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# EDITED TRANSCRIPT

PLCE - Q1 2018 Childrens Place Inc Earnings Call

EVENT DATE/TIME: MAY 17, 2018 / 12:00PM GMT

**OVERVIEW:**

PLCE reported 1Q18 net sales of \$436m and adjusted EPS of \$1.87. Expects FY18 total net sales to be \$1.920-1.935b and adjusted EPS to be \$7.95-8.20. Co. also 2Q18 expects total sales to be \$423-428m and EPS to be \$0.51-0.61.



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## CORPORATE PARTICIPANTS

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**Jane T. Elfers** *The Children's Place, Inc. - CEO, President & Director*

**Michael Scarpa** *The Children's Place, Inc. - COO and EVP*

**Robert J. Vill** *The Children's Place, Inc. - Group VP of Finance*

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## PRESENTATION

### Operator

Good morning and welcome to The Children's Place First Quarter 2018 Conference Call. (Operator Instructions)

At this time, I'll turn the call over to Mr. Bob Vill, Group Vice President, Finance.

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**Robert J. Vill** - *The Children's Place, Inc. - Group VP of Finance*

Thank you for joining us this morning. With me here today are Jane Elfers, President and Chief Executive Officer; Mike Scarpa, Chief Operating Officer; and Anurup Pruthi, Chief Financial Officer. A copy of our press release can be found on our website.

Before we begin, I would like to remind participants that any forward-looking statements made today are subject to the safe harbor statement found in this morning's press release as well as in the company's SEC filings. These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially. The company undertakes no obligation to publicly release any revision to these forward-looking statements to reflect events or circumstances after the date hereof.

In addition, to find disclosures and reconciliations of non-GAAP measures that we use when discussing our financial results, you should refer to this morning's earnings release and to our SEC filings that can be found on our Investor Relations site.

After the prepared remarks, we will open the call to questions. (Operator Instructions)

I will now turn the call over to Jane Elfers.

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**Jane T. Elfers** - *The Children's Place, Inc. - CEO, President & Director*

Thank you, Bob, and good morning, everybody. After reviewing Q1 performance and current business, I will focus my remarks on our digital transformation roadmap and provide additional detail regarding implementation and timing of key digital milestones over the next 12 to 18 months. I will conclude my remarks with an update on our private label credit card strategy. I will then turn it over to Mike, who will update you on the status of our China partnership, our Amazon initiatives and our fleet optimization strategy initiative. Anurup will then provide Q1 detail, including an update on where we currently stand with respect to our accelerated share repurchase program. He will then review the path to our 12% operating margin target for 2020 with a particular focus on the key drivers of our operating margin expansion over the next 3 years. He will conclude his remarks with forward guidance.

So starting with Q1. While we stopped providing monthly color long ago, we felt it was important to provide a deep level of transparency into our monthly performance based on how severely we were impacted in Q1 by the significant number of winter storms and the sustained below-normal temperatures that persisted throughout the quarter. In addition, our Q1 results were further pressured by the performance of our outlet channel. We consolidated clearance into our outlets at the end of Q4. But since the majority of our outlets are in outdoor centers, our outlet traffic was even more severely impacted by the weather than our place stores. This forced us to continue lowering AURs to ensure we entered Q2 on our inventory plan.

So starting with February. We delivered a negative 3.4% sales comp and a negative 4.6% traffic comp due to the significant number of winter storms and store closures throughout the month.

In March, while we delivered a positive 11.1% comp due to the Easter shift, we did not deliver nearly our planned sales volume with traffic up only 5.5%. Unfortunately, the persistent winter storms and below-normal temperatures continued during our peak Easter weeks, severely hampering demand for our seasonal products including shorts, playwear, swimwear, tanks, sundresses and casual footwear. Due to our significant top line miss in March, we also lost a key month in which to sell our seasonal product at peak AURs. The snow persisted post-Easter with another major storm occurring the first week of calendar April, coinciding with our place cash redeem event.

Moving on to April. While April was always planned to deliver a negative comp due to the Easter shift, the continuation of winter storms and record-setting low temperatures through the third week of fiscal April continued to severely hamper our top line and our ability to sell seasonal merchandise at peak AURs. Through the first 3 weeks of April, we were running negative 23% comp sales and negative 24% comp traffic. As difficult as the weather was in our U.S. stores, it was even worse in Canada, where we ran a negative 7.1% comp for the quarter.

And finally, while our digital business did perform significantly better than our brick-and-mortar channels during Q1, the weather also hampered online demand for seasonal products. It was not until the 13th week of the quarter that we saw the weather normalized across the country, and the minute the weather changed, our sales turned aggressively positive. Our comp for the last week of April was positive 24%, a 47-point swing from our month-to-date comp, and our comp traffic was positive 9%, a 33% swing from our month-to-date comp traffic. We ended April at a negative 15% in comp sales and a negative 17% in comp traffic.

Quarter-to-date, we're currently running a positive 24% comp. This is wholly driven by a significant increase in pent-up demand for our seasonal product. Now that mom is out shopping and the weather patterns have normalized, we expect to deliver a strong top and bottom line performance in the second quarter.

Moving on to an update on our digital transformation. We provided a lot of detail on the last call, but we want to continue to provide as much transparency as possible on this key strategic initiative. Digital transformation, with the goal of 1:1 personalization, is our single biggest top and bottom line opportunity. We believe that the disruptive change that retail is experiencing, largely due to digital advancements, is not only going to continue but is going to rapidly accelerate. The retailers that plan for this accelerating digital disruption are going to be the long-term survivors, and that is why we are investing now to accelerate our own digital transformation.

Our digital investments, with the goal of gaining market share, are focused on improving customer retention, driving customer acquisition and increasing customer engagement with our brand. As we said on our last call, our digital transformation has over 100 key initiatives that we intend to tackle over the next 24 months. I think the best way for us to share and track our progress against our roadmap is to provide you with a forward



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view of the major initiatives we intend to accomplish by quarter and then report back against those targets on the following quarterly earnings call.

So let's jump in. On our last call, we said that we would be investing an incremental \$50 million in SG&A over the next 3 years in support of digital transformation with \$30 million in 2018, \$15 million in 2019 and \$5 million in 2020. We also stated that we anticipate that our digital penetration will grow to approximately 35% of our total business by 2020.

While Q4 2017 is not included in the incremental investment numbers we provided, I want to recap for you what we did deliver in Q4 of 2017 with respect to our digital transformation roadmap, as much of what we delivered is foundational to our future transformation initiatives. So for Q4, we delivered our customer database, we rolled out WiFi to all U.S. stores, we rolled out BOPIS to all U.S. stores, shipped from store was rolled out to all U.S. stores, we launched SMS texting capabilities and we implemented our new campaign management tool.

In Q1, we implemented everyday free shipping with no minimum purchase, we rolled mobile POS to all U.S. stores and we relaunched our mobile app.

For Q2, we intend to implement the following new capabilities: implement a new state-of-the-art on-site search tool, enhanced e-mail trigger capabilities and dynamic display retargeting.

For Q3, our plan is to implement a new state-of-the-art pricing, promotion and coupon system that will enable us to deliver personalized offers to mom in whichever channel she prefers to shop; a new state-of-the-art loyalty system that will deliver real time personalized communication and promotion; and foundational improvements to our e-commerce platform that will allow us to scale our digital business in line with our strategy, improve site responsiveness, provide a more seamless check-out and enable personalized SMS delivery.

For Q4, our plan is to implement BOSS, buy online, ship to store; enhanced predictive modeling capabilities that will allow for sophisticated personalization capabilities; and we will also begin to assess the feasibility of technology improvements in the following areas and the ERP upgrade and an upgrade to our order management system.

And looking ahead to 2019, we will implement several key capabilities including: a new point-of-sale system in conjunction with the implementation of a single pool of inventory and a rollout of Save the Sale functionality to all stores, a new state-of-the-art content management system and dozens of improvements to our mobile site, focused on speed and ease for mom.

These digital initiatives and the balance of our digital road map will further separate us from our competition. They are critical to our continuing to drive sales and operating margin expansions through improved acquisition, retention and engagement strategies as we work towards achieving our 12% operating margin target for 2020.

Now let's move into a discussion of our private label credit card. While the majority of you, who have covered retail for a long time, clearly understands how private label credit cards work and specifically how our private label credit card strategy fits into our larger digital transformation strategy, there are still some who are not clear on how our program works, the financial benefits to our brand, our results since launch and the long runway still associated with this initiative. So we thought it'd be a good idea to take some time this morning to educate everyone on this very important strategic initiative.

To provide some history, the current management team inherited a program that was significantly lagging the industry with respect to credit card penetration, and we had an outsized opportunity to catch up by developing and implementing a robust omnichannel loyalty strategy to increase our private label credit card penetration. Our private label credit card customers are our most engaged customers, and we saw major opportunity on both the top and bottom line by implementing a more robust loyalty program with particular emphasis on increasing our private label credit card customer base.

In addition, we clearly understood that we have a unique customer base with respect to credit and that our ability to develop a strategic road map that's focused on the advantages of that unique credit profile would also benefit our top and bottom line. The first step was the decision to change



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our private label credit card provider, which we made in the second half of 2015. Together with our new provider, we developed a two-pronged approach for our loyalty relaunch. First, we developed a new tender-neutral loyalty program called MPR, where we simplified the messaging and the value proposition. We did this in conjunction with the relaunch of our private label credit card, where we provided additional benefits to our private label credit card holders who are our most engaged customers, over and above the value proposition we provide to our non-private label credit card MPR loyalty members.

With respect to our private label credit card launch, we partnered with our provider to provide training for all our stores' associates and our store management prior to launch and worked with our marketing team to ensure that the new value proposition was clearly called out in our in-store and our online marketing. We launched our private label credit card and loyalty program in October of 2016, and our results to date have been outstanding. We have increased our private label credit card penetration of the U.S. sales from 13% prelaunch to 21%, ending full year 2017 with significant upside still to come. Industry average is around 25% penetration but our provider believes that based on our unique customer base, our compelling product offering, our competitive positioning, the strength of our program and our internal laser-like focus on this initiative, that, together, we should be targeting a 30% penetration by the end of full year 2020.

Now in an effort to clear up any confusion that still may linger regarding our program, let me share with you some of the questions and challenges we have received regarding the success of our program and our responses. For example, we've heard the challenge, "Your PLCC business drove your outsized comp in Q4." Our response is, of course, the private label credit card business contributed to our comp in Q4. The relaunch of our loyalty and private label credit card program is an important component of our strategy to drive comp. In the U.S., we comped positive 8.2% in Q4 on top of the positive 7.6% comp in Q4 of 2016. And while we were up against the program for the full quarter from last year, we substantially increased our private label credit card penetration of U.S. sales to 21% from 17% in Q4 of 2016. In Canada, where we don't have a private label credit card program, we generated a positive 8.4% comp.

We've heard the challenge, "You are just signing people up to get the short-term benefit so a large percentage of your private label credit card customers are just one and done." Our response to that is the churn rate of our private label credit card customer is half that of our regular customer file, and the lifetime value of our most engaged private label credit card customers is more than 15x our infrequent non-loyalty customers. So continuing to add to our private label customer base is clearly a top, long-term priority for us.

We've heard the challenge, "These are all new customers and the success of the program cannot be sustained." Our response to that is over 1/3 of our private label credit card enrollment in 2017 came from existing customers so they're clearly seeing the benefits of the card. And year-to-date 2018, the metric is even more impressive as over half of our new private label credit card accounts are from existing customers. In general, there are many people with other sources of credit that still sign up for credit cards they don't need. That is not the case for many of our customers, where the ability to obtain an additional source of credit for their kid's clothing provides them with additional household purchasing power. Our strong loyalty and private label credit card program, coupled with our compelling product offerings, create one of the best value propositions in the kids space. These factors, coupled with our core millennial customer, who is more likely to take advantage of our loyalty program than an older customer, make our private label credit card program a standout now and for the future.

Again, we are unique in our space, and we continue to leverage that advantage time and time again. That's why our private label credit card provider believes that based on our unique customer profile and our compelling product offering, that we can achieve a 30% penetration by the end of full year 2020. To that end, applications continue to grow and approval rates remain high and current private label credit card holders remain in the program for extended period, creating significant lifetime value versus non-private label credit card members. And for Q1, even though our brick-and-mortar business was negatively impacted by the weather, we were still able to grow our private label credit card penetration by 400 basis points as compared to last year, and what is more impressive is that our private label credit card e-comm penetration grew by 790 basis points in Q1 compared to last year.

We've heard the challenge, "An outside percentage of your profit in 2017 came from your private label credit card through higher royalties and the avoidance of interchange fees." Our response to that is, as you would expect, profits from our private label credit card program have had and will continue to have a positive impact on our operating profit growth, not only through higher royalties and the avoidance of interchange fees, but also by driving sales and gross margin. Our private label credit card program is only one of many contributing factors to our profit growth. We have also benefited from: compelling product that has driven positive comp growth over the past 4 years, our inventory management initiatives,



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our fleet optimization program and growth in alternate channels of distribution. All of these initiatives have enabled us to continue to invest in strategic initiatives that will drive future results.

So with respect to our private label credit card program, we think that if you take the time to understand the strategy behind it, its impact to date and its future potential, one will come to realize that this is not some short-term play to drive results. This is a well-thought-out, strategic, long-term top and bottom line opportunity for our brand that is a critical strategic piece of our personalization strategy. Simply put, our private label credit card strategy is just one more example of us internally identifying a meaningful self-help opportunity based on our unique positioning, putting a comprehensive strategy behind it, executing it flawlessly and delivering outsized results versus our peer set.

In closing, we are focused on continuing to deliver for our shareholders. While we cannot control the weather, we do have total control over how we execute our strategic initiatives, and we intend to continue to execute at a very high level.

Thank you, and now I'll turn it over to Mike.

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**Michael Scarpa** - *The Children's Place, Inc. - COO and EVP*

Thank you, Jane, and good morning, everyone. First, I want to provide you with a brief update on our China partnership. Everything is on track, and we are expecting to open our first 5 stores in the super Tier 1 cities of Shanghai, Beijing and Shenzhen, along with our new e-commerce site with Tmall in the second half of 2018. This partnership with Semir is a game changer for our international business as it unites 2 of the world's largest children's apparel retailers and provides us with an opportunity to enter the China market in a way that would not otherwise be possible with any other partner. We anticipate that our partnership will open approximately 300 points of distribution, generating between \$125 million and \$150 million in retail sales in year 5.

Moving to wholesale. Our business with Amazon continues to progress. We will be launching a brand store on their site in the second quarter, which will provide a brand experience that showcases our offerings. We will also be participating in the launch of Amazon's Prime Wardrobe, which provides Prime members the ability to try on the product before they buy.

Moving on to our fleet optimization strategy and its impact on our 12% operating margin target. First, let's start with the current contribution of sales from our brick-and-mortar stores versus our digital channels, and then let's move into an analysis of what that mix is projected to look like at the end of 2020 and its impact on our P&L. We are often described as a mall-based retailer, but actually, only 40% of our sales currently come from malls. So 60% or the majority of our current sales are not mall-based with 23% of our sales being generated by our digital channel. Key elements of our fleet optimization strategy have been: one, transfer rates in excess of 20%; two, our ability to successfully negotiate rent reductions for a significant percentage of our expiring leases; and three, lease flexibility with the majority of the lease renewals being 1 to 2-year deals, which has resulted in a significant reduction in our average lease term to 2.5 years. We now have over 1,000 lease events occurring over the next 3 years.

Now let's take a look at what our mix of mall-based brick-and-mortar stores and digital channels is projected to look like at the end of 2020 and the corresponding operating margin contribution from our fleet optimization strategy. By the end of 2020, our digital business is projected to be larger than our brick-and-mortar mall-based business. Factoring in our current fleet optimization plans, which calls for 300 store closures by the end of 2020, our digital business will represent 35% of our sales. We expect our mall-based brick-and-mortar stores will represent only approximately 30% of our total sales, resulting in approximately 70% of our sales in non-mall channels in fiscal 2020.

With respect to operating margin contribution from our fleet optimization strategy, our target is 200 basis points. Taking into account transfer rates in excess of 20% as well as rent concessions on lease renewals, we have already captured 100 basis points of the 200-basis-point target with the 181 store closures we have completed. Anurup will provide more color on this in his prepared remarks. But with respect to the impact that our fleet optimization program has on comp sales, the remaining 119 store scheduled to be closed ran in negative low single-digit comp last year, making their closures the driver in continuing to generate positive low single-digit brick-and-mortar comps.



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And finally, we will use 2018 to gauge, based on the results of our accelerated digital transformation, whether we believe that additional store closures are appropriate. And if so, these additional closures would drive further efficiencies in our corporate structure by driving our brick-and-mortar base percentage of business even lower.

Now I will turn it over to Anurup.

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**Anurup Pruthi - The Children's Place, Inc. - CFO & Senior VP**

Thank you, Mike. Good morning, everyone. In the first quarter, we generated adjusted EPS of \$1.87 compared to \$1.95 last year. This compares to our guidance of \$2.12 to \$2.22. Our first quarter results were significantly impacted by the challenging weather, which resulted in lower-than-anticipated traffic throughout the quarter.

Details for the first quarter are as follows: net sales decreased 0.1% to \$436 million, comparable retail sales decreased 1.8% compared to a positive 6.1% comp in the first quarter of 2017, U.S. comp sales decreased 1.4%, Canada comp sales decreased 7.1%. As a result of the negative impact of the weather, store traffic and store transactions were down mid-single digits while AUR, ADS, UPT and conversion were flat.

Adjusted gross margin deleveraged 220 basis points to 37% of sales. The lower traffic in the quarter pressured gross margins as we lowered AURs to clear merchandise, allowing us to exit the quarter with inventory on plan. This was heightened in the outlet channel, where we experienced a disproportionately negative impact on gross margin. The negative comp also resulted in deleveraging of fixed expenses.

Also impacting gross margin rate in the quarter was the increase in penetration in our digital business to 26% of total net sales from 23% last year. Our digital business operates at a lower gross margin rate due to higher fulfillment cost but is accretive to operating margin. Gross margin rate was positively impacted by the reclassification of certain items due to the new revenue recognition rules.

Adjusted SG&A deleveraged 270 basis points to 27.2% due to a \$12 million incremental investment in our transformation initiatives and a \$4 million increase, driven by the reclassification of certain items due to the new revenue recognition rules, partially offset by lower incentive compensation and expenses. Depreciation was \$17.4 million for the quarter. Adjusted operating income was \$25.4 million compared to \$48.4 million last year, deleveraging 530 basis points to 5.8% of net sales.

Our adjusted tax rate was negative 32.4% for the quarter versus positive 25.7% last year, primarily due to the impact of the accounting rules related to the income tax impact on share-based compensation and the impact of a lower corporate tax rate. The income tax impact on share-based compensation contributed \$0.80 to adjusted EPS in the first quarter compared to \$0.19 in the first quarter of 2017 due to the timing of share vesting.

Moving on to the balance sheet. Our cash and short-term investments at the end of the quarter were \$90 million compared to \$231 million last year, reflecting the impact of the \$175 million in cash repatriated in the first quarter, which was utilized to fund the accelerated share repurchase program and working capital. We ended the quarter with \$47 million outstanding on our revolver compared to \$27 million last year.

Inventory was up 30% at the end of the quarter, in line with guidance. The 53rd week in 2017 resulted in a calendar shift in 2018, whereby Q1 ended on May 5 compared to April 29 in Q1 2017. The majority of our back-to-school in-transits and our incremental investment in basics were included in our Q1 inventory compared to 2017 when the majority of our back-to-school receipts were included in Q2. We expect this calendar shift and the additional investment in basics to impact Q2 as well with Q2 inventories projected to be up approximately 20% compared to Q2 2017. We expect inventory increases in the second half of 2018 to be in line with sales.

Cash flow from operating activities was negative \$13 million in the first quarter compared to \$29 million in 2017, driven by the timing of inventory purchases and additional rent payment in the quarter, resulting from the calendar shift and lower operating income. We repurchased \$162 million in stock in the first quarter. This includes the repurchase of shares related to our \$125 million accelerated share repurchase program and shares surrendered to cover tax withholdings associated with divesting of equity awards. This equates to over 1 million shares repurchased in the quarter, inclusive of 757,000 shares received to date and retired upfront through the ASR. We will receive and retire the balance of the shares when the program is completed in the second quarter. We also made dividend payments of \$8 million in Q1.



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Before we move on to guidance, we want to reaffirm our fiscal 2020 financial targets of a 12% adjusted operating margin and a \$12 in adjusted EPS that we outlined on our fourth quarter call. We are targeting adjusted operating margin in the range of 8.5% to 8.7% in 2018, a range of 10% to 10.5% in 2019 and 12% for fiscal 2020. We are confident that the strategy that we discussed with you on the fourth quarter call will enable us to achieve these targets.

We expect total net sales to be approximately \$2.1 billion by 2020, based on a 3.5% to 4.5% comp sales growth in 2018 and mid-single-digit comp sales growth in 2019 and 2020, in addition to growth in our international and wholesale businesses. This growth will be primarily driven by our digital business, which we expect to grow at a compound annual growth rate in the low 20% range, increasing our digital penetration to approximately 35% of our total net sales by 2020. Our digital business is unique because it is accretive to operating margin, primarily due to our high basket size and low return rates.

Let's analyze the mid-single-digit comp increase we are now projecting in 2019 and '20. Our digital compound annual growth rate has been over 20% for the last 2 years, which we have achieved even without our current digital leadership and the significant new capabilities, which we are accelerating. We have also achieved positive low single-digit comps in our brick-and-mortar channel during the same time period. If you assume we continue to generate a 20% digital CAGR and we continue to generate low single-digit positive comps in our brick-and-mortar channels, we are comfortable with the mid-single digit comp embedded within our guidance. And as Mike said in his prepared remarks, the remaining 119 stores we plan to close by the end of 2020 have been running low, negative single-digit comps, giving us further confidence in our ability to consistently generate positive low single-digit brick-and-mortar comps. Also, with our average lease life of 2.5 years and more than 1,000 lease events through 2020, we have the flexibility to close additional doors as business dictates and further drive productivity.

As we previously discussed, during the 2018 to 2020 period, we expect to invest approximately \$50 million incremental in nonrecurring SG&A or less than 1% of total sales over this 3-year period, consisting of \$30 million in 2018, \$15 million in 2019 and the remaining \$5 million in 2020. This SG&A investment is nonrecurring. The \$30 million investment in 2018 will step down to \$15 million in 2019 and then step down further to \$5 million in 2020. As a result, we expect our SG&A dollar spend at the end of 2020 to be similar to our 2017 SG&A dollar spend as we will benefit from the impact of 119 additional store closures and further efficiencies in our corporate structure. This comparison excludes the impact of the reclassification of approximately \$17 million into SG&A related to the new rules on revenue recognition. We expect CapEx to be approximately \$250 million over this 3-year period with the majority of this attributed to our transformation initiatives.

The capital and SG&A investments are focused in 4 key areas: digital and omnichannel capabilities; supply chain and inventory management enhancements, including the requirement of our distribution and logistics network that will support these digital capabilities; our connected in-store experience to deliver customer personalization; and growing our partnership with Semir in China, announced in March, along with the continued growth of our wholesale business.

Based on our continued strong cash flow generation and consistent shareholder return program, further aided by the ability to repatriate excess cash with the new tax legislation, our projections include \$0.5 billion in share repurchases over the next 3 years.

Now let me take you through detailed full year 2018 and Q2 guidance. Full year 2018 guidance. We are reaffirming our full year guidance for fiscal 2018 for adjusted EPS in the range of \$7.95 to \$8.20. We now expect adjusted operating margin to be in the range of 8.5% to 8.7%, reflecting lower adjusted operating income compared to our previous outlook. We expect the shortfall to be offset by a lower tax rate.

We now expect total net sales for the year to be in the range of \$1.92 billion to \$1.935 billion with comp sales growth of 3.5% to 4.5% compared to fiscal 2017. We project digital penetration to grow from 22.7% to approximately 26% of net sales. The total revenue guidance includes the impact of the new revenue recognition rules. Due to this new accounting standards, total revenues, gross margin and SG&A will all increase by approximately \$17 million in fiscal 2018. The reclassification of certain items due to the new revenue recognition rules has no impact on adjusted EPS and comp sales.

We now expect our adjusted tax rate to be approximately 16% to 17% for the year as compared to 20% in 2017 as a result of the positive impact of the new tax legislation, the impact of the excess stock base compensation deduction and ongoing tax-planning initiatives. The new tax rate



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represents our current best estimates and will be subject to change as we evaluate the many aspects of the new tax law in future regulatory updates. We expect weighted average shares for 2018 to be approximately 17 million shares.

Let me discuss the key components of our EPS guidance for 2018. The operating results associated with our planned 3.5% to 4.5% comp, excluding the impact of our accelerated investments, are now expected to generate \$0.91 to \$1.16 in incremental EPS. We now expect a \$0.51 EPS benefit from the shares we expect to repurchase associated with the accelerated share repurchase program and other share repurchases. We expect that a lower tax rate will now generate an incremental \$0.33 in EPS due to the new tax legislation and ongoing tax planning. And finally, we now expect EPS, resulting from the income tax impact on share-based compensation, to be \$0.04 lower compared to fiscal 2017. This adds up to a range of \$9.62 to \$9.87 in EPS in fiscal 2018, an incremental \$1.71 to \$1.96 over last year. This will be partially offset by the negative \$1.67 impact of the acceleration of our investments and higher depreciation, resulting in the EPS guidance of \$7.95 to \$8.20 for fiscal 2018.

Let me now discuss some additional key metrics. Our CapEx is expected to be approximately \$75 million to \$85 million for the year. We expect to close approximately 40 to 45 stores in 2018. By the end of fiscal 2018, we expect to have 210 to 215 store closures completed of our target of 300 store closures by 2020. As our digital penetration grows, the flexibility provided by our average lease term of less than 3 years enables us to continue to evaluate the opportunity for additional store closures.

Second quarter guidance. For Q2, we are guiding to EPS in the range of \$0.51 to \$0.61 compared to adjusted EPS of \$0.86 in Q2 2017. This includes a projected \$0.03 benefit, due to the income tax impact of share-based compensation, compared to a \$0.68 tax benefit in Q2 2018, due to the timing of share vesting. Total sales for the quarter are projected to be \$423 million to \$428 million, inclusive of an expected \$20 million positive impact resulting from the calendar shift. Our comp trend reflects pent-up demand for our products, resulting from the challenging weather experienced in the first quarter. Comparable retail sales are projected to increase high-single digits in the quarter. We project operating margin to be in the range of 2.8% to 3.4% in the second quarter compared to 1.4% in 2017.

Let me discuss the key components of our EPS guidance for Q2 2018. The operating results associated with our planned high single-digit comp, excluding the impact of our accelerated investments and higher depreciation, are expected to generate \$0.81 to \$0.91 in incremental EPS. We expect EPS, resulting from the income tax impact on share-based compensation, to be \$0.65 lower compared to Q2 fiscal 2017 due to the timing of share vest. We expect a \$0.03 benefit from a lower tax rate associated with the new tax legislation. We expect a \$0.04 EPS benefit from the shares we expect to repurchase associated with the accelerated share repurchase program and other share repurchases. This adds up to a range of \$1.09 to \$1.19 in EPS in Q2 2018, an incremental \$0.23 to \$0.33 over last year. This will be partially offset by the negative \$0.58 impact in Q2 resulting from the \$12 million incremental SG&A investments in our transformation initiatives and \$3 million in higher depreciation compared to last year, resulting in EPS guidance of \$0.51 to \$0.61 for Q2 2018.

At this point, we'll open the call to your questions.

## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Your first question comes from the line of Susan Anderson with B. Riley FBR.

**Susan Kay Anderson** - B. Riley FBR, Inc., Research Division - Analyst

Thanks for all the details around the comp shifts. It was very helpful. I was wondering if you can touch on the puts and takes on the gross margin in the quarter? I guess how much of the decline was markdowns and then the shift to online? And then also, maybe if you could talk about just the impact that you saw from the rollout of the free shipping initiative.



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**Anurup Pruthi** - *The Children's Place, Inc. - CFO & Senior VP*

So Susan, it's Anurup. As far as free shipping goes, as we've indicated on prior calls, a lot of that is baked into our P&L. We've obviously now finished executing it completely. So I would characterize that as relatively minor in the quarter. The bigger impact was obviously ensuring that we had clean inventory coming into Q2 and adjusting our seasonal inventory and adjusting our AURs accordingly, given the tough weather, to be in good shape coming into Q2 and reacting -- and doing the right thing in terms of managing our inventory. So that probably had the biggest impact from an overall margin perspective. As you noted, digital grew in penetration, even in a tough quarter, from -- to 26% of our total net sales versus 23% last year. That had a relatively less impact, but obviously it operates at a lower gross margin rate. So I think the biggest impact was probably around the merchandise margin and making sure that our inventory was well positioned getting into Q2.

**Susan Kay Anderson** - *B. Riley FBR, Inc., Research Division - Analyst*

Great, that's helpful. And it's nice to see the significant pickup in second quarter. And I guess just to follow up on that. For second quarter, it looks like, just based on the guidance, you guys aren't expecting the promotions or markdowns to continue at the rate that you saw in the first quarter.

**Anurup Pruthi** - *The Children's Place, Inc. - CFO & Senior VP*

That's right, Susan. We took -- we made the adjustments we had to make in Q1. And besides, we've noted on our prepared remarks, as the weather has normalized, we're certainly seeing a very strong aggressive comp and quarter-to-date trends. So that would be the answer.

**Operator**

Your next question comes from the line of Adrienne Yih of Wolfe Research.

**Adrienne Eugenia Yih-Tennant** - *Wolfe Research, LLC - MD and Senior Analyst Retailing, Department Stores & Specialty Softlines*

Jane, I wanted to ask you. Kind of in your experience with these transitory weather issues, how much -- like what percentage do you get back? And what is that visibility? Is it sort of that first 3 weeks of that first month is when you actually recapture those sales? And then for Mike, if you would. On the 2020 kind of breakdown, can you also give us some color on the implication for wholesale and international mix as well as the retail mix? And then Anurup, just really quickly. Cash from ops was down \$12 million. I'm assuming last year, inventory was a source of funds. It looks like this year, I'm guessing, it used the funds. And then should we expect in the third quarter sales that calendar shift, that \$20 million, to be obviously taken out of the third quarter? And should we expect op margins to be down year-over-year because of that shift?

**Jane T. Elfers** - *The Children's Place, Inc. - CEO, President & Director*

Sure. Well, Adrienne, just to take the first part of it. I've been with The Children's Place for 33 quarters now. And I pretty much thought I'd seen it all, but I certainly have never experienced the weather quarter that even approaches what we just went through in Q1. When you think about it, it was until the last week, the 13th week of the quarter, that we saw weather normalized across the entire country. We're not just talking about having a bad snow pattern in the Northeast for a few weeks. We're talking about 12 weeks of weather impact, mostly all of our major markets one way or the other, whether it was snowstorms or the wettest spring on record or the coldest spring on record and also when you look at -- like the key part of the quarter, when you think about March, the 2 weeks leading up to Easter, which are our biggest weeks, and then the 2 weeks post-Easter, where we have our big place cash redeem event, those 4 weeks were severely impacted by the weather and there was just no way we were ever going to be able to make up for the lack of traffic, like during those 4 weeks. When you think about the place cash redeem event, a lot of that redeem event is based on the traffic that's driven pre the event and, certainly, people getting the coupons that they're able to redeem post. So we didn't only get hurt in the big pre-Easter weeks. We got hurt in a couple post-Easter week. I think the good news is that it's clearly not a structural issue. It's a temporary issue we saw in week 13. The business opened up immediately with almost a 50-point swing in comp and we've seen the business, into quarter-to-date, continue with the 24% comp that we mentioned. Traffic is way up as well, and we believe that the strong Q2 will



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be driven by continued pent-up demand in the months of May and June for our summer products. We are in good shape as far as inventory is concerned. So we think that we will get a lot of it back in Q2 and be ready when we enter early July to start to ramp up for back to school.

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**Operator**

Your next question comes from the line of Anna Andreeva of Oppenheimer.

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**Anna A. Andreeva** - *Oppenheimer & Co. Inc., Research Division - Executive Director and Senior Analyst*

A couple of questions. Just a follow-up on the quarter-to-date comps, up 24%. Just curious, what kind of improvements are you guys seeing in the more weather-challenged regions, whether it's Northeast and the Midwest? Should we think the outlet in Canada both return to positive territory? And then secondly, to Anurup, on your annual guide, you're raising the comp for the year but lowering the EBIT margin, can you maybe talk about what's driving that margin reduction?

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**Jane T. Elfers** - *The Children's Place, Inc. - CEO, President & Director*

Sure. I'll take the first part of it. As far as the comps are concerned, we've seen them across-the-board stabilize. So we're seeing strongly positive comps in Canada, strongly positive comps in the outlet channel and strongly positive comps in our U.S. play stores as well. From a state-by-state view, when you look at Q1, we had close to 30% variances from the best state in Q1 to the worst state. And when you look now, there's much more consistency across the states. I don't think there's any states that we have that is negative comp in quarter-to-date. So we pretty much rebounded across-the-board.

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**Anurup Pruthi** - *The Children's Place, Inc. - CFO & Senior VP*

As far as our second half goes, as far as your question about op inc for the year, I'd start off by saying our second half outlook, in terms of sales and operating income, is basically the same as it was in the prior -- in our prior guidance. As we've indicated in our prior remarks, we've obviously had a tough Q1, heavily affected by the weather. And in Q2, we expect to make up most of that shortfall based upon a guide of a high single-digit comp. And for the full year, we are retaining our guidance of -- at the high end of \$8.20, albeit with a small operating income shortfall offset by our tax-planning initiatives.

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**Operator**

Your next question comes from the line of Janet Kloppenburg of JJK Research.

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**Janet Kloppenburg**

I just had a couple of questions. Jane, you touched on it, but in weather markets, where it was seasonal, I assume you met your plan in the first quarter. If you could just -- or if you could let us know what happened in those markets, that would be important for us to understand. Also, now with the comp up 24%, I'm wondering if AUR trends are back to normal or if you're feeling, because the season is shortened, that perhaps pricing is a little bit sharper than you had anticipated it to be. And just lastly, on the inventory content, what the level of clearance is this year versus last and how you'll manage that through the quarter.

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**Jane T. Elfers** - *The Children's Place, Inc. - CEO, President & Director*

Sure. As far as markets are concerned, we pretty much -- it was pretty tough across-the-board. I would say the most pressure by far was on the Northeast to the Mid-Atlantic all the way through the Midwest. The Southeast was hit with a lot of rain and colder weather, particularly in the

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Carolinas and Atlanta, and Texas, certainly had its share of bad weather as well. By far the best performer was the West, California up into the Northwest, and those are really the stores that I referred to before that would have been in the positive comping range, the ones where I said there was like close to a 30-point swing from best to worst. The West in California and the Northwest would be included in the best of those stores. From a clearance point of view, we spent a big focus in Q1, making sure that our inventories were clean coming into the quarter. The way that we need to move from the pent-up demand from Q1 to Q2 to ensure that we need to do what we get done this quarter is to -- it was very important to us to make sure the inventories were clean. So from a clearance point of view, I would tell you that we're very clean, and the good news part of that is to answer your AUR question. AUR is up, conversion's up, UPTs are up, ADS is up. All our metrics are up, but what is interesting is if you look at our business and you look at our key categories out in the stores right now, we have higher AURs on some of our key seasonal products right now than we did in the March and April period, based on the pent-up demand. So we have that flexibility there to ensure that we start to get back some of this margin that we lost in Q1.

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**Operator**

Your next question comes from the line of Dana Telsey of Telsey Advisory Group.

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**Dana Lauren Telsey - Telsey Advisory Group LLC - CEO & Chief Risk Officer**

As you think about the closures that we are -- that have been announced from Toys "R" Us, obviously, we know the benefit that you get from Gymboree, what do you see for Toys "R" Us? And how is the status progressing with Gymboree?

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**Jane T. Elfers - The Children's Place, Inc. - CEO, President & Director**

Sure. As far as Gymboree is concerned, we had called out on several calls that we see approximately \$150,000 annual transfer volume from the stores that are closed. So we don't see anything that would take us off that number, even in a difficult quarter. The stores, where they have closed and we're co-located with them, performed better, to the tune of almost 2 percentage points better. So we feel good that those projections are intact. As far as Babies "R" Us, Babies "R" Us, we have -- at those 435 Babies "R" Us freestanding stores, and we're only co-located directly with about 9 of them. But we are within about 5 miles of 334, 77% of them. We are not big in the baby businesses. We've said it's about 6% of our total. With the launch of bundles and the multipacks, that's been a pretty successful initiative for us, quarter-to-date. We're seeing strong acceptance by the customer online in the select 75 stores that we're in, in brick-and-mortar. And then certainly as we called out from an international and wholesale partners, they're very hungry for the bundles products as multipacks are something they've been asking for. So I think there's some potential for us to get a little bit of the baby business, but I would say Gymboree is the much bigger play for us right now.

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**Operator**

Your next question comes from the line of Kelly Crago of Buckingham.

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**Kelly Lauren Crago - The Buckingham Research Group Incorporated - Associate**

My question is around the full year comp guidance range. Just doing the math, it seems like you're raising back half comps to the mid-single-digit range, whereas before, it was kind of 2.5% to 3%. What has changed there in your thinking? And where do you expect the upside relative to the previous guidance come from?



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**Anurup Pruthi** - *The Children's Place, Inc. - CFO & Senior VP*

Kelly, it's Anurup. As I said a few minutes ago, the second half, in terms of our sales outlook and our op inc outlook, is essentially the same versus what it was in the prior call. Obviously, we've talked about Q2 and guiding up to a high single-digit comp based upon weather reflection and pent-up demand changes and the business trend in a positive manner. So that's really what the change is all about.

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**Operator**

Your next question comes from the line of Pamela Quintiliano of SunTrust.

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**Pamela Nagler Quintiliano** - *SunTrust Robinson Humphrey, Inc., Research Division - MD*

So there's been a lot of broad commentary out there regarding improved macro factors and the consumer feeling better. Do you think now that your customer is back with a more seasonal weather that you're benefiting from the macro environment?

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**Jane T. Elfers** - *The Children's Place, Inc. - CEO, President & Director*

Yes. I mean, I think when you think about our business for the last 4 years, we've had positive comps for the last 4 years, we've had sequential improvement in traffic for the last 7 or 8 quarters, I think this quarter was a bit of an anomaly with traffic kind of falling off a cliff based on all the weather talk we've had this morning. I think the consumer confidence being the highest it's been in a long time, unemployment being the lowest it's been in a long time and people starting to talk about how (inaudible) formations, there are a lot of positives going on. And I think, certainly, from what we spoke about in the last call when we said our millennial customers, 25 and older, is starting to -- birth rates are starting to tick up again. I think all those factors taken into account are certainly that tailwind for us as a brand.

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**Operator**

Your next question comes from the line of Jim Chartier of Monness, Crespi, Hardt.

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**James Andrew Chartier** - *Monness, Crespi, Hardt & Co., Inc., Research Division - Security Analyst*

I just wanted to follow up on an earlier question. So by my math, the high single-digit comp in second quarter gets you to about 2.7% to 3% comp for the first half, and again, you're raising your full year comp guidance by 100 basis points. So just trying to understand the rationale for raising, given the first quarter miss, and what's changed either in second quarter or this second half of the year.

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**Anurup Pruthi** - *The Children's Place, Inc. - CFO & Senior VP*

Jim, the -- as we talked about with the change in getting out of the awful weather in Q1, as we got into more seasonable better patterns, we've certainly seen a strong uptake and an aggressive comp, given the pent-up demand. This would still put our first half comp in the low single-digit range. So from a first half perspective, we -- a low single-digit comp Q2 based upon pent-up demand, and that gets us -- and the second half of the year is essentially intact with what we had talked about or what we had guided to previously.

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**Operator**

Your final question comes from the line of Marni Shapiro of The Retail Tracker.



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**Marni Shapiro** - *The Retail Tracker - Co-Founder*

I just wanted to follow up on what Janet said because you talked a little bit about you coming into the quarter very clean in the second quarter and you have some flexibility. I've noticed your pricing. I mean, you're running denim prices higher today than you were pretty much anytime since I can remember, and graphic prices are higher. How much flexibility do you have within the quarter, as we sit here on May 17, to play around with that pricing, to take advantage of the pent-up demand? Or is it, at this point, it pretty much set for the second quarter?

**Jane T. Elfers** - *The Children's Place, Inc. - CEO, President & Director*

Marni, it's Jane. I think there's a lot of flexibility in pricing. There's only about 3 or 4 key categories that drive our business in Q2, when you think about May and June. Certainly, in July, it broadens out when we're really into the back to school, starting in like week 2 or 3. But for the next couple of months, those 3 or 4 critical categories has a tremendous amount of elasticity in them, depending on what the weather does. So if we continue to see positive weather like we saw in week 4 of April and the first week and half in May, we do have the flexibility there. To your point on denim, sadly enough, when you look at first quarter, the highest comp in category we had was denim, obviously, due to the fact that it was cold out, that would not normally be what our highest comping category would be, closely followed by long sleeve woven. So I think that kind of speaks to a little bit around the weather. Denim is not that important of a category for us till we get into July, and I think we're still sitting at that \$12 mark versus our normal \$7.99 or 9.99 due to our ability to have gotten a lot of volume off of that in second -- in first quarter, certainly not enough to offset the summer categories. But I think to answer the question, yes, there is flexibility.

**Operator**

Thank you for joining us today. If you have further questions, please call Bob Vill at (201) 453-6693. You may now disconnect your lines, and have a wonderful day.

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