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PRESENTATION

Operator

Greetings and welcome to the Express Inc fourth-quarter and FY2013 earnings conference call.

(Operator Instructions)

A brief question-and-answer session will follow the formal presentation.

(Operator Instructions)

As a reminder this conference is being recorded. I would now like to turn the conference over to your host, Marisa Jacobs, Vice President of Investor Relations. Thank you, you may begin.

Marisa Jacobs - *Express Inc - VP of IR*

Thank you and good morning, everyone. 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 those 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.



With me today are Michael Weiss, Chairman and CEO, David Kornberg, President, Matt Moellering, Executive Vice President and COO, and Paul Dascoli, Senior Vice President and CFO. I'm going to turn the call over to Michael, now, to speak with you about our recently completed quarter and our priorities for 2014. When he completes his remarks, David will focus on some of our product initiatives and Paul will cover our fourth-quarter financial performance as well as our first-quarter and full-year 2014 outlook. We will then turn to Q&A before concluding the call.

Michael Weiss - Express Inc - Chairman & CEO

Thank you, Marissa. Good morning, everyone. Thank you for joining us today.

It's not news to any of you that the fourth quarter was tough for most retailers and of course that included us. We managed through a highly promotional holiday, the overall slowdown in January and several months of awful weather across most of the country.

We came in within our revised guidance range. Despite that, we're clearly not happy with our results since we were expecting, and continue to expect, far better from ourselves.

Our Holiday 2013 assortment was much better than the year before in terms of the fashion being offered. We also sold significantly more units than in the fourth quarter of 2012.

The holiday was extremely promotional and we fought hard for our share of the business in the face of disappointing mall traffic. This meant our promotions were both deeper and longer than the year before. This drove our year over year AUR down even more than we anticipated, and consequently, our top line and our profits.

On the plus side, we moved through a lot of inventory to finish the quarter with inventory down 1% from the end of last year's fourth quarter. The first quarter guidance we issued this morning reflects the fact that we have seen a significant decline in our business since the quarter began. I want to stress that we expect a sequential pick up in our business during the subsequent three quarters. However, our outlook for the first quarter has a material impact on our full year guidance.

With respect to our first quarter, there are four key contributors to the projected decline in our business.

First, traffic has continued to decline.

Second, the weather has been unusually severe and is still not back to normal. We understand that all retailers are struggling with these occurrences.

The third issue relates to promotional cadence, which has led to a kind of customer fatigue. During the fourth quarter, we ran all-store 40% to 50% off sales quite a bit more than in 2012 and also quite a bit more than originally planned.

While it was the right approach for that quarter, it is having a residual affect since some of our customers used those fourth quarter events to stock up on new Spring fashion. This in turn has contributed to a soft Q1 traffic. It also resulted in some very strong key items being low in stock and we are only now getting back into them.

Our ultimate objectives are to strategically adjust our promotional cadence in an effort to become less dependent on promotions long term and to manage inventories more tightly to assist in achieving this goals. We won't eliminate our all-store promotions; they are important during key traffic days. We will approach this carefully, balancing short-term business needs with the long-term health of the brand.

The fourth issue relates to the merchandise, and David will elaborate on this momentarily.

That was a lot to cover, but we wanted to be sure you understood our thinking behind our first quarter guidance. At the same time, I want to be certain that the accomplishments of 2013 are recognized.

We have four growth pillars and they are the strategic initiatives which will enhance the Express brand and drive our future growth. Just in case there is anyone new on the call, they consist of driving store productivity, capitalizing on our eCommerce opportunity, expanding our North American store base and international expansion.

During 2013, we advanced three of them. Specifically:

eCommerce growth continued at a rapid double-digit pace.

We opened our San Francisco flagship, continued executing our hub-store strategy and laid the ground work related to the opening of our first outlet stores this quarter.

We expanded our international store base.

And, While outside of the context of our growth pillars, it is important to note that we also tightly managed our expenses and capitalized on a strong balance sheet to complete our \$100 million stock buyback.

It was a busy and productive year. Our work will continue in 2014 And notwithstanding the challenging start to the year, we remain excited about the long term opportunities that lie ahead.

A variety of things drive store productivity, but first and foremost is product. We have some very strong key items and have used our open to buy dollars to buy back into the best ones for Q2. The merchandise and design team just returned from Europe and after shopping Paris, London and Milan, have a high conviction that our assortment encapsulates all of the major trends.

Driving traffic is another way to improve productivity And two ways of doing so are through marketing and our promotional strategies. During 2014, we will be increasing our marketing spend and also making some significant changes to the allocation of those dollars.

We also have to keep customers engaged and to do so we are testing new promotional concepts and when proven, will roll them out at appropriate times during the year.

We are very excited about our new partnership with Kate Upton, who we just signed as a brand ambassador. She's an iconic American celebrity with global relevance who we believe is perfect to represent Express here and abroad. She's making her first appearance for us at our upcoming Miami runway show, which actually takes place tomorrow.

I hope some of you have seen our 9,000 square foot LED screen on top of our new Times Square store. It provides us with another means of generating brand awareness, particularly among international tourists visiting that must-see destination.

We are simultaneously investing in highly targeted marketing efforts, employing social media, digital and mobile tactics. In contrast to print advertising, they contain an immediate call to action. We are continuing to enhance our presence in hub locations, since we believe they will be the destinations with the healthiest traffic patterns going forward.

To drive productivity gains, we took the necessary actions to close out 2013 with lean inventories and have kept open-to-buy levels for the second quarter higher than at the same time last year. Going forward, our goal is for inventory growth to generally mirror expected sales gains. We also regularly review our prices against the competition and sales trends and where we have seen sufficient price elasticity, we have been able to increase prices on select items.

eCommerce, at 15.3% of total 2013 sales, reached our publicly stated 15% goal more quickly than I thought it would. It speaks both to our executional skill and to the rapid shifts in how our customer is shopping. We'll continue to invest in this area and while we don't see any need to set a new target, we once again expect eCommerce to deliver double-digit growth in 2014.



To support this growth, throughout the year, we'll be rolling out a variety of enhancements to our website as well as to our mobile platforms. As different phases of these upgrades are completed our progress towards being a true omni channel retailer will advance as well.

Store associates are already ordering online to fulfill customer requests for items not available in a particular store. Our next phase will be to ship from the stores. The ultimate objective is one universal view of inventory so that turns can be maximized, markdowns minimized and customer orders filled more quickly.

Store expansion continues to be an important growth vehicle and we are particularly excited about our outlet initiative. Paul will run through the planned store openings with you. The main point I want to make is that I'm very optimistic about this new part of our business and the associated growth potential.

Of course the most exciting store opening this year is our Times Square flagship store, which had a soft opening a few weeks ago. We're gearing up for our Grand Opening later this month and hope that many of you will stop by when you are in the area and take a look around. I will tell you it is spectacular.

The international business is progressing well. We closed out the year with 26 stores representing a build of 73% and generated a profit.

We anticipate opening between three and six new franchised locations in our current countries of operation during 2014. We are continuing our focus on international expansion via the franchise model by allocating capital to outlets rather than Company owned international stores, we will deliver more immediate, sizeable returns to the shareholders.

Let me make a few final observations and then I'll wrap it up.

While 2013 was clearly challenging for retailers, we made real progress in terms of executing against three of our four growth pillars. From a more immediate vantage point, we ended the fourth quarter with lean inventories, which set us up well for 2014. The year nevertheless got off to a slow start and the guidance we issued today is reflective of that fact.

While we expect the challenging environment to continue throughout 2014, we have initiatives in place that are expected to drive sequential improvements in our results throughout the balance of the year. We will continue to be disciplined with the management of our inventory and expenses and drive greater efficiencies across our supply chain to improve margins.

Longer term, we have multiple channels to deliver robust growth. We are also pursuing longer-term initiatives involving our hub store enhancements, ongoing eCommerce growth, our new outlet venture and continued international expansion, all of which will drive long term profitability.

David, let me turn the call over to you now to add your remarks.

David Kornberg - *Express Inc - President*

Thank you, Michael. Good morning, everyone. In his remarks, Michael focused on our growth pillars and the work we will be doing to advance each of them during 2014.

I want to spend a minute on the common theme that unites them and that is the customer. The point is that in order to drive shareholder value, we have to focus on our ultimate purpose, which is to serve the customer as well as possible. That involves enormous flexibility to meet their demands so that they can shop when, where, and how they want.

It's about so much more than great stores. Now it's stores and eCommerce, with outlets opening in May and enhanced ways of browsing, purchasing and receiving product coming online this year and next. As Michael said, it's about adapting successfully and also about thinking and acting with a single omni channel vision of our brand.



Consumers have lots of choice, and their options keep expanding. We're committed to retaining the loyalty of our existing customers and to attracting new ones. So, we begin by providing fashionable, quality product that meets their major lifestyle needs and which delivers a fair price/value proposition.

We had a strong offering heading into the Holidays. As you already know, our primary disappointment was that we sold so much more product at promotional prices than initially planned, thereby reducing AUR. Even a single dollar per item more would have delivered a significant upside to our bottom line when you think of the millions of units we moved through in this very important quarter.

On the positive side of the ledger, we cleared through a lot of cold weather product and entered 2014 with a greater percentage of Spring product than at the same time last year.

We also learned a lot about which spring items are the biggest winners and we have used our key-to-open to buy dollars to deliver heavily into those items.

In terms of the women's business, its decline so far this year has been steeper than the decline in traffic. In some cases, we are under inventoried. For example, certain woven tops and knit leggings sold rapidly once we extended our all-store promotions. We have re-ordered these items, but we are just now getting back into that inventory in the proper depth.

In our dressy woven pant department, sales have slowed as we over corrected in our shift away from color and went too neutral in our selection. Within knit tops, our fashion items are doing extremely well, especially lace.

However, sales of the more basic styles have slowed. We're working to rebalance our assortment and expect to be in a better position in the coming months.

There were also important bright spots in terms of our women's business. The biggest news is the continued growth of a new silhouette, which is all about the higher rise and the shorter top and the tucked-in top.

In addition to leggings and full length jeans, our high waist denim shorts are turning fast. Our crop and trapeze tops work really well with all of our high rise offerings and we're getting great results with them as well.

I'm equally pleased about the overall strength of our soft woven shirt business.

Dresses and skirts continue to be a particular area of strength for us and we expect them to remain an important category for Spring as we redeliver our best selling items.

Moving on to the men's business. Our men's business continued to do well during the fourth quarter, showing sequential improvement. We turned in strong results across many of the same categories we spoke with you about on our last call. Our tailored pieces continue to drive the business with suits, blazers and dress pants all performing very well.

Sweaters experienced a positive shift in Q4 driven by merino and our higher price point novelty sweaters and a strong key item presentation in December of cotton sweaters which transitioned into Spring.

In other tops we did very well with our patterned dress shirts. We also chased into long-sleeve henleys, novelty tee shirt bodies and graphics.

Denim continued to be challenging during the quarter, but we saw improvements in December and we believe that the move to straighter legs and darker washes sets us up well for Spring.

Non-apparel items also did well with the growth being driven by the success of men's furnishings. Watches had a good Christmas and the re-launch of boxed underwear program is off to a strong start.



In January, we delivered our Men's shoe collection to our top 100 stores and online and while it's only been a few weeks, early reads look very promising.

I'm feeling positive about the men's collection for Spring and expect this business to perform well as we see the traffic strengthen.

As we plan for the balance of 2014, our focus remains on delivering the great fashion our guy and girl want and enhancing the brand equity associated with Express through our new brand ambassador Kate Upton, and enhanced marketing activity. The opening of our Times Square store is a real milestone. I'm excited about what outlets will mean over the next few years.

Simultaneously, we are focused on the economics of the business and what we need to do to succeed in a difficult retail environment. Lowering quality is not an option, but being especially vigilant when it comes to the bottom line is paramount. So, we will continue to use our test-and-react strategy to make the most informed purchasing decisions possible while simultaneously managing prudently to reduce costs and improve operating margins.

At this time, I'm going to turn the call over to Paul to go into more detail about our financial performance.

Paul Dascoli - *Express Inc - SVP & CFO*

Thank you, David. Good morning, everyone. I'll begin by reviewing our results for the fourth quarter and then turn to our outlook for the first-quarter 2014 along with the year as a whole.

As you've already heard from Michael and David, we believe we did a good job in the fourth quarter of managing through an extremely difficult environment. To compete effectively and to ensure that we ended the quarter in a clean inventory position, we increased the duration and the depth of promotions to levels that exceeded what we had planned for earlier in the quarter.

We got our share of the traffic, especially on the heavy shopping days, and also cleared through our inventories so we started 2014 with our inventories in good shape. We are, however, disappointed that we didn't deliver better results.

Before I turn to the details of our fourth-quarter and full-year financial results, I want to comment on the reclassification that was referenced in our press release. The impact is quite small, but I wanted to be sure you're aware of it and understand what we did.

We have been netting the revenue derived from selling discontinued product to third-party vendors against the Cost of Goods Sold. Going forward, that revenue will be included in our net sales with only the product costs in cost of goods sold. While our gross margin dollars won't change, this new methodology will result in our gross margin percentages changing slightly.

We've detailed the changes impacting 2012 and 2013 in Schedule 5 of our press release. Our 2013 10-K will include revisions to our five year financial summary and our two year quarterly financial data table reflecting these changes.

So let's move on to our fourth quarter recap. Net sales for the fourth quarter were \$716 million, a decrease of 2% compared to last year's fourth quarter. Without the approximately \$27 million associated with last year's 53rd week, our fourth quarter sales increased by 2%.

eCommerce sales increased to \$139 million, a 14% increase on a 53-week basis. On a 52-week basis, eCommerce sales grew by 18%. On a comparable-sales basis, the business grew at 1% on top of last year's fourth-quarter gain of 1.5%.

Our gross margin came in at 32%, declining 300 basis points. Merchandise margins declined by 220 basis points.

We've already spoken repeatedly about this metric, it primarily reflects the need for us to heighten our fourth-quarter promotions. And just to be clear, for the purposes of this calculation, our fourth-quarter sell-off revenues were included in Net Sales.

As a percentage of net sales, buying and occupancy expenses deleveraged by 80 basis points; the low single-digit comp simply wasn't enough to allow us to gain any leverage.

SG&A as a percent of sales came in at 20.1%. In last year's fourth quarter it was 19.7% of net sales. This increase on a rate basis is in line with our December commentary.

Operating income was \$85 million or 12% of sales. This compares to \$111 million or 15% of sales in last year's fourth quarter. Our effective tax rate was 39.9% versus 39.7% in last year's fourth quarter.

Net income for the fourth quarter was \$48 million or \$0.57 per diluted share. This compares to net income for the fourth quarter of 2013 of \$64 million or \$0.75 per diluted share, which included approximately \$3 million and \$0.04 per share, respectively, associated with the 53rd week.

Our balance sheet remains very healthy. Our cash and cash equivalents were \$312 million at the end of the quarter and our Revolving Credit Facility remains untapped.

Our long-term debt was \$199 million, virtually unchanged from last year. Our capital expenditures during the quarter were \$27 million compared to \$26 million last year.

When we spoke with you about inventory levels during our last call, we told you that we were planning receipts so that our inventory at the start of 2014 would show single digit increases. In fact, we ended the fourth quarter with \$213 million of inventory, down 1% from the same time last year and down 5% on a per square foot basis. These results reflect the heavy sell-through associated with the extended Q4 promotions as well as our determination to quickly rationalize inventory levels.

Turning to our full-year results, net sales for 2013 were \$2.2 billion an increase of 3% compared to 2012. On a 52-week basis our 2013 sales increased by 4%.

eCommerce sales of \$341 million represented 15.3% of our Net Sales and grew 25% on a 53-week basis. On a 52-week basis eCommerce sales grew by 27%. Comp sales increased 3%, an improvement over last year's flat comps.

Gross margin was 32.3% down 210 basis points. SG&A totaled \$504 million, or 22.7% of sales, compared to \$491.6 million, or 22.8% of sales, for 2012 computed on a 53-week basis.

EPS was \$1.37 per diluted share. This compares to last year's EPS of \$1.60, which included approximately \$0.04 per share from the 53rd week.

Capital expenditures for 2013 were \$105 million compared to \$100 million last year. This increase relates primarily to real estate spending and information technology investments to support our growth.

I'm going to turn now to 2014 and provide some additional color on our guidance for the first quarter and the full year. In light of the slow start to the year, we have taken an appropriate yet cautious approach to our guidance. We have reflected the actual performance seen year to date but have also assumed a positive change in the trend of the business as we progress through March and April as well as the balance of the year.

First quarter comparable sales are expected to decline in the high single-digit to low double-digit range. Merchandise margins are expected to be up slightly compared to last year's first quarter.

In terms of Buying and Occupancy, we told you last year that we are in a heavy lease-renewal cycle, particularly for our A stores, which are obviously our largest and most expensive stores. Many retailers have been discussing rent pressures as they renew in these key locations where demand for space outstrips supply and we are no different.



The other factor that most of you already know of is that the straight-line rent means that what you're expensing in the later years of an old lease is less than the current rent actually being paid. Conversely, when you enter into new leases, your early year, straight-line rent expense is higher than your actual cash outlay, so these renewals have a more dramatic effect on our P&L.

Of course, we have to contend with the rent associated with the new outlet stores as well as routine annual rent and other inflationary increases. When layered on top of negative comps, we expect deleveraging in each quarter with heightened pressure in our first quarter.

SG&A as a percentage of sales is expected to de-lever for the quarter and for the full year, with the first quarter making up the greatest amount of the full-year de-leverage. Marketing expenses are expected to increase approximately 70 basis points in connection with the various initiatives noted earlier. Normal inflationary pressure tied to labor costs and the incremental expenses associated with higher depreciation, as we continue to make IT investments will also contribute to the de-leverage.

For the first quarter, we anticipate net income ranging between \$10 million to \$15 million and diluted earnings per share within a range of \$0.12 to \$0.18.

For the full year, as Michael already noted, we expect to see sequential improvement and a return to positive comps in the back half of the year. This will translate into full-year comps ranging from negative low single digits to flat. In terms of merchandise margins, we expect the inventory management initiatives outlined earlier to pave the way for modest full-year merch margin gains.

When you think about modeling interest expense for 2013, we've projected a notable increase in that amount. The increase over the last year's \$20 million is due to the accounting rules related to the rent on our Union Square and Times Square stores now that they are both open. This treatment requires us to allocate a portion of the rent expense to interest.

We anticipate net income ranging between \$88 million to \$105 million and diluted earnings per share within a range of \$1.03 to \$1.23. The EPS calculation is based on an estimate of 85.1 million diluted weighted average shares outstanding.

With respect to our real estate footprint, our first quarter plans for retail stores call for us to open two US and one Canadian store while closing nine US stores. For the full year, we expect to open approximately 10 new retail stores, 2 of which will be in Canada. Approximately 15 US stores will be closed. We also plan to remodel 25 to 30 stores.

Looking beyond this year, I do want to note that the pace of new retail store openings will slow given the lack of compelling locations that the eCommerce business continues to grow. In terms of the outlet stores, as Michael already mentioned, we plan to open 17 stores in early May, 15 of which are conversions from our existing fleet of stores.

By the end of the year, we expect to be operating approximately 30 outlet stores. In terms of size, those stores are averaging approximately 7,600 square feet.

We're on track to open the first 22 outlet stores by the end of the second quarter. As I told you previously, 15 of those will be conversions from existing stores. We'll shut them down briefly to make the necessary renovations and bring in new merchandise.

Later in the year, we're planning to open approximately nine additional stores, bringing the outlet store total to approximately 30 by year end.

2014 outlet related incremental revenues are estimated at approximately \$30 million. Buying and occupancy expenses will on average be lower than for our regular stores.

And in terms of SG&A, we noted last year that we added some headcount as we launched this new initiative. We do, however, expect to leverage much of our current infrastructure to support this business.



Capital expenditures are expected to range between \$110 million and \$115 million for the full year compared to \$105 million in 2013. This increase primarily reflects investments in new stores, including outlets, and our ongoing store remodel program as well as investments in multiple IT initiatives, including new retail management and enterprise planning systems as well as eCommerce upgrades.

As we noted in the press release, we will be refinancing our long-term debt. Our guidance, however, does not yet reflect the impact of this transaction.

That concludes my remarks. At this time, I'm going to turn the call back over to Michael for his closing remarks.

Michael Weiss - *Express Inc - Chairman & CEO*

Thank you, Paul. In conclusion, we continue to take a disciplined approach to the business as we make improvements in the way we operate. We are delivering desirable and fashion-right product to our customers and driving engagement to enhance loyalty. At the same time, we are intently focused on introducing new customers to Express.

We've been building this business for a very long time and I have always been guided by one mantra: continually challenge your assumptions and learn to look at things in a new way. We must be able to articulate not only what we believe about this business but why we believe it. When the why becomes difficult to articulate, we see symptoms of a brand that has become ideological versus strategic. We must remain strategic because becoming ideological as opposed to strategic is a formula for irrelevance. This exercise has kept Express relevant and profitable and ensures that we will remain so in years to come.

Operator, at this time, please open the lines so that we can turn to the question-and-answer portion of the call. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

In the interest of time and so that other participants have the opportunity to ask their questions during the conference as well, we ask that you please limit yourself to one question and one follow-up question during the Q&A.

Simeon Siegel, Nomura Securities.

Simeon Siegel - *Nomura Securities - Analyst*

Can you talk through the confidence around of Q1 first margin increase? Just given all of the commentary around the promotional environment.

Paul, can you talk to the expected interest expense for the year? You've been expensing, if I got that right, you've been expensing the rent for the flagships for the past year? Is the increase in interest now in place of the already expensed cost of COGS, if that makes sense?

I know you didn't quantify it, so I'll apologize for the question. But given the high in interest expense, can you just address what benefit you'd expect to see from the refinancing or at least the expected timing around when you expect to share that? Thanks.



Paul Dascoli - *Express Inc - SVP & CFO*

Sure, so your first question was around the merch margins. We feel pretty confident seeing that we can expect right now to see a modest increase based on our assumptions of where the promotional environment is right now. It won't be a significant increase, but we are doing some things in terms of inventory management as we talked about before that should help us in that regard.

As well, we have taken an opportunity, as I think David alluded to, to bring prices up on certain items that we have that are turning quite quickly and being well accepted in the marketplace. That helps us both in terms of full price selling. It also helps us improve our margins when we're actually on promotion as well, because we still get some of that incremental price uptick in our margins.

Again, it's not a significant uptick. I think we will see some merch margin improvement. We're modeling merch margin improvement for Q1.

In terms of interest expense, you know right now, our notes are out there at about 8.75%. We do think that right now, by refinancing those at about the same level that we should be able to get an interest rate that we would hope to get an interest rate south of 4%.

I think that equates into about \$10 million roughly of potential interest savings for the year. The refinancing, we don't expect to be completed until the end of the first quarter, so we wouldn't get that full year basis.

Simeon Siegel - *Nomura Securities - Analyst*

Okay, great. Then, just that point around the incremental expense now due to the flagships being an interest. Does that come from COGS that you've been expensing last year?

Paul Dascoli - *Express Inc - SVP & CFO*

Not all of it. I think we can talk last year that there would be some incremental expense on top of the pre-opening rent all in. It's about \$1 million a quarter going to interest expense, that's incremental.

Simeon Siegel - *Nomura Securities - Analyst*

Great, thanks a lot, guys. Good luck for the year.

Paul Dascoli - *Express Inc - SVP & CFO*

Thanks, Simeon.

Operator

(Operator Instructions)

Neely Tamminga, Piper Jaffrey.

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

A question here for David first, and my follow up is going to be for Paul on stock buyback. David, first for you. Considering that the traffic environment is contracted as much as it has, how do we have confidence that this hasn't damaged the ability to do the read-and-react strategy?

If there's no one there to vote on the products, how can you get the test that gives you the confidence for the positive comps in the back half? Some clarity around that would be helpful?

Then, Paul, as a follow up here is, what is the appetite for stock buyback? What's the latest and greatest on your authorization opportunity? Thank you.

David Kornberg - *Express Inc - President*

Neely, I think first of all, in terms of the traffic, I don't think it has damaged the ability in terms of the test-and-react strategy, our ability to operate with that strategy. I think it's very clear in terms of what the winners are and in terms of what we're looking at and what we seen for the first couple of months of the year, in January and February.

The best items continue to be the best items. We've reordered into those for Q2. We already have some of the deliveries already hitting.

I think that those are also some of our highest margin items as well. It all really depends on the customer voting in terms of what they want. Yes, while there is less traffic in the mall, we're seeing less traffic, the customer clearly votes in terms of what they want versus what they don't.

Paul Dascoli - *Express Inc - SVP & CFO*

In terms of the stock buyback, Neely, certainly it's something we discuss, as we've talked about before, on a pretty regular basis with the Board. Right now, we felt like the most prudent thing to do considering the circumstances around business and the guidance that we just provided was to remain as flexible as we could with our cash position. We have an upcoming Board meeting when certainly we will talk about the overall capital structure with the Board, but certainly, we have our eye on what's the appropriate time to maybe think about another share repurchase.

Michael Weiss - *Express Inc - Chairman & CEO*

Could I just add one thing? Because I think it's important, and David did say it, but I want to reaffirm that in terms of the test and react and the lower traffic. I think that what we're seeing is that with the lower traffic, the buying on the part of the customer has become much more specific.

It's much more difficult to sell things than it used to be. As a result of that, what is very good and what is not good at all is much clearer than it's ever been.

I don't think I ever seen such sharp lines of demarcation between the good stuff and the bad stuff. I'd rather have the traffic, but with the less traffic we're getting much more conclusive information.

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

That really helpful, Michael, thank you.

Operator

Betty Chen, Mizuho Securities.

Betty Chen - *Mizuho Securities USA - Analyst*

I was wondering, David, if we heard you correctly? Could you give us a little bit more color regarding the knit top business? I think you may have said that you're seeing a little bit softness around the more basic styles?

Give us more color around that if you could, as well as I think some of the dressy wear, I think you may have continuous to neutral? How are you thinking about that? Related to that, how should we think about the difference in terms of more open to buy year over year to give you more flexibility?

Then my follow-up question for Paul is regarding SG&A. You mentioned they will delever. Can you give us some additional color on how much we could expect in the first quarter? Thanks.

David Kornberg - *Express Inc - President*

Okay, Betty. In terms of the first question, the knit business. We have seen trends in terms of our dressy knit business.

The casual knit business has been tougher, but within the casual knit business, items such as lace continue to be very strong. Trapeze shapes continue to be very good.

Then, all the whole idea of cami and bare is also very encouraging. That's really what we've reordered into. As I look at it, yes, you're right.

In terms of the more basic items, they have been more challenging. As we look at the total business, where we've seen it is on some of the dressier styles. Then, in surface interest and texture, which is what we really chased into.

Paul Dascoli - *Express Inc - SVP & CFO*

Betty, from an SG&A standpoint, the first quarter is actually the most significant quarter that we're looking at in terms of deleverage on a full-year basis, primarily driven by such a significant decrease in the comps as well as some increased investment, particularly in marketing. We're looking actually at about a 350 basis point deleverage in our SG&A for the first quarter. That includes a pretty significant increase in investment in marketing to cover things like the ownership and operation of the LED sign up in New York as well as just increases behind our initiatives that Michael spoke about earlier.

Betty Chen - *Mizuho Securities USA - Analyst*

Okay, thank you and best of luck.

Operator

Lindsay Drucker Mann, Goldman Sachs.

Lindsay Drucker Mann - *Goldman Sachs - Analyst*

On the SG&A side, have you thought about or is there any visibility to the potential of a broader restructuring? Understanding that you need to invest in the brand and on the marketing side, but how close are we to an opportunity to pull some of the SG&A costs out of the base business given what's happened with pricing and with productivity pressure that we've seen of late?



Secondly, on the rent inflation from resigning those leases, so you're going through it soundings like a big chunk of your A malls this year. Is that mostly a one-year event or should we be looking for another year of inflation with lease renewals next year? Thanks.

Paul Dascoli - *Express Inc - SVP & CFO*

I don't think right now that we see a need for a major restructuring in our business. We have, over last few years, have done a good job in managing our overall SG&A expenses.

Last year, for instance, our SG&A on a full-year basis was actually flat to the prior year. It's been a constant area of focus for us.

With the magnitude of the initiatives that we have going on right now, I actually think we've done a pretty good job at keeping our SG&A in check. As we look ahead to things like outlets and continued growth in the eCommerce and the investments we are making in our IT infrastructure and the people and all that are required for that, I think that a significant major restructuring would not really be appropriate for us at this point in time.

I will assure you that we continue to focus on our SG&A. We're looking for ways to take money out so that we can continue to invest in marketing to try to drive the business. That's probably the most important priority for us right now. In terms of -- could you please repeat your follow up for me?

Lindsay Drucker Mann - *Goldman Sachs - Analyst*

Sure. Where are we in the lease renewal process? You have a big batch that's getting renewed this year. Are there anymore we should think about for rent inflation for next year also or are we mostly done?

Paul Dascoli - *Express Inc - SVP & CFO*

No, I think that was really a three-year cycle for us. Last year we saw some of it; we talked about it. We'll see some of it this year.

Then, as we get ourself into next year. You should expect to see probably one more year of a little bit heightened rent expense.

Matt Moellering - *Express Inc - EVP & COO*

The other thing we are looking at, we are in the process of looking at fleet rationalization as well in some of our stores that may be trading with each other. We're looking at that as well, actively right now.

We don't have the final information to share at this point because we're still in the process. Hopefully, that can offset some of the impact as well.

Paul Dascoli - *Express Inc - SVP & CFO*

Some of the closures, to just fill out what Matt said, that we're talking about this year, are actually stores where we believe the volume can transfer to nearby stores, leveraging those other existing stores.

Operator

John Morris, BMO Capital Markets.



John Morris - *BMO Capital Markets - Analyst*

A question I think for David and/or Michael. Denim, your denim business the performance there relative to the rest of the assortment, what are you seeing compared to last year? Particularly as a subset of that, is the rate of adoption of high waisted silhouette, how's that doing?

That rate of adoption compared to let's say the rate of adoption of skinny? Also, if you guys have any comments about performance that you've seen in the warmer weather markets versus the rest of the fleet? Thanks.

David Kornberg - *Express Inc - President*

Okay, so in terms of your first question, John, with denim and the adoption of high rise. High rise has been very good. In terms of the terms, we see it becoming a much bigger penetration of the total as we go forward.

Also mid rise, we have also seen big growth of, so there's some customer whose are not prepared to go all the way at this stage in terms of going to high rise. We're seeing progress in both of those areas. In total, we're seeing denim performance largely in line with the rest of the business. Your second question was about?

John Morris - *BMO Capital Markets - Analyst*

Rebuild.

David Kornberg - *Express Inc - President*

In terms of looking at California, looking at Florida, down but not down as far as the rest of the business has been.

John Morris - *BMO Capital Markets - Analyst*

Can you give us a rough feel for the delta between the two? Was it several points of comp? What's the order of magnitude?

Paul Dascoli - *Express Inc - SVP & CFO*

It's anywhere, John, from 4 points to 8 or 9 points.

John Morris - *BMO Capital Markets - Analyst*

Okay, great, thanks, good luck for the rest of Spring.

David Kornberg - *Express Inc - President*

Thank you.

Operator

Brian Tunick, JPMorgan.

Kate Fitzsimmons - *JPMorgan - Analyst*

This is Kate on for Brian. Thanks for taking my question. I wanted to ask about how you're thinking about the comp levers as the year progresses? Specifically, how are you planning AUR just given commentary that you're seeing some success in passing along price increases?

My second question would be just what are your thoughts on a normalized gross margin rate for the Company longer term? Do you think it can get back to that 35%, 36% level just given the promotional environment and now commentary that maybe rent increases are more to come? Thank you.

Paul Dascoli - *Express Inc - SVP & CFO*

On the gross margin piece, I do think there's some opportunities for us to continue to recapture some of the gross margin, but it will be over a longer period of time. I think it's going to be challenging to get back to some of the levels that we've necessarily seen, the 36% level in the past. We do have a number of initiatives around inventory, and as David talked about, around price ups on certain products.

I think those couple of things will contribute this year to helping us improve the merch margin. As I said, by the end of the year we should have some modest gains in merch margins. It won't be anything that would certainly bring us back to the levels that we had seen before.

In terms of the AUR this year, we generally don't comment on forward-looking AUR. I will tell you that in the first quarter we are seeing some success in moving AUR somewhat with the price increases that we have been able to take on product.

Michael Weiss - *Express Inc - Chairman & CEO*

There's one other piece to that. I think Paul is absolutely right, I think the price increases are counting, but it's so far on a very small percentage of the inventory. I think the slight increase in margin that we have gotten is practically all attributable to the fact that we did not wind up too much inventory.

Kate Fitzsimmons - *JPMorgan - Analyst*

Just in terms of the increases that you're passing along, does it give you confidence that maybe you could do it on more of the assortment?

Michael Weiss - *Express Inc - Chairman & CEO*

Oh, you're talking about price increases?

Kate Fitzsimmons - *JPMorgan - Analyst*

Yes.

Michael Weiss - *Express Inc - Chairman & CEO*

Yes, absolutely. The astonishing thing is we, basic rates practised on a few of our very, very best tops, and by best I'm talking about rate of return. How many you sell out of how many a week? It's all the same kind of judgment, so the numbers get to be very huge in terms of inventory.

We saw no erosion in sales, none. That's very good news, and it's something that we had gotten quite used to a few years ago. We dropped that ball, but I would repeat that the idea of winding up with flat to slightly down inventory saved us margin in a very difficult early first quarter.

David Kornberg - *Express Inc - President*

I think that the other thing to add is in terms of our air-ocean initiative. We've made real progress in that area.

If you look at Q4, the women's business, we had probably close to 50% less than we had in last year. That is another opportunity as we go forward and as we look at the business in terms of optimizing margin.

Matt Moellering - *Express Inc - EVP & COO*

That's a good point, David. One piece we didn't talk about, we've talked about the fact that we're not taking any quality out of the product, but we are looking at our air-boat mix.

We are also looking at the sourcing, where we source. We have continued to move more production into Vietnam and Indonesia and out of China, where the labor costs are a little higher. Then, we're also aggressively counter sourcing fabrics where it's appropriate, where we can get the same quality with different mills in order to help reduce some of the raw material costs as well.

Michael Weiss - *Express Inc - Chairman & CEO*

We talked about this quite a bit at ICR, really looking at what are the initiatives that we can drive in terms of the buy side and the sell side. Clearly, we are selling more units than we sold last year.

We sold in Q4 more units than we sold last year. We need to work out how we're going to get more dollars in terms of margin for the business out of that.

Paul Dascoli - *Express Inc - SVP & CFO*

There's also something that we very rarely talk about that go into our margins that we've also got initiatives to manage against. One of those is our shrink in our stores and another one is any cancellation expense associated with us pre-positioning fabric, which we've tightened the controls around both of those this year and seen some pretty significant improvement. Those are things that we don't generally talk about and you all wouldn't really see, but they clearly have an impact on our margins.

I also just wanted to take a quick opportunity and make sure that I had a clarifying point on Simeon's initial question around interest expense and make sure that I did say that we have not decided on any sort of a hedging strategy or not with respect to our refinancing of our debt, which could have an ultimate impact on the interest rate. What I was referring to is our expectations for rate strictly by going out and refinancing the debt instrument.

Kate Fitzsimmons - *JPMorgan - Analyst*

Great, thank you.

Operator

Janet Kloppenburg, JJK Research.

Janet Kloppenburg - JJK Research - Analyst

A couple of questions. First up, Paul, on the merchandising margins, do you expect in the back half you can recoup some of the, back half of FY14, can you recoup some of the lost merchandising margins from this year, from FY13? Will that help the buying and occupancy deleverage moderate, or make the gross margin declines moderate in the back half?

As far as inventory levels go, I know that they're down, but they are still higher than your sales trends. I'm wondering if you're conformable with them? Where we should expect them to be at the end of the first quarter, Paul?

David, I was wondering the imbalance that you're having in assortment, clearly you've sold out of key items, but maybe there's some content that is higher than it should be? I'm wondering when that balance will be in check? Michael, maybe you'll comment on the fast fashion retailers, and if you think they're taking some share from you at this time? Thank you.

Marisa Jacobs - Express Inc - VP of IR

Janet, we'll come back to that if we have time. We have to be able to move on to other folks, but Paul and David will take your first two questions.

Paul Dascoli - Express Inc - SVP & CFO

We are modeling, Janet, there's some pick up in merchant, merch margin as we get into the back end of the year. We do see that it will get a little bit better in the back half of the year, so that we do expect, as I said in my prepared comments, to have a modest improvement in merch margin, at least that's how we're modeling right now.

I'd say we are comfortable with our inventory. Right now, as David said, we're chasing into some products for Q2 that we think will help the comps as well in Q2. As you know, we generally don't provide guidance on inventory, forward looking.

Janet Kloppenburg - JJK Research - Analyst

Okay.

Michael Weiss - Express Inc - Chairman & CEO

Just let me add one more thing. I agree with Paul, we are modeling very, very conservatively, but if you look back against last year at the amount of inventory we went into fourth quarter with, and you look at the fact that we have shown we can control inventory, we know how to do that. I don't know how we couldn't get more margin.

Janet Kloppenburg - JJK Research - Analyst

Okay, thank you.

Michael Weiss - Express Inc - Chairman & CEO

I mean, we would have to, based on the mix. When you look at first quarter, which has been so awful, the margins okay for one simple reason, the inventory is okay.



Janet Kloppenburg - *JJK Research - Analyst*

Okay, and on balance --?

Michael Weiss - *Express Inc - Chairman & CEO*

We should have stuff to take down.

David Kornberg - *Express Inc - President*

Janet, moving on to your question about the imbalance in the assortment. I think as we get into April, we are going to be in a much better position. As it continues to flow in throughout the month of April, I think that we will see that progress.

Janet Kloppenburg - *JJK Research - Analyst*

Okay, thank you very much.

Operator

Richard Jaffe, Stifel Nicolaus.

Richard Jaffe - *Stifel Nicolaus - Analyst*

Guys, given the environment and the challenging or weak sales trends we've seen, is there an opportunity here or need to reconsider your test-and-chase discipline to rethink it both in terms of fabric and in terms of product mix, given the uncertainty and the general, softer trends? Have you considered that and if so what directions are you going in?

David Kornberg - *Express Inc - President*

In terms of reconsidering or test and chase, I feel like we covered that earlier. Our test-and-chase strategy is absolutely central. It loads the way that we think about the business. As Michael said, it has become much, much clearer in terms of the demarcation lines between what the winning items are and the items that are not so good.

We've reordered into what we have seen has been significantly better and thoughts are turning. The other thing I think that's also important is we keep fabric positions on what are really our core and key fabrics so that we can chase into the items that we see are good. As we stand here today, I think it continues to be central to our strategy in terms of the way that we think about the business and I don't see that changing at all.

Michael Weiss - *Express Inc - Chairman & CEO*

If anything, Richard, I would think or the way I see the bulk of it and read the selling report every week, that in times like these, it is more significant and more important, especially when you're trying to control inventories. You can't afford to buy a whole bunch of stuff that you know nothing about.



Matt Moellering - *Express Inc - EVP & COO*

That's right and we are more open, we have kept more inventory dollars open this year than we have the past couple of years just to that point. While we are boating more goods in, we continue to look at ways to speed up the rest of the supply chain.

Really, what we're focusing on, boating more goods in, is the seasonal and basic type of product that we can predict with more certainty farther out. If those items aren't selling, we can push those out with very little risk from an inventory perspective.

Richard Jaffe - *Stifel Nicolaus - Analyst*

Got it. That's very helpful, thank you.

Operator

Roxanne Meyer, UBS.

Roxanne Meyer - *UBS - Analyst*

I'm just wondering on your guidance that contemplates a return to positive comps in the back half of the year and in light of the dramatic weather impact that you know you're seeing in 1Q, I'm just wondering what assumptions you're making about Q2 that you do expect comps to still be negative in Q2? As a follow up just wondering if you can give us any initial feedback from the opening of your San Francisco store and any learnings there?

Paul Dascoli - *Express Inc - SVP & CFO*

Sure, so for the second quarter, Roxanne, we are expecting that the inventory David's talked about will help us improve the trend of the business as well. That we are expecting to see a break in the weather and expect that to have an impact on the business. We are not forecasting as significant of a decline as we are in the first quarter, but we do expect it to take until the second quarter for us to turn around and have positive comps.

As you and I think have talked about, we triangulate from a number of different ways, particularly looking at builds, year over year and quarter over quarter, to estimate what our outlook should be like. As we look at the builds in the business, year over year and quarter over quarter for Q2, we still do expect to have negative comps and not see positive comps until Q3 and Q4.

David Kornberg - *Express Inc - President*

Your second question was about Union Square, right?

Roxanne Meyer - *UBS - Analyst*

Yes.

David Kornberg - *Express Inc - President*

Okay, in terms of Union Square, it's obviously been opened for three or four months now. The learnings that we've seen. First of all, in terms of the traffic period in Union Square, it's not the busiest time of the year that they get in San Francisco from what we understand.



We see that the traffic, in terms of the big tourist uptick, is really as you get into the second quarter and beyond when the big tourist season starts. I think that the other big learning that we've seen is that, it really hasn't taken a penny away from San Francisco Center, which is literally down the street. What we're seeing there in terms of the sales are really incremental to that neighborhood.

Matt Moellering - *Express Inc - EVP & COO*

In terms of what the customer seems to really like out there, they seem to really like party and dressy dresses and fashion items. We've been able to adjust our fixtures in what we call the party zone to increase our inventory levels for those categories.

For mens, our suiting and sweaters and denim seemed to be quite strong in that store as well. We're getting good data in terms of what the customer out there really likes out of that store.

Roxanne Meyer - *UBS - Analyst*

Okay, thanks.

Operator

Thank you. Ladies and gentlemen, I would now like to turn the floor back over to Michael Weiss for closing remarks.

Michael Weiss - *Express Inc - Chairman & CEO*

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

Operator

Thank you. This does conclude today's teleconference. You may disconnect your lines at this time. Thank you for your participation.

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