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Vince Holding Corp.

Fourth Quarter 2015 Earnings Results Conference Call

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PRESENTATION

Operator:

Good afternoon. My name is Mike, and I'll be your conference Operator today. At this time, I would like to welcome everyone to the Vince Holding Corp. Q4 2015 Earnings Results Conference Call. All lines have been placed on mute to prevent any background noise. After the speaker's remarks, there'll be a question-and-answer session. If you would like to ask a question during this time, press star, then the number one on your telephone keypad. If you would like to withdraw your question, press the pound key.

I will now turn the call over to Jennifer Pohland, VP of Finance. You may begin your conference.

Jennifer Pohland:

Thank you, Mike, and good afternoon everyone. Welcome to our Fourth Quarter and Full Year Fiscal 2015 Earnings Conference Call. I'm Jennifer Pohland, Vice President of Finance. Joining me today is Brendan Hoffman, our Chairman and Chief Executive Officer; and David Stefko, our Chief Financial Officer, who will be our speakers for today's call.

Before we begin, let me remind you that certain statements made on this call may constitute forward-looking statements which are subject to risks and uncertainties that could cause actual results to differ from those that we expect. Those risks and uncertainties are described in today's press release and in the Company's SEC filings which are available on the Company's website. Investors should not assume that statements made during the call will remain operative at a later time, and the Company undertakes no obligation to update any information discussed on the call.

In addition, in today's discussion, we are presenting our financial results in conformity with GAAP and on an adjusted basis. The adjusted results that we present today are non-GAAP measures. Discussions of these non-GAAP measures and reconciliations of them to their most comparable GAAP measures are included in today's press release and related schedules, which are available in the Investors section of our website at investors.vince.com.

After our prepared comments, we will be available to take your questions for as long as time permits.

Now, I'll turn the call over to Brendan.

Brendan L. Hoffman:

Thank you, Jen, and thanks, everyone, for joining us today. I've been at Vince for five months now, and one of my primary goals was to build a strong foundation and position the Company to succeed over the long-term.

Everything we have done since that point has been moving us toward that goal. I am pleased with the progress we have made, and proud of the work that we have done thus far. We are making great strides with our product, our top priority as we work to create everyday casual luxury essentials with modern, effortless style.

As you know, our founders Rea Laccone and Christopher LaPolice recently returned to Vince as consultants to oversee our product and merchandise. In addition, we have added a new Artistic Director overseeing all categories, along with new leads in both product development and production, all three of whom previously worked with Rea and Christopher to build Vince.

Last month was the first market that featured products from them and our design team, and we are very encouraged by the response that we received. Our wholesale partners were thrilled to see that we have recaptured the brand DNA that had made us so successful in years past, and we were pleased to see that the very emotional connection that our partners had towards the brand has been restored.

The team has done a fantastic job creating a collection that embodies the brand, with fashion that is both fresh and relevant to multiple generations. Vince remains a leading brand with our department store partners, and we believe we have an opportunity to further strengthen our market share position based on the positive reaction we received to the new collection.

I am confident that we are on the right path. However, given the timing of Rea and Christopher's return, we decided to focus on Fall deliveries, which are primarily received in Q3, and dramatically reduced the pre-Fall product that was already in the pipeline for Q2. Therefore, it will not be until our holiday delivery in the fourth quarter that you will see the on-floor assortment fully represent the look and feel of the brand.

In addition, despite the very positive feedback given the tough retail environment, our partners are remaining conservative with their buys and taking a latency approach. This is not unexpected from our standpoint, and has been built into the guidance.

We are working on some initiatives that will enable us to quickly chase business and capture incremental sales if performance exceeds expectations, while remaining prudent in the way we manage inventory levels. Quite frankly, at this juncture we would much rather have demand outweigh supply and potentially miss a few sales, than to build inventory too quickly and risk excessive markdown events.

Overall, we're focused on doing what's right for the business over the long-term, and in some instances this may mean we have to take a step or two back in order to move forward again in the right direction.

To that end, we have also hit the pause button in our Handbag business. We felt that the product did not accurately reflect the Vince brand, and we have begun the process to find a designer to lead that business going forward. We fully believe that this is a great opportunity for us, but again, we want to make sure that everything we are doing is right for the brand, so we will be strategic and methodical as we work to reset this piece of the business and we will keep you updated.

In terms of our Direct-to-Consumer business, we are bringing more depth and focus to the merchandise assortment, which we believe will drive more full price business. We are also reworking a small selection of stores to ensure that they reflect the go-forward DNA of the brand and serve as a roadmap for all locations.

In addition, we continue to be pleased with our eCommerce business, and we'll be migrating to a new platform that will enable us to increase the functionality of the site. This will be followed by a creative overhaul to ensure that the site is more reflective of the Vince brand, as we want consumers to have a consistent experience across channels.

Lastly, we are taking steps to reduce overall discounts and promotions. We eliminated the nearly four-week tiered promotional event that we had last year in our stores and online during Q1, as these types of promotions train the customer to wait for sales and handcuff our wholesale partners. While we expect these efforts to impact our sales in the short-term, which is already reflected in our guidance, we believe this is the right course of action to protect the long-term health of the Vince brand.

As we look at our Outlet and Off-Price business, our primary goal was to see that the surplus of inventory was moved out and that we are more thoughtful about managing the flow of merchandise into this channel. This remains a viable business for the brand; however, there needs to be better controls in terms of what product and how much flows through this channel. As we employ greater diligence, we believe that the profitability in our Off-Price business should improve as well.

Internationally, we are also seeing great response to our new products. We are confident that the assortments the design team is creating will work equally well, both internationally and domestically. We continue to grow with our international partners and see significant opportunity for growth in these markets.

As we look at 2016, we expect that the business will remain challenged throughout much of the year. We're working through our Spring product and looking forward to debuting our Fall collection from our new team. Moreover, we're very excited about what you'll see on the floors in the back half of the year, and believe that we will start to see an inflection point in our performance during the holiday season.

We know that this is not going to be an overnight fix. It will take time for us to return to growth, but we are taking the necessary steps to get there and doing what's right for the long-term health of the brand. In some instances, as I mentioned earlier, this means taking a step back or forgoing some short-term top line gain in order to build the brand back in a way that is sustainable.

We are also focused on making the necessary investments in the business to support our long-term growth objective, and taking steps to put us in a financial position to do so with our recently announced Rights Offering, which we commence today.

Overall, I'm very proud of the work that the team has done thus far. We believe that we are on track to achieve improved results for holiday 2016 and into 2017, and look forward to continuing on this path to deliver consistent sales and earnings growth over the long-term.

Now I will turn it over to Dave to review our financial performance. Dave?

David Stefko:

Thank you, Brendan. For the fourth quarter, net sales decreased 13.6% to $81.8 million, versus $94.7 million in the prior year period. Our Wholesale channel sales were down 30.2% to $48.1 million, due primarily to a decline in our US wholesale segment, and to a lesser extent, declines in our international and licensing businesses.

Our Direct-to-Consumer segment sales increased 30.5% to $33.7 million in the fourth quarter, driven by the addition of 11 new stores since the fourth quarter of last year, as well as a 10.7% increase in comparable store sales, including eCommerce. The increase in comparable store sales was driven mainly by an increase in the number of transactions.

Moving on to profitability; gross profit in the fourth quarter was $41 million, or 50.1% of net sales, which includes a $2.2 million benefit from the recovery on inventory write downs taken in the second quarter. Excluding this benefit, gross profit was $38.8 million, or 47.5% of net sales. This compares to $45.8 million, or 48.3% of sales in the fourth quarter of last year. The adjusted gross margin decline was due primarily to increased discounts and markdowns, partially offset by a channel mix shift to the Retail channel, and an increased mix of Full-Price channel sales.

Selling, general and administrative expenses in the quarter were $36.2 million, or 44.2% of sales. This includes a $300,000 favorable adjustment to Management transition costs taken in the second quarter. Excluding this favorable impact, selling, general and administrative costs were $36.5 million, or 44.6% of net sales in the quarter. This compares to $25.5 million, or 26.9% of sales for the fourth quarter of last year. The increase in SG&A was largely driven by store labor and occupancy costs associated with 11 new store openings since the end of fiscal 2014, as well as expenses related to the new Management Team, and other corporate-related costs. The increase in SG&A as a percent of sales was attributable mainly to the deleverage on lower wholesale sales.

The resulting operating income for the quarter was $4.8 million. This compares to operating income of $20.3 million in the fourth quarter of last year. Excluding the benefit from the recovery on the inventory write down and favorable adjustment to Management transition costs, operating income for the fourth quarter of fiscal 2015 was $2.3 million.

Net income for the fourth quarter was $1.8 million, or $0.05 per diluted share, compared to net income of $10.5 million, or $0.28 per share in the fourth quarter of last year. Excluding the benefit from the recovery on the inventory write down and favorable adjustment to Management transition costs, net income for the fourth quarter of fiscal 2015 was $0.3 million, or one penny per diluted share.

In looking at our annual results, net sales for fiscal year 2015 were $302.5 million, a decrease of 11.1% compared to fiscal 2014. This was the result of a 22.4% decrease in Wholesale segment sales, and a 25.1% increase in our Direct-to-Consumer segment sales. Our comparable store sales, including eCommerce, for fiscal 2015, increased 4.2%. The comparable sales growth was driven primarily by an increase in transactions, partially offset by a decline in transaction size.

On a GAAP basis, for fiscal year 2015, the Company reported net income of $5.1 million, or $0.14 per diluted share, which includes a $6.1 million, or $0.16 per share net charge associated with the write down of excess inventory and aged product to expected net realizable value incurred in the second quarter, and the subsequent recovery of inventory in each the third and fourth quarters, and a $1.6 million, or $0.04 per share in net Management transition costs. This compares to net income of $35.7 million, or $0.93 per diluted share in fiscal 2014, including the impact of secondary offering costs.

Adjusted net income was $12.8 million, or $0.34 per share in fiscal 2015, compared to Adjusted net income of $36.1 million, or $0.94 per diluted share in fiscal year 2014.

Now moving on to the balance sheet; our debt decreased by $17.9 million to $60 million during the quarter. Our debt to leverage ratio at the end of the fourth quarter of fiscal 2015 was 2.7 times on a reported basis, and 1.7 times on an Adjusted basis. Our debt to leverage ratio at the end of the fourth quarter of fiscal 2014 was 1.2 times on both a reported and an Adjusted basis.

At the end of the fourth quarter, we had $28.1 million of availability remaining under our revolving credit facility.

Inventory at the end of the quarter was $36.6 million, compared to $37.4 million at the end of last year's fourth quarter. The year-over-year decrease was primarily driven by the increase in inventory reserves, partially offset by the addition of 11 new retail stores since the fourth quarter of last year.

Capital expenditures for the quarter totaled $3.5 million, of which $2 million was attributable to new stores. Leases are signed for six stores that we expect to open in fiscal 2016. As of today, March 29, the Company has 49 stores in the US, including 35 full-price stores and 14 outlet stores.

Now turning to a review of our outlook for fiscal year 2016, which we introduced in our press release on March 7. Other than the impact of our current Rights Offering on diluted EPS, there is no change to the guidance we've presented. We expect total sales for the year to be between $290 million and $305 million, including revenues from six new retail stores and comparable sales growth inclusive of eCommerce sales, in the flat to low single-digit range.

Total sales guidance reflects an expected mid to high single-digit sales decrease for the first half of the year, and a low to mid single-digit sales increase in the second half of the year.

While we don't provide quarterly guidance, please keep in mind that last year, Spring product deliveries were moved forward into the fourth quarter of fiscal 2014 from the first quarter of fiscal 2015. The cadence of Spring shipments this year have been reversed back to the first quarter of fiscal 2016 from the fourth quarter of fiscal 2015. In addition, the reduction of shipments in the pre-Fall line collection is expected to impact our second quarter sales, given that we reduced the size of this collection by approximately half.

We expect gross margin to be approximately 47% for the year, and expect SG&A to be between $132 million and $135 million. Diluted EPS is expected to be flat, to a gain of $0.06 per share.

For the first half of the year, we expect a net loss per share in the mid teens range, due to higher SG&A growth from continued store and strategic investments earlier in the year, as well as the annualization of store openings and strategic investments from the first half of last year. Note that these EPS amounts do reflect additional 11.8 million shares outstanding that would result from the completion of the $65 million Rights Offering. For 2016, we expect capital expenditures between $10 million and $12 million.

Finally, we expect to receive the $65 million from the Rights Offering in mid-April, which will enable us to further pay down our debt. Importantly, as Brendan noted, this will provide us the liquidity needed to make investments to support the long-term growth of the business.

This concludes my comments regarding our fourth quarter financial performance and outlook for 2016. We will now take your questions. Operator?

Operator:

At this time, I'd like to remind everyone, in order to ask a question, press star, one on your telephone keypad. We'll pause for a few moments to compile the Q&A roster.

Your first question is from Ed Yruma from KeyBanc Capital Markets.

Jessica Schmidt:

Hi, this is Jessica Schmidt on for Ed. Thanks for taking my question.

So I know inventory build in the Off-Price channel has been a particular issue that you've been working to improve. But I guess, how do you feel about levels in the channel now? Do you think that you've cleaned them up, or I guess, is there still more that you can work through?

David Stefko:

We have, still, inventories that we need to move through, but we did get our Off-Price channel sales for the year closer in line. We've talked about a target of 20% to 25%. We made an improvement in that area, and we're targeting to be in that range for 2016 also.

Jessica Schmidt:

Great, and then turning to the pause on the Handbag business. I guess, what do you think the Handbags missed about the Vince brand, and specifically on pricing, where do you think the Vince handbags should sit, because I know that it's—it moved from a sub $1,000 price point to then well below $500. But, I guess, what would be more appropriate?

David Stefko:

Yes, I think that's what we're trying to establish, and in part, it will be dictated by the design talent that we can recruit. I think that—you know, when I got here, it was a—I was a little confused by the customer we were going after with our handbags as it relates to our core ready-to-wear line. Then shortly after, when Rea and Christopher came back, it was clear that the product offering was going to be elevated. The handbags just weren't congruent with what we want the brand to stand for.

As I mentioned in my remarks, we look at this year as a time to reset the brand and take some short-term hits to try and build a more—a better foundation and a more profitable brand in the future. We do believe that handbags and accessories are a big part of that, but just felt it was better to—rather than trying to reposition the Handbag line while we were continuing to market it, to just take a pause—we hope it's a short pause, and then come back stronger.

We'll see about the price points. There'll be a range of price points that, like with the Apparel, will be a value, but that—you know, value isn't necessarily the cheapest product out there.

Jessica Schmidt:

Great, thank you.

Operator:

The next question is from Jeff VanSinderen from B. Riley.

Jeff VanSinderen:

Hi, good afternoon. Maybe we can just start, if you could give us any insight into the eCommerce versus brick and mortar comps. I was wondering, also, what drove transactions to be up? Was that driven by discounting?

You mentioned you're still working through some inventory, but I wasn't totally clear if that was related to full-price or just an issue of off-price.

Then maybe if you could just touch on gross margin for Wholesale and Retail for Q4, if there's any color you could give us there, and then discounting and promotional levels by channel in Q4 versus last year.

David Stefko:

That's a lot of questions. So, we do not split out our brick and mortar stores from the eCommerce side. I would tell you that the growth in transactions is driven naturally from the growth that you've seen in just traffic overall, and frankly, we're happy with our eCommerce business and we see similar growth in that area, that other eCommerce platforms are seeing.

So it's definitely not from discounting, as Brendan mentioned, we're going more away from discounting. We eliminated promotions in the back half of fiscal 2015, and as we've talked about, the elimination of a promotion, a (inaudible) promotion that we ran, that was run last year in the first quarter of 2016.

Brendan L. Hoffman:

Yes, and you'll even see, next month we have the re-anniversary of our Friends & Family event from last year. This year we're going to be much quieter about how we market it. Last year, you know, we had decals on the stores, we actually had sandwich boards out there, we—it—lots of e-mail blasts, lots of affiliated marketing.

This year, we're—it's really going to be—it's a by invitation event that's going to be to our customers. So we think that it will reset the brand and be more reflective of the brand we're aspiring to be, and also, as I mentioned in my remarks, be more cognizant of the fact that we have a big wholesale business, and when we promote within our own stores, that directly impacts our wholesale business. In many cases, they'll price-match us which just exacerbates all the promotions that are going on out there.

Jeff VanSinderen:

Right, that's helpful. Maybe you could give us a little more detail on what you're seeing in your wholesale order book? I know you gave kind of some broad brushstrokes there, but just wondering how much of the Fall book is in at this point, where are the relatively weakest and strongest areas. I think you mentioned you see that evolving in second half, maybe you could just give us a little more detail there. Just wondering if second half order book for wholesale is expected to be down overall? That'd be helpful.

Brendan L. Hoffman:

Yes, so just—so I'm not going to give you specifics, but I can give you a little bit more color. Yes, so we—in February we had our Fall market, as I mentioned, which is end of July, August, September deliveries, three months of deliveries, I'm talking specifically for women's wholesale apparel. This was the first collection that Rea and her team did, and Christopher oversaw the presentation and the marketing.

We were thrilled with the reaction we got. There was a standing ovation from one account that I won't mention and tremendous enthusiasm across the board. The accounts are generally cautious because business is—you know, it's a tough environment out there, which we were anticipating. We know that the orders are much more—that they're much more bullish than the path we've been on and the trend of the business, but we also were anticipating having to earn our way back into major growth orders.

So we think Fall is a great start. It gives us the platform and the assortment out there that we need and, as I mentioned in my remarks, we're happy to let demand outweigh supply because that hasn't happened here in a while.

Fall, when it delivers, will sit with some of the Summer deliveries that will still be on the floor and start to be marked down, which is why I mentioned the holiday as being when you'll see the newest—the assortment from the new team fully represented in both our wholesale partners and our own stores. I think as they come back from market in June to place holiday, or we call it pre-Spring, I think they'll be able to come back, hopefully with a little bit more confidence—even though they won't have selling on the Fall merchandise, but having had some time to digest what they saw in terms of the elevated product that they now can expect from Vince.

Jeff VanSinderen:

Okay. So, I'm sorry, just to clarify, are you saying that the Fall order book is still down, but you're expecting it to be up for holiday? Is that how I should read into it?

Brendan L. Hoffman:

No, I didn't give you any specifics on that. I just said we—they came in line with what we had anticipated, which was reflective of the environment and their enthusiasm for the line kind of balanced together. So we're very comfortable that the orders will place to a level that will allow Vince to be—to start to grow again, and then hopefully anticipate further growth in terms of the orders as we move forward.

Jeff VanSinderen:

Okay. Thanks very much, and best of luck for the rest of the quarter.

Brendan L. Hoffman:

Thank you.

Operator:

The next question is from Matthew Boss from JP Morgan.

Christina:

Hi, it's Christina on for Matt. In that roughly flat gross margin guidance, you're down 20 basis points. How should we be thinking about the cadence throughout the year and the drivers there?

David Stefko:

Well, I mean, I think it's—you know, we really haven't gone down from the quarter standpoint we don't give (phon). We would expect if the back half of the year obviously to be a higher margin rate based on our expectation of seeing better full-price selling. From that standpoint, you know, we're still in the first half of the year working through the Spring product that we—that was inherited, and appropriately, we would anticipate a higher markdown rate necessary there than we would in our Fall product.

Brendan L. Hoffman:

Yes, I mean, we also—you know, we want to support our wholesale partners and make sure any liabilities we have in Spring are taken care of so that we can clear the decks and give the new product every opportunity to perform, which we think—you know, we're in the process of doing.

The product, as I mentioned in my remarks, it's more depth and less breadth, and it's a much more edited collection, as over the last couple of years the assortment had gone way too wide. Now we're much more focused, which we think will allow us to stay in stock on best sellers, chase the winners.

Really, the goal, as I continue to talk about internally and externally, is raising our regular price selling. That's gotten away from us. We've become a very promotional brand over the last few years, both out of necessity and because of steps we've taken in our own Direct-to-Consumer channels, and as we've discussed, we're working hard these last six months and the next few months to clean that up in anticipation of the elevated product and how it will connect with the consumer.

Christina:

Thanks, and then on your debt levels at this point. With the Rights Offering you mentioned wanting to pay down additional debt and to use the proceeds. Do you have a target leverage ratio that you're looking at, or a targeted amount of debt that you'd be more comfortable with, and any kind of time horizon behind that?

Brendan L. Hoffman:

I mean, I guess the answer is not really. I mean, the Company is sitting on $45 million of term, approximately. Two years ago it was $170 million. We'll pay our revolver down completely with the Rights Offering, in addition to settling our TRA liability that we have sitting on our balance sheet, and then have cash available for operations and investment going forward and have the full use of our revolver going forward.

So, we're comfortable with where the Rights Offering is going to position us.

Christina:

Great, thanks.

Operator:

As a reminder, if you would like to ask a question, press star, one.

The next question is from Richard Jaffe from Stifel.

Richard Jaffe:

Thanks very much. If you could just comment on the store portfolio? You talked about, I guess, cleaning up or doing some work on some stores. Are there stores that are under performing that you would consider closing, editing the store portfolio down—and given the tremendous Direct-to-Consumer, without being specific, was it driven by the online business or the new retail stores—is the retail or the brick and mortar business really growing as strongly as Direct-to-Consumer, or equally?

Brendan L. Hoffman:

Yes, well, I'm—yes, sorry.

Richard Jaffe:

Okay.

Brendan L. Hoffman:

The remarks I made earlier were specific to the look and feel and ambiance of the store, the store environment, so we're going to pick a couple—one store in the Los Angeles area and one store here in the city and just kind of reset them and hope that can be the kind of benchmark and the window into how we want all of our customer touch points to look like. So that wasn't reflective of any numbers or anything.

Certainly we continue, and we will continue, to look at our store portfolio. We certainly expect to continue to grow our retail footprint.

Do we have stores that are under performing? Sure. I mean, you know, the business has been so tough for us over the last year or so, that clearly our own stores are impacted by the product we've been delivering. So as we talk about addressing the portfolio, we have to do it understanding that we have high expectations for how these stores will start to perform in the back half of the year and into 2017, and don't want to make any premature decisions until we see what these stores can do with the Vince product of going forward.

As we look for new locations, we just want to make sure that it's in environments and we're surrounded by where we believe our customer shops. So we're kind of evaluating that now to make sure that we make decisions appropriate for the way we've reset the brand.

Richard Jaffe:

That makes sense. Just a question on margins in stores, did the full-line stores become—or the full-price stores and the direct channel, become a venue for a lot of the clearance activity? Just concerned about the margins going forward, in stores, and that—if you…

Brendan L. Hoffman:

No, that—you know, coming from the department stores, I mean, the markup and margin environment is so different in a specialty store. Even all the promotions, you know, doesn't ding you too badly. That's why in my remarks I talked about handcuffing our wholesale partners with some of our promotions, and training our customers to buy on sales.

So no, I mean, we liquidated a lot of the over-merchandise and the overstocks through the off-price channels, both our own outlets and aggressively through third parties, that they've alluded to pulling back.

One thing that's important to me and Rea and Christopher is making sure that product—whatever has the Vince label is reflective of the Vince brand. So we tied that—that's one of the reasons why Handbags is being relaunched. Same thing with what's in the outlet stores.

We want what's in the outlet stores to be reflective of the Vince brand, because we think that customer in many ways showcases her label more than somebody who buys it at the full-price store. So we don't want somebody to be introduced to the brand and see inferior products, so we're working hard, as I mentioned in my remarks, to make sure we're able to produce product for the off-price channels that is worthy of the Vince label.

Richard Jaffe:

That's great. Thank you very much, and good luck this season.

Brendan L. Hoffman:

Thank you.

Operator:

There are no further questions at this time. I will turn the call back over to the presenters.

Brendan L. Hoffman:

Okay. Well, thank you, everyone. We look forward to getting back to you after our Q1 ends sometime in late May. Thank you very much.

Operator:

This concludes today's conference call. You may now disconnect.