total to 85.

During the second quarter, we will be opening six additional stores and converting three existing retail stores. We currently expect to end 2016 with 104 Express Factory Outlet locations, and we still expect to reach our target number of 140 to 150 stores within the next few years.

Turning to e-commerce, at the beginning of May we completed the relocation of our e-commerce fulfillment center, and the new center is up and running. We eased up on product deliveries in anticipation of the move, which led to us leaving a small amount of sales on the table.

Absent that, we believe e-commerce sales would have been slightly positive rather than down 1%. With the reduction of normal inventory flows, we have seen e-commerce demand accelerate.

The relocation of our customer engagement center was also successfully completed. We expect to realize multiple benefits from each of these moves.

The new fulfillment center is better equipped to respond to volume fluctuations during peak season and to reduce package transit times. The new customer engagement center better supports round-the-clock customer inquiries, and I want to thank the teams who worked extremely hard to plan and carry out these two moves.

We are continuing to ensure that our e-commerce site remains compelling to both current and prospective customers. Mobile remains a particular area of focus, given the rapid rate at which customers are migrating to this method of browsing and purchasing. We are also continuing to build out the editorial and video content on our site, given its importance to our audience.

I'd like to update you now on our 2016 priorities.

Improving profitability through a balanced approach to growth continues to be a primary objective.

The full-year guidance we issued this morning makes clear that we will encounter obstacles along the way, but we believe our 2016 priorities provide a sound roadmap to navigating this difficult environment. In fact, we are accelerating the pace of several of our initiatives and expect them to benefit both the short-term and long-term health of the business.

We have also identified a number of new cost savings initiatives that we will implement. These will result in approximately $14 million of savings on an annual basis and will benefit the second half of 2016 by approximately $7 million.

This brings me to another priority, which is providing an exceptional brand and customer experience across all touch points. We continue to focus on training our associates in the best ways to engage our customers, assess their needs, and exceed their expectations on the selling floor, in the fitting rooms, and at checkout.

Online, we're also working to deepen the engagement between our customers and the brand. In addition to improving product presentation and search results, we are building out the editorial content our customers find so valuable as they curate their personal looks.

I'm also excited to announce that this summer we will launch visual search on the Express app. Users will be able to submit a picture of an item or outfit that they like, and we'll identify the most relevant Express products, which they can then easily purchase.

From a social media perspective, we continue to be active across all of the relevant channels. We've recently launched a new men's Instagram channel, @expressmen, which is "the gentleman's guide to basically everything". It's off to a great start, attracting almost 10,000 followers in its first two weeks.

We're ramping up our Snapchat presence as well, having embarked on a strategic partnership with them to reach new and existing customers, since more than 40% of Millennials use this channel. We were pleased with the results from our Snapchat Discover campaign on ESPN during the Super Bowl. That game also marked our first use of the Periscope app.

Our growing use of influencers and customer ambassadors is providing shoppers with additional relevant touch points that further their association with the brand. As it relates to our primary brand ambassadors, I'm thrilled to announce that later this year, Karlie Kloss will be returning to Express, this time for a longer engagement. She is an iconic and inspiring personality, and we're looking forward to resuming our partnership. We are also very pleased with the response to our new affiliation with Kris Bryant, the Chicago Cubs third baseman and 2015 National League Rookie of the Year.

With respect to systems upgrades, everything is proceeding as planned. Earlier this month, we launched our order management system. It's the first of the three major programs scheduled to come online this year, and everything has been proceeding smoothly since the transition occurred.

We are currently in the final stages of testing the other two systems and remain on schedule to transition to our new retail management and enterprise planning systems at the end of the spring season.

Last but certainly not least, our focus on supporting our people remains a priority. 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.

Let me turn now to product and the performance of the women's and men's businesses. We remain confident that our spring product is trend-right. Selling was strong during February and the first half of March. The April assortment did not materially change. Rather, we saw a significant drop in traffic during that time. Having said that, with a goal of continuous improvement, we have identified certain areas where our execution could have been better, and we are in process of addressing these opportunities.

Sales trends for our men's and women's businesses were quite similar, with both genders turning in stronger results during the first half of the quarter and weakening thereafter. Our restrained use of promotions and disciplined approach to inventory management applied to both genders, so the merchandise margin impact of lower sales was limited.

We continue to be focused on presenting the trends that are right for our customers, along with the key items our customers rely on us for. 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.

Before turning the call over to Perry, I want to make a few additional observations. We set out on a new path at the beginning of last year, and the results were extremely positive.

It marked the beginning of a journey to return Express to top-line growth and double-digit operating margins. We know there will be challenges along the way; and as they emerge, we are taking appropriate steps to limit their impact.

During the first quarter, our balanced approach to driving profitability served us well. Lean inventories provided flexibility to maneuver, and we used our open-to-buy dollars judiciously.

We maintained our discipline around promotions, showing particular restraint when sales slowed in the back half of the quarter. This steadfastness enabled us to preserve our merchandise margin, slightly grow our gross margin, and minimize the potential impact to our operating margin.

The second quarter guidance we issued this morning represents our point of view given the current retail environment. We believe our strategy is sound and will ensure the long-term success of our business. It incorporates a need to continuously adapt and evolve in response to changing circumstances.

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.

We believe our healthy balance sheet and ability to generate strong free cash flow leaves us well positioned to drive future stockholder returns. And, I want to close by thanking everyone at Express for their dedication and resolve during the last quarter and for their 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. I'll begin by reviewing our financial results for the first quarter of 2016.

Our net sales came in at $503 million, essentially flat compared to last year's first quarter. Comparable sales declined by 3%, which was below our guidance.

This aggregate number reflects negative results at our retail stores and online, although the latter would have been positive absent the impact of the fulfillment center relocation. Our outlet store business continues to perform well.

As sales softened during the second half of the quarter, we maintained our disciplined approach around promotions. This restraint, in combination with other inventory management activities, led to a 20 basis point improvement in our merchandise margins on a year-over-year basis.

Buying and occupancy as a percent of sales improved by 10 basis points due to our ability to reduce expenses. Collectively, merchandise margin and buying and occupancy improvements enabled us to expand gross margin by 30 basis points.

We managed expenses well. SG&A was approximately $3 million over the prior year, and came in at 27% of net sales, with this increase primarily reflecting our ongoing investment in information technology. As David mentioned, we have identified $14 million of annualized savings that we'll eliminate from the business, $7 million of which will be realized in the back half of this year.

The net result was an operating income decline of $2.1 million or 6%. On a rate basis, our operating margin came in at 6.3%. Given that, earnings per share rose 7% to $0.16, and adjusted diluted earnings per share increased by 14% to $0.25.

As a reminder, adjusted net income and adjusted diluted earnings per share do not reflect the impact of the agreement that we entered into with the landlord of our Times Square store early in the first quarter, allowing the landlord to market the space and terminate our lease early if or when an alternative tenant is identified. In connection with that agreement, we recorded an $11.4 million charge in Q1.

During our Q4 2015 earnings call, we indicated that $7.4 million would be classified as buying and occupancy expense, with the balance falling below the operating income line but above profit before taxes. In actuality, the entire amount was recorded as interest expense. I also want to note that this agreement remains outstanding.

Our balance sheet remains very healthy. We ended the first quarter with $111 million of cash and cash equivalents, compared to $128 million last year. This change reflects the use of $110 million to repurchase common stock under our share repurchase plan over the last 12 months, $41.5 million of which occurred during the first quarter of this year. We have approximately $30 million remaining under the current share repurchase program.

Capital expenditures for the first quarter came in at $18 million. Inventory at the end of the first quarter totaled $281 million, representing a 6% increase over the same time last year. This included approximately $59 million of Express Factory Outlet inventory, a significant portion of which relates to new stores.

With respect to our retail business, inventories decreased by 3.4% in the aggregate. As David mentioned, we are working on additional inventory optimization projects to bring further efficiencies to this important area.

Turning to our IT projects, we successfully moved our e-commerce fulfillment center and our customer service engagement center. We also successfully transitioned to our new order management system earlier this month.

We remain on track to bring the retail management and enterprise planning systems online at the end of July. And we expect to achieve the initial operational and financial benefits from these systems in 2017.

The final topic I want to address is our guidance for the second quarter and for fiscal 2016, which is predicated on trends we began to see in mid-March as well as our expectations for the balance of the quarter and the year. For the second quarter of 2016, we currently expect: comparable sales to be in the negative mid-single-digit range; net income in the range of $12 million to $15 million; and diluted earnings per share in the range of $0.15 to $0.19, assuming an estimated 79.7 million diluted shares outstanding.

Based on the midpoint of our guidance, we expect our operating margins to contract by approximately 250 basis points. This will primarily be driven by merchandise margin contraction along with modest B&O and SG&A deleverage associated with lower sales expectations.

With respect to our merchandise margin, we expect to incur deeper markdowns on our clearance goods to ensure that we are well positioned for our transition to fall. I want to call out that we intend to continue to be restrained in our use of promotions on full-priced product.

Turning to fiscal 2016, we expect: comparable sales to be negative mid-single digits to negative low-single digits; adjusted net income to range from $113 million to $123 million; and adjusted diluted earnings per share to range from $1.41 to $1.54 per diluted share, assuming an estimated 80.1 million diluted shares outstanding. On a full-year basis for 2016, we now expect that at the midpoint of our guidance our operating margin will contract by approximately 30 basis points. This is driven by a modest merchandise margin contraction along with modest B&O and SG&A deleverage.

Lastly, in terms of guidance, our capital expenditures are still expected to range from $110 million to $115 million as we continue investing in new outlet stores and our IT systems overhauls.

The expected results for the year do not in any way change our objective of returning to full-year double-digit operating margin within the next few years. On our last call, we laid out a multiyear path that included approximately 200 basis points of merchandise margin gains, primarily driven by leveraging our new system implementations. Along with that, we expected approximately 100 basis points of B&O leverage and approximately 100 basis points of SG&A leverage.

I want to reiterate our commitment to that path and believe it remains attainable. At this time, I'd like to turn the call back to David.

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

Thank you, Perry. In closing, we are focused on our key business objectives and priorities for the balance of the year. We remain confident that by further building our brand and improving our execution, we will deliver strong assortments and customer experiences while maintaining disciplined control of our inventory and expenses.

We believe that, in combination, these measures will enable us to move beyond current challenges to deliver increased sales, strengthen profitability, and enhance value for all Express stakeholders. Before beginning our Q&A, Marisa has one quick announcement.

Marisa Jacobs - *Express, Inc - VP IR*

Thank you, David. I would like to request that Q&A participants limit themselves to one question and one follow-up so that we can get to everyone in the queue. Operator, please open the lines so that we can begin the question-and-answer portion of the call.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Betty Chen, Mizuho Securities.

Betty Chen - *Mizuho Securities - Analyst*

Good morning, everyone. Thank you for taking my question. We were curious. David, I think you called out that Outlet continues to perform well. Can you give us some additional color there and whether you're also seeing some similar trends between men's and women's in the Outlet channel?

I guess my follow-up question would be for the online business. You mentioned now that we've completed the transition to the fulfillment center we are seeing e-commerce accelerate. Can you also share with us what kind of acceleration we've seen now since the transition is completed? Thank you.

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

Okay. First of all, in terms of Outlets, we're very pleased with the performance that we had in the first quarter. What I would say is that the comp also decelerated in Outlet at the same time as we saw the comp decelerate in frontline retail stores. It was just coming off of a higher base.

But in general, we were very pleased with the performance. And the performance that we've seen between men's and women's in Outlet has been consistent with the way in which it has been prior.

In terms of your question on the online transition, in terms of the acceleration we're very pleased with what we've seen over the past few weeks. I can't go into any more detail and give you any more color, but demand is looking very positive.

Betty Chen - *Mizuho Securities - Analyst*

Okay; thanks. Best of luck.

Operator

Simeon Siegel, Nomura Securities.

Simeon Siegel - *Nomura Sescurities - Analyst*

Thanks; good morning, guys. What were the comp metrics over the quarter? I guess, David, can you talk to the plans you have to return to positive comps? Any color on the current trends?

And then can you guys take a step back, can you talk to your comfort in the longer-term op margins, just in light of the expectations for this year and in light of the trends in the macro you've been talking about?

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

Okay, Simeon, that was very fast. It was primarily, I think, the plan to get back to positive comps, which is probably the most important message.

I think that we are actively focused on driving positive comps and getting back to that level. But as I've talked about for a while, we are focused on a balanced approach and ensuring that we are driving top-line growth, margin expansion, and expense leverage. And that is going to continue.

In terms of going after the top line, really the things that we believe are going to drive that are threefold. One, looking at our product and our value proposition in a really laserlike focused way, which we continue to do.

Two is the work that we're doing in terms of elevating our brand. Some of the work that we're doing there is around doubling down on our brand ambassadors, giving a greater focus on customer segmentation and the communication that we're doing. And we're doing a number of projects working with external agencies in terms of giving the brand a greater creative clarity; and we believe that that will help significantly.

Thirdly, it's around customer acquisition and retention, and clearly there is a lot of work that needs to be done there. As I said, I'm pleased with the recent performance that we've seen on e-commerce; but we've got to drive traffic to the stores. And the work that we're doing around that is really paid media, social media efforts, the Snapchat partnership that I talked about, work we're doing with Instagram.

We are really increasing our engagement with videos and work with YouTube. But then there is also focus around getting new buyers into the business. We've had a successful test of working with collegiate ambassadors; we are going to expand that program significantly into the fall.

We're doing a lot of work with influencers. We are doing a lot of work with fashion buyers and we're working on a launch of various style programs.

Then we're also working on refreshing our loyalty program. So a number of initiatives; but as I said at the beginning, we are actively focused on driving this business back to positive growth in the top line.

Perry, I'll let you answer the question on margin.

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

Simeon, on the operating margins our goals remain the same. We're going to continue to strive to improve our operating margin through merchandise margin expansion, B&O leverage, and SG&A leverage.

As you have seen in the prepared remarks, we have identified $14 million of expense savings by looking at the overall expense financial architecture and identifying savings across multiple areas of the business that we're going to start implementing for the back half of the year.

Simeon Siegel - *Nomura Sescurities - Analyst*

Okay. Then any -- what were the comp metrics for this quarter? And then anything you guys want to say in terms of current trends and color there?

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

From a comp metrics standpoint, Simeon, what we saw in Q1 is the decline in the comps was driven primarily by traffic declines. As David has mentioned in the prepared remarks, we saw an unexpected decline in our traffic around mid-March. That was the driver, the majority of the driver, for the decline in the overall comps.

From a trend standpoint our guidance would reflect what we have seen in the back half of Q1 and what we believe we can achieve in the balance for Q2.

Simeon Siegel - *Nomura Sescurities - Analyst*

Great. Thanks, guys. Best of luck for the rest of the year.

Operator

Neely Tamminga, Piper Jaffray.

Neely Tamminga - *Piper Jaffray & Co. - Analyst*

Great. I'm going to do my follow-up first, on Simeon's question there. Is it fair to assume that AUR or average transaction value was actually positive but transactions were down in Q1? And then in Q2, you're expecting both of those dynamics to be down, thus the mid single-digit decline? Some further context on that would be helpful.

Then, David, for you, as we navigate Q2 and we think about the timing, duration, and the overall markdown rate of clearance, could you help set that up for us this year versus last year, as we think about your big clearance event?

Then more importantly, as we look into July in terms of initiatives, what are we going to see incrementally this year versus last year that could potentially -- fueled by your tests -- that could help get people excited about fashion again as we head into fall? Thank you.

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

To answer the first question around the overall metrics, as I mentioned earlier, what we saw is a significant decline in the traffic; and then from a conversion standpoint that was up; and therefore our transactions overall were down. From an AUR, what we saw in Q1 is the AUR was close to flat and slightly up.

And as far as Q2, looking forward into Q2, we're expecting those trends to remain obviously, as I said, similar, given the guidance that we provided.

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

Going into your question, Neely, for me, in terms of the retail inventory and the position going into Q2, what I was pleased about was at the end of Q1 we finished with retail inventory down 3.4%. So in terms of the spread versus the comp I was pretty happy in terms of how that finished.

Total inventory was up because of the Outlet inventory, the Express Factory Outlet inventory, and the new stores that we'd opened. Giving guidance on inventory further into Q2, I can't do that. But overall at the beginning of the quarter, I'm pleased at where we stood.

Talking about July, I think what I'm most excited about is a relaunch of One Eleven, which we will be doing with both men's and women's. This will be the first introduction of the launch of One Eleven in men's, and I think we have a great assortment lined up in the way that we're looking at it in women's.

I think in terms of some of the trends that we're seeing overall, we've seen continued strength in denim in both men's and women's, so happy about going into the back-to-school time frame with a position of strength in denim. But some of the trends that we've seen really successful results with are the 1990s trend, so looking at mid- and high-rise. We've done very well with bralettes and bodysuits, and we're starting to see some really great results with bombers.

We're looking at romantic tops -- and feminine but less boho, continuing with off-the-shoulder. And then details continue to be important in women's.

So overall I feel good about the trends that we have going into the back half of Q2 with and also going into the fall season.

Neely Tamminga - *Piper Jaffray & Co. - Analyst*

Thank you.

Operator

Adrienne Yih,

Wolfe Research.

Adrienne Yih - *Wolfe Research - Analyst*

Yes. Thank you; good morning, everybody. David, I wanted to know, in terms of the open-to-buy that's available for the third quarter, how much of that is from the read and react; you've done so much work with speed to market, so how much of that allows you the flexibility? And at this point, seeing what you've seen year to date, does it change your demand prospects for the back half of the year?

Then my follow-up is for Perry. Can you give us any color in terms of the comp differential or the spread between less weather impacted areas, say the West Coast, and then the Northeast? Thank you very much.

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

Okay, Adrienne. In terms of your first question, on open-to-buy for Q3, one of our focuses has been in terms of shortening our lead-times and ensuring that we are keeping our open-to-buy dollars open even longer. We have done great work around that, and looking at the numbers, we are significantly open into Q3.

In terms of the levels of demand that we expect, I think based on the amount that we have open I think we're in a position to respond very, very quickly to the demand of the customers and ensure that we have the right levels in Q3 and in Q4.

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

This is Matt; I'll follow-up on that as well. Perry mentioned that we will be clean heading into the fall season. We planned for obviously low-single-digit comp and came in at a negative low-single-digit comp, with a lot of that happening back half of March and into April.

So it was more of a sudden drop for us and therefore there will be some liquidation. But we're committed to going into the fall season very clean, while at the same time protecting the newness as we head into fall to make sure that we can generate some momentum.

Adrienne Yih - *Wolfe Research - Analyst*

Great. And Perry?

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

As it relates to the question from the regional performance, what we saw in Q1 is better performance in the Northeast and mid-Atlantic and Midwest compared to the rest of the country.

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Adrienne Yih - *Wolfe Research - Analyst*

Okay; very well. Thank you very much and best of luck.

Operator

(Operator Instructions) Susan Anderson, FBR & Company.

Susan Anderson - *FBR Capital Markets & Co. - Analyst*

Hi. Thanks for taking my question. I was wondering if you could go over the comps by month to help us better understand the comp falloff in the quarter.

Then also, as we look to the back half, obviously you're looking for an inflection. So do you feel like the performance this quarter mainly was weather and traffic driven? And I guess if we don't see that improve in the back half, how should we think about the trajectory? Thanks.

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

Sure. From a monthly comp standpoint, we do not report monthly comps. But what we said in the prepared remarks was we saw strong performance in the first half of the quarter; and then right around the mid-March time frame, we saw drop-off in the traffic and therefore an impact in our comp performance for the quarter.

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

I think in terms of preparation for the back half, it's not a matter of if we don't see the traffic improve. We are actively focused on ensuring that we are driving the traffic that we can get into our stores. As I said to Simeon's question earlier, we are focused on our product and our value proposition, elevating our brand, and ensuring that we are acquiring customers and retaining customers.

As I said, in terms of the open-to-buy liquidity, the great news is that we are very open in terms of our inventory. So as we go into Q3 and into Q4, we will plan the business accordingly.

Susan Anderson - *FBR Capital Markets & Co. - Analyst*

Great. That's helpful. Thanks.

Operator

John Morris, BMO Capital Markets.

John Morris - *BMO Capital Markets - Analyst*

Thanks; good morning, everybody. A couple questions.

First, David, you've touched on the environment a little bit. I want to just get your feel on how much of this do you think is the macro environment? Do you feel some of this may even be coming from the competitive promotional activity going on in some of the other sectors, like the department store space, and what your outlook there might be?

Then also, the e-commerce down 1%; you had some brief comments on that. I'm wondering if you have other insights or learnings there, and if you can give us a feel for what degree e-comm directionally is an indicator about retail sales and store sales.

And then, when does the Karlie marketing start? Those are my three quickies. Thanks.

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

Okay. I'm just writing down your final one. Okay.

John Morris - *BMO Capital Markets - Analyst*

Yes, Karlie marketing.

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

Okay. In terms of the environment, we saw that we were doing very well in February and at the beginning of March, okay. And then, it literally just dropped off. So I think a significant amount of it is the macroeconomic environment.

Having said that, we're focused on controlling what we can control and ensuring that we are doing the best job possible that we can do. I am extremely proud of the team here in terms of the work that I'm seeing day in and day out. I think it's as good if not better than anything that we have done here at Express in the past.

So I feel very positive about the way that we look into it.

In terms of the competitive promotional environment and what we've seen, yes, clearly people are trying to move through inventory and liquidate inventory. Our focus is in ensuring that we're going after a balanced approach and that we're not going after one of the three levers; we're going after all three levers, and we're going to continue down that path.

E-commerce results was your second question. Directionally what we have seen, as I said on the call, on the prepared remarks, directionally we have seen a significant improvement in our e-commerce performance since we transitioned to the new distribution center. So I'm very pleased with the results that we've seen there.

Yes, I think that it is directional in terms of what we're seeing. But again I'll go back to what I said: We're focused on driving the traffic that we need to drive into the stores, but we are focused above all else on the total Express brand.

Then finally in terms of Karlie Kloss, you will really see the work ramp up on that in August. You will see her appearing in all of our work around the back-to-school time frame.

John Morris - *BMO Capital Markets - Analyst*

Great, thanks. Super helpful. Best of luck.

Operator

Paul Trussell, Deutsche Bank.

Paul Trussell - *Deutsche Bank - Analyst*

Good morning. Just a question on expenses. You mentioned that you are taking some cost out and expect annualized savings of $14 million. Maybe you can just give us a little bit more details on that initiative and how we should think about the cadence of expense growth throughout the balance of the year.

And just as a follow-up, you've emphasized going into the fall season clean. How should we think about inventory levels in the aggregate at the end of 2Q, what you are planning for?

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

So from the $14 million standpoint that we've mentioned on the prepared remarks, as I said earlier, we look at the financial architecture constantly and look for ways to improve our overall financial architecture and be more efficient and effective. As such, we have identified through our expenses that we have a $14 million opportunity that is across all channels of the business, across all the departments.

So we're going to start implementing that in the back half of Q2, with expectation that by the beginning of Q3 and the back half of the year we are going to see about $7 million of expense savings. Most of these saves will be materialized from an SG&A standpoint and not B&O. Some of it will be in the B&O, but most of this will be in the SG&A area; I would say it is more like a 90/10 ratio.

As far as the SG&A expenses and the expectations for the balance of the year, I would say that at this point we're expecting our overall SG&A expense to be relatively flat to up from an absolute dollars standpoint, slightly up to last year's absolute dollars.

Then on the last part of your question, from an inventory standpoint, we do not provide guidance on forward-looking inventory. But what I will tell you is that we constantly strive to ensure that our inventory levels as we are going into the August BOM and any forward-looking BOM is not ahead of the expectations from a sales standpoint. Therefore, we're going to continue to manage our open-to-buy and inventory levels to ensure that we don't find ourselves in a position that the inventory is significantly higher than expectations of the business.

Paul Trussell - *Deutsche Bank - Analyst*

Thank you. Good luck.

Operator

Rebecca Duval, BlueFin.

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

Good morning. Thank you, guys. David, I had a question. You had mentioned that you are seeing some accelerated improvement in your online business over the last couple weeks that you were pleased with.

I'm just wondering, in terms of store traffic, are you seeing any improvement at all there? Or are you seeing very similar trends as you were experiencing in April?

THOMSON REUTERS

Then the follow-up question is: Are there any categories that you can highlight that were performing better in Q1 and maybe at the start of Q2 versus others? Thank you.

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

Okay. In terms of the store traffic, it's very similar to what we have seen, and we're seeing that continue.

In terms of trends by department, I really don't want to go into too much detail for competitive reasons. We continue to see strength in denim; we see strength in knit tops. But overall I don't want to go into a lot of detail against those.

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

Okay. Thanks so much and best of luck.

Operator

Roxanne Meyer, MKM Partners.

Roxanne Meyer - *MKM Partners - Analyst*

Great; thanks. I just wanted to follow up on your guidance for a negative low- to mid-single-digit negative comp for the full year. Is it fair to say that that's the approach you've taken in light of the environment that we've had to date? Or are you embedding some degree of category softness or just execution challenges that you don't necessarily think could be remedied? Thanks a lot.

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

The guidance that we provided is in light of what we have seen in the back half of Q1 and our belief of what the trends will continue to be in the balance of the year. The guidance does not in any way, shape, or form include any softness in specific categories of the business.

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

It's really largely predicated on the traffic declines that we've seen and the results that have been associated with that.

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

And as David mentioned, there clearly are some macroeconomic issues at play here. But we are turning over every stone in this business to make sure we're executing as well as we possibly can and looking at those three facets in particular that he talked about around product/value proposition, the brand building, and the customer acquisition and retention. That's critical, and we're all actively working on each of those every day to make sure we're putting our best foot forward.

Roxanne Meyer - *MKM Partners - Analyst*

Okay, great. Thanks so much for the clarity and best of luck.

Operator

Marni Shapiro, The Retail Tracker.

Marni Shapiro - *The Retail Tracker - Analyst*

Hi, everybody. Great work in what was a very tough April and into May. Can you talk a little bit about your promotions, without getting into too many specifics? I've noticed you've played around with some of the deals and the pricing on the deals. I guess, have you seen any resistance and/or good success with them?

And will you be able to play around with it or change that for the better in the back half of the year, so it's more opportunistic for Express but the customer still feels like they're getting a deal?

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

Absolutely. What we're trying, is to pull the levers that we can pull to see the response in the business. As Matt just said, we are actively looking at everything in terms of driving the business and in terms of driving the traffic into the stores.

We are constantly testing and experimenting in terms of the approaches that we should take to drive the traffic and to drive the transactions. So, yes, expect to see that continuing.

Marni Shapiro - *The Retail Tracker - Analyst*

Then can I just follow-up on the denim portion of it? You've really nailed all of the trends, and you mentioned the denim business had held in.

Was that true across the long bottoms? Was it a little bit softer in the shorts? I recall you guys talking about the shorts starting well early in the season.

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

Yes, they did start off decently. I don't think that we've seen that continue.

You look across the market; you look at the levels of promotion on shorts. I would say that everybody is having a hard time.

We're focused on what we need to be doing in terms of our short business to drive that forward. The denim shorts continue to be good, but we're hoping to see this weekend with Memorial Day and with warmer weather across the country that we will see that business pick up.

Marni Shapiro - *The Retail Tracker - Analyst*

Fantastic. Best of luck, guys.

Operator

Janet Kloppenburg, JJK Research.

Janet Kloppenburg - *JJK Research - Analyst*

Good morning, everyone. Just a couple questions, David, and we can keep it broad. But I was wondering about the strength of your key item program --

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

Sorry, can you repeat your question, Janet? We can't hear you clearly.

Janet Kloppenburg - *JJK Research - Analyst*

Yes, I apologize; hold on. Let me get off speaker. I was wondering if you could talk a little bit about the strength of your key items program. I imagine you don't want to go into particulars on Portofino, or One Eleven, etc., but I'm wondering if you saw a slowdown in those, and across the board, or if they continue to be strong; and then the other areas, maybe some of the dressy areas have slowed. Maybe you can just give us an idea of what's going on in the key item program and your confidence in that for the second half of the year.

Then, Perry, it seems like in your second-half guidance that you're looking for merchandise margins to be down perhaps more than in the second quarter. I'm just wondering if that's just general caution. It sounds like your inventories are going to be well controlled; so maybe if you could address that, that would be great.

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

Okay, in terms of the key item strength, we've seen the decline in the sales of key items very similar to the decline in total that we've seen. So it's not a matter of collection versus key item, key item versus collection; it is very similar across the board.

What we have seen in terms of the slight difference in terms of the trends of the categories is a greater strength on the casual side of the business than we've seen on the wear-to-work side of the business.

Janet Kloppenburg - *JJK Research - Analyst*

So on that side, David, are your inventories aligned correctly? Have you built investments in casual and down-trended those in the dressier areas as we go forward?

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

We are constantly adjusting. With the open-to-buy liquidity that we have, we are constantly adjusting that and we're doing it weekly.

Janet Kloppenburg - *JJK Research - Analyst*

David, when you examine the key fashion trends in the market right now, do you think you've missed anything? Or you feel confident that you've been where you should be in terms of that?

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

No, I feel very good about our trends and the way in which we've covered our trends over the quarter.

Janet Kloppenburg - *JJK Research - Analyst*

Okay, great. Thank you.

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

Perry, do you want to answer the --?

Janet Kloppenburg - *JJK Research - Analyst*

Perry, yes?

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

Janet, you asked in the back half of the year if we're expecting merchandise margin to contract by more than what we're expecting in Q2; is that correct?

Janet Kloppenburg - *JJK Research - Analyst*

That's correct.

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

Actually in the back half of the year, and that is Q3 and Q4, given the fact that we're planning on clearing through the spring merchandise in Q2 and be in a clean position for the fall season, our expectation of the merchandise margin is by no means being worse than Q2 expectations. Actually, at this point we're expecting them to be flat to slightly up.

Janet Kloppenburg - *JJK Research - Analyst*

Great, great. But with some occupancy deleverage then in the gross margin?

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

We expect on the back half overall some contraction and deleverage in merchandise margin and -- sorry, in B&O and SG&A, given the sales expectation.

Janet Kloppenburg - *JJK Research - Analyst*

Great; thanks so much. Good luck, you guys.

Operator

Lindsay Drucker Mann, Goldman Sachs.

Lindsay Drucker Mann - *Goldman Sachs - Analyst*

Thanks, good morning, guys. Perry, I was wondering just quickly if you could highlight if there was any difference in your A, versus B, versus C malls in terms of comp momentum.

Then separately, I was curious if -- philosophically you guys have done a really fantastic job reducing the promotional message to your consumers over the last year. As you think about some of the macro challenges and the pressures on traffic, it looks like you're single biggest point of attack is improving brand equity and focusing on product.

I'm wondering if you think at any point there is a place to increase some of the promotional message or lower ticket in order to fight for that traffic, or if you think that would just be a brand-dilutive proposition and you're not willing to go down that road. Thanks.

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

On the first part of your question, we do not disclose specific A versus B store mall performance. But we've seen fairly consistent performance across the board.

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

In terms of your second question on brand equity versus product and lowering ticket, look, we are constantly looking at every single department and the approach that we're taking to ensure that we are driving our business. You will have noticed some lower tickets in One Eleven, in our One Eleven line this season. We've seen some success from those items.

We're constantly assessing it and we're balancing it between the level of brand equity, promotion, and product. Really, we want to ensure that we are offering our customers the best price-value proposition that he and she can get in the mall.

We will not compromise on quality, but we are constantly looking at our sources of supply. But we have very good partnerships out there, and we work very, very well with our supply base.

Lindsay Drucker Mann - *Goldman Sachs - Analyst*

Great. Thank you.

Operator

Thank you. We've reached the end of our question-and-answer session. I'd like to turn the floor back over to David for any further or closing comments.

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

This concludes our call for today. Thank you for joining us this morning and for your ongoing interest in Express.

Operator

Thank you. That does conclude today's teleconference. You may disconnect your line at this time and have a wonderful day. We thank you for your participation today.