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PLCE - Q4 2017 Childrens Place Inc Earnings Call

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OVERVIEW:

Co. reported 4Q17 net sales, inclusive of impact of 53rd week, of $570m, adjusted operating income of $57m and adjusted EPS of $2.52. Expects 2018 total net sales to be $1.905-1.925b and EPS to be $7.95-8.20. Expects 1Q18 EPS to be $2.12-2.22.

CORPORATE PARTICIPANTS

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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 Fourth Quarter 2017 Conference Call. (Operator Instructions)

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

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.

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

Thank you, Bob, and good morning, everyone. After briefly reviewing the highlights from 2017, I will spend the bulk of my time this morning outlining the next phase of our strategic growth plan. Anurup will then cover Q4 and full year 2017 financials, detail the accelerated SG&A and CapEx investments associated with our growth strategy and provide forward guidance.

Following our prepared remarks, Mike, Anurup and I will be available to answer your questions. Our prepared remarks are extensive, so if we do not get to all of your questions, we'll be happy to regroup with you after the call.

Starting with 2017. Simply put, 2017 was a stellar year for The Children's Place, and we are extremely proud of our consistent track record of rewarding our shareholders. I want to thank all of our associates for their efforts this past year.

We delivered adjusted diluted EPS of $7.91 versus $5.43 in full year 2016, a 46% increase. Comparable retail sales increased 5.8% versus 2016. We comped positive in all channels and all geographies. U.S. comp sales increased 6.5%. Canada comp sales increased 0.6%. And all of our key selling metrics, AUR, ADS, transaction, UPT and conversion, were positive for the year. And our traffic has improved for 7 consecutive quarters, with Q4 traffic ending down only slightly negative.

We've made great progress on our strategic initiatives over the past few years, and we're now ready to move into the next phase of our strategic growth plan. We have delivered consistent industry-leading results for several years, with 2017 being our fourth consecutive year of positive comps. 4 years of positive comps is quite an accomplishment in this environment and certainly makes us an outlier in the children space. A large part of our success comes from our ability to consistently grow market share through our unique and compelling product offering.

In addition, the successful execution of our long-standing strategic growth plans, which relies predominantly on self-help initiatives, has enabled us to consistently deliver best-in-class returns for our shareholders.

We are uniquely positioned to grow market share by accelerating our investments in transformation capabilities. Digital transformation is our single biggest opportunity for growth, and we will be making significant SG&A and CapEx investments in transformative personalization capabilities, which will position us to continue to outperform in the long term. We are focusing our investments in 4 key areas: digital capabilities, supply chain optimization, our four-wall customer experience and our new China partnership that we announced this morning.

In addition, we expect to return significant capital to our shareholders through the 3-pronged approach that we also announced this morning: first, a $125 million accelerated share repurchase program; second, a new $250 million share authorization; and third, a 25% increase in our dividend. Based upon the significant investments we are making to accelerate our digital transformation, our unique and consistently compelling product offering, our proven ability to grow market share, our strong operating fundamentals, our best-in-class management team, and, most importantly, our long and consistent track record of delivering results for our shareholders, we now expect to achieve a 12% operating margin by the end of 2020, with an adjusted EPS of $12.

So how are we going to get there? The core 4 pillars of our strategic growth plan remain intact: product, business transformation through technology, alternate channels of distribution and fleet optimization. We expect to continue to drive results in 2018 and beyond through many of the same self-help initiatives that we've been focused on for several years. However, today, we are outlining several new self-help initiatives that fall under these same core 4 pillars and represent the next phase of our evolution.

Let's review each of the 4 pillars of our strategic growth plans and the new strategic initiatives within each one. First, product. In 2017, the addressable U.S. kids market was approximately $26 billion and many times that globally. Our 2017 U.S. market share increased to 5.8% versus 5.6% in 2016. We have consistently demonstrated our ability to grow share in a hypercompetitive space that has experienced significant headwinds in the past several years and has seen many of our competitors struggle on the top line, file for bankruptcy or exit the kids space entirely.

Our dominance in the kids space is largely due to our product offering. Product is and has always been our #1 priority. We've had 4 years of positive comps, and we believe our industry-leading results come from having the most compelling product offering in the kids space. However, we must identify and develop additional product opportunities to maintain our leadership position and continue to gain market share.

So let's cover some of our key incremental product opportunities for 2018. First, the basic opportunity. As we detailed for you last year, by utilizing our new tools, we identified a large opportunity within basics. We added an additional 3 million units of basics for back-to-school '17 with great success. Immediately following back-to-school 2017 and then again postholiday 2017, we repeated similar analysis which identified that significant opportunity within basics still existed.

Starting with back-to-school '18. We have secured approximately 2.5 million additional basic units, which will positively impact our basics business starting with the back-to-school '18 selling period and continuing into holiday '18. This basic opportunity represents an incremental $15 million sales opportunity in 2018.

Second, the expanded size opportunity. Some of you who have been following our stock for a long time may remember that when I first arrived at the company, we identified a major opportunity based on demographics to focus on engaging and retaining older kids in our brand longer. Our designs have become stale and immature in their outlook, and our penetration in the larger sizes was declining just as the population of older kids was about to increase significantly. We have been very successful in our efforts to retain older kids as we have seen the penetration of sizes 12 and 14 grow significantly over the past several years, as the outlook of the product has been modernized and updated in trend and color. We also believe that we have taken share from some of our mall-based competitors who cater to older girls.

As you may recall, last year, we detailed the opportunity associated with the addition of size 16 to our apparel assortment. We projected that the addition of size 16 in apparel to all of our brick-and-mortar stores in both girl and boy genders could generate $50 million in annual sales volume. We are thrilled to report that in just 1 year, we have already exceeded that goal. Based on the success of size 16 in apparel, we added extended sizes in shoes and accessories to our online assortments in 2017. Not surprisingly, these extended shoe and accessory sizes were a huge success online, so we are now adding extended sizes to our shoe and accessory offerings in all of our brick-and-mortar stores beginning with back-to-school '18. We believe that the addition of extended sizes to our shoe and accessory business could be worth approximately $15 million over time, so that brings the combination of extended larger sizes in apparel and accessories to an almost $100 million sales opportunity.

Our market share gain through successful size extensions, both online and in store, speaks to our unique ability through our compelling product offering to successfully reach an incrementally older customer. We have a deep understanding of our older customer, and we are consistently optimizing our assortments in apparel and accessories to meet their needs. We have been very strategic with the addition of extended sizes. We made sure that there was a strong desire on the part of our consumer for these extended sizes by first testing them online prior to rolling them out to our physical stores.

Third, the baby opportunity. Just as we identified the demographic opportunity in big kids several years ago, we have been focused on current positive demographic shift with respect to the baby business. The experts have been predicting a rise in birth for several years but those did not materialize. However, now for the first time since the recession, millennial birth for moms 25 and over have started to increase. As you know, our target customer is a millennial mom, and with the rise in millennial birth rates projected to continue for the foreseeable future, we are taking advantage of this positive change in birth rates.

When you take this encouraging demographic information, together with the fact that we already have a sizable market share opportunity in baby, it is our most underdeveloped category, making up less than 6% of our business, this presents a significant long-term opportunity for our brand. In addition, one of our mall-based competitors dropped the baby category from their assortments entirely due to poor sales and another has never carried baby sizes. And in the off-mall space, Toys "R" Us, Babies "R" Us just announced the closure of their entire U.S. fleet of approximately 750 stores.

So based on our market share opportunity in baby, coupled with the competitive dynamics, we are excited to announce that we have officially launched a new sub-brand, Bundles Baby Place. We launched Bundles Baby Place online and an 85 select brick-and-mortar stores back in early February. Bundles Baby Place is comprised solely of multipack essential items serving newborns and babies sizes 0 to 5T in basics, with a focus on sleepwear, and sizes 0 to 24 months in playwear. After extensive research, coupled with our own success in selling multipack essential items online and in our stores, we concluded that multipacks of baby essentials are the preferred choice for new parents as well as gift givers.

In addition to the exclusive Bundles products that we just launched, we will be rebranding all of our existing multipack baby essential products both online and in stores to the Bundles Baby Place label as of back-to-school '18. We believe that the Bundles could conservatively represent a $50 million incremental sales opportunity, with our goal being closer to $100 million over time. In addition to our own significant opportunity with bundles, our wholesale and international partners are already enthusiastically participating in the Bundles Baby Place launch.

Four, Gymboree. The Gymboree bankruptcy and the subsequent closure of 25% of their stores presents another significant market share opportunity for The Children's Place. From a competitive standpoint, we are by far the best positioned children's retailer to benefit from Gymboree's 326 store liquidation. Gymboree has closed 326 stores since they announced their store closure program, leaving them with approximately 970 stores. Of these 970 stores, there are now only approximately 275 Crazy 8 stores left versus their peak of almost 400 Crazy 8 stores just 2 years ago.

Of the 326 stores that Gymboree have closed, the Children's Place operates 188 stores in those centers. 245 of their 326 store closures or 75% were in traditional malls, and 179 of them or 73% were in A and B malls. Of these 245 Gymboree traditional mall store closures, we are in 170 or 70% of these malls. Of the 170 centers where we are co-located, 132 or 78% of these are A and B mall locations. In Q4, our stores that were co-located with Gymboree store closures outperformed the rest of the fleet. As mentioned on previous calls, past experience indicates that we generate $150,000 in sales on average in the first 12 months in our stores that are co-located in malls where Gymboree closed. Gymboree's current round of liquidations represent approximately $30 million of opportunity for The Children's Place.

Our second pillar, business transformation through technology. There are 2 key work streams embedded within business transformation through technology: inventory management and digital transformation. First, inventory management. Inventory management have been and will continue to be a very important part of our transformation. We have extensively detailed the inventory management opportunities at The Children's Place and have implemented multiple tools over the past few years, including assortment planning, inventory allocation and replenishment, size and pack optimization, store tiering and basics order management. While all of these are delivering inventory efficiencies, we are still far from optimizing and fully integrating our suite of tools and capabilities.

Importantly, as we move into the next phase of significantly more complex omni-channel use cases, our inventory management capabilities must continue to evolve. As online demand is fulfilled with store inventory and the in-store customer order is fulfilled with online inventory, the relationship between demand and supply requires constant optimization. As we learn more about this relationship and moms' purchase intent, we will get better at planning and allocating inventory across our different channels. As there is still a lot of work to do and a very long runway as it relates to sales and margin upside through advanced omni-channel capabilities, we are targeting additional investments for these initiatives in 2018.

Digital transformation. Digital transformation with the ultimate goal of one-to-one personalization is our biggest opportunity. Digital transformation is our future, and it's the key to our continuing to generate industry-leading top and bottom line growth. Digital transformation is our future and it's the key to our continuing to generate industry-leading top and bottom line growth. Digital transformation investments are direct investments in our customer and her shopping experience with our brand. As we have said many times, we have the dream customer for the digital experience: a mobile, digitally savvy millennial mom who is shopping our brand with and for our built-in current and future Gen Z customers.

Our digital investments are designed to quickly accelerate market share gains, and now is the right time for us to accelerate these investments. We have the right leadership in place and the right digital road map for success. In addition, when you consider our competitive landscape, we have an opportunity to gain market share by accelerating the implementation of sophisticated digital tools. These digital transformation efforts are key to improving customer retention, driving acquisition and increasing customer engagement with our brand. Digital transformation represents the majority of our incremental investments in 2018. We anticipate over time that our digital transformation will represent a minimum incremental opportunity of $200 million.

Now lots of companies talk about digital investments and marketing investments and branding investments in very broad terms but they don't provide a lot of detail. As is our practice, we'd like to get specific, so please bear with me. Our e-commerce sales for full year 2017 were $425 million, a 22.7% penetration. This is an industry-leading statistic on its own, but it's even more impressive when you consider our current deficit with respect to digital tools and capabilities. As you've heard me say for years, there was no ERP system and no inventory management tools when I arrived. We've come a very long way with respect to inventory management capabilities, and now it's time to turn our focus to implementing state-of-the-art digital capabilities.

The first step toward success is getting the right talent in place to successfully lead the initiative. We would not be in a position to digitally transform our company without a very experienced leader and an experienced digital team. As you know, we hired Steve Rado in August of 2017. Steve is our Chief Digital and Technology Officer. Steve brings a wealth of digital and technical expertise as well as first-hand experience in delivering personalization.

Steve has quickly assembled his leadership team by filling the digital knowledge gap with experienced digital talent from outside the organization. After getting his team in place during the third and fourth quarters of 2017, the next step was to fully develop our digital transformation road map. Our digital road map identified slightly over 100 initiatives in the digital and technological space that we intend to fully implement over the next 24 months.

So now we have the talent and the road map, but before we can begin to implement personalization at scale, we needed to start with one very important tool, a state-of-the-art customer database. In 2016, we hired a VP of CRM with deep database experience, and we made the necessary investments in fiscal 2017 to deliver our new state-of-the-art database, which went live at the end of Q4 2017.

This database provides us with a single 360-degree view of our customer. Without a single view of our customer data, we cannot deliver personalization. If we do not know what mom purchases from us, how and where she shops with us, how she prefers to interact with us, we cannot deliver personalization. In creating this single view, we integrated data from over 50 disparate systems, transactional data across channels, customer online data and added third-party data such as demographics and psychographics.

Now that we have our database, we need to be able to communicate directly with mom when and where she wants. So recently, we started to implement several new capabilities and tools, including campaign management to allow for segmentation of our customer file and SMS tech that will enable us to communicate directly with mom when and where she wants. Without sophisticated segmentation capabilities and delivery mechanisms, personalization would not be possible.

But even though we've made progress, we still have major gaps in tools, systems and process capabilities, and that's where our strategic digital road map, combined with our accelerated SG&A and capital investment will combine to quickly close these gaps. To generate the highest performance and greatest ROI, we have to do 4 things well: one, recognize and reach the right customers across all their devices; two, build profiles that are enhanced with each interaction and touch point with our brand; three, make data-informed decisions about the best message to deliver; and four, measure the impact of that message across all channels. With this approach, we will eventually be able to personalize each brand interaction.

So let's take a look at the digital runway ahead of us by reviewing some of the common tools and systems that we have not had the benefit of. Bear in mind that most of our competitors have had the benefit of these tools and strategies for a long time and we're still outperforming them. While this speaks to the strength of our product offering and the consistent execution of our strategic plan, it also speaks to the outsized market share gains possible through an accelerated digital transformation. The following lists just some of the 100-plus key initiatives that we plan to tackle on our digital road map over the next 24 months: advanced analytics; predictive analytics; effective on-site analytical tools; a single view of the customer; sophisticated campaign management tools; an advanced mobile app; a state-of-the-art search tool; AB testing capabilities; live chat; a customer preference center; mobile payment option; social log-in; SMS capabilities; integrated database acquisition, retention and engagement strategies; the ability to auto-trigger personalized email campaigns; display retargeting; sophisticated paid search strategies; an automated, integrated loyalty system; and a state-of-the-art POS system in our stores with data sales functionality and the ability to extend personalized offered to checkouts.

And here's a snapshot of some of our key digital accomplishments that we completed in Q4 2017 that are foundational for future personalization capabilities. Connected stores. WiFi has now been rolled out to all U.S. stores, and mobile POS devices have now been rolled out to all U.S. stores. BOPIS has been rolled out to the entire U.S. fleet, and we are already seeing attachment rates in the mid-20s. BOPIS will be rolled out to Canada by Q3 2018. Ship-from-store capabilities were tested in Q4, with a full rollout to U.S. stores by the end of Q2. BOSS, buy online ship to store. We are working to bring this capability live in the back half of 2018 or early 2019.

Save the Sale. Save the Sale functionality has existed at most other retailers for some time now. Save the Sale is one of our single biggest top and bottom line opportunities with respect to omni-channel capabilities. Save the Sale opens up the inventory so one pool of inventory is viewed by both the stores and digital channels. This allows us to make sure we can get mom what she needs wherever she needs. For example, when mom is in one of our stores and we are missing a size or color, we can get it from our e-commerce site or from another store and have it shipped to her store of choice or to her home. The foundation for Save the Sale is being addressed in 2018, but Save the Sale will officially launch in mid-2019 in conjunction with our new state-of-the-art POS system.

And free shipping. As at the end of 2017, we have converted all of our regular e-commerce shipment to everyday free shipping with no minimum order amount. We have been working this strategy through our P&L for several years now, and it is complete. This is a major digital competitive advantage for The Children's Place as none of the other kids brands currently offer everyday free shipping with no minimum purchase. We believe that being the only kids retailer who offers free shipping every day with no minimum purchase is clearly resonating with our millennial mom and will continue to further accelerate our digital market share gains.

Our digital road map initiatives are critical to driving sales growth and operating margin expansion by improving customer retention, increasing customer acquisition and improving customer engagement. In a recent survey, The Children's Place was the second most preferred brand for children ages 0 to 4 and the second most preferred brand for children 5 to 9 years old. The Children's Place is the second most popular children's brand in the United States among the key millennial demographic.

Additionally, The Children's Place scored as the #2 children's brand with both middle-income households and the higher-income households. This is the right time to accelerate our digital investment. We have the talent, we have the strategy, we have the resources, and most importantly, we have the perfect target customer for our digital transformation. We project that based on our accelerated digital investments, our digital penetration will grow to approximately 35% of our total business by the end of 2020.

Our third pillar, alternate channels of distribution. We see additional growth opportunities in both domestic and international wholesale channels. Let's start with international, and let's start with China. We announced a partnership this morning that fundamentally changes the trajectory of our international growth opportunity. We are absolutely thrilled to announce that we have partnered with Semir, owner of the #1 children's apparel retailer in China, Balabala. Today's announcement unites 2 of the world's largest children's apparel retailer, both with long and outstanding track records of success. This strategic partnership is a game-changer for our international business, and it's clearly a case where 1 plus 1 equals 3.

The children's apparel market is already one of the fastest-growing categories in China. It is currently estimated at $24 billion, and with China's 2-child policy firmly in place, it's forecasted to double by 2025. Semir, through their Balabala brand, currently operates and franchises over 4,400 children's apparel stores as well as having the largest children's apparel e-commerce business in China through their partnerships with third-party platforms such as Tmall, JD and VIP.com.

Over the first 5 years of this agreement, Semir will execute an omni-channel strategy, opening at least 300 Children's Place locations in Greater China and managing our e-commerce business. This partnership will generate between $125 million and $150 million in retail sales in year 5. This partnership provides an entrée for The Children's Place into the China market that would not otherwise be possible with any other partner. Semir's #1 position in children's retail in China, their strong retail and operational capabilities and their extensive knowledge of the Greater China market provides The Children's Place with instant access to prime retail locations, established relationships with a large number of franchisees and significant local sourcing and logistics capabilities. This partnership enables us to grow in China and takes us one step closer to our goal of becoming a leading global kids specialty brand.

As for the balance of international, in 2012, we began our international franchise growth. In 5 years, we have grown to 190 points of distribution in 19 countries with 7 partners. Around the world, we are recognized for fashion, outfitting and value where busy moms can quickly and easily assemble head-to-toe outfits that are affordable and always in style. We are one of the fastest-growing children's brand internationally with stores throughout Asia, Latin America and the Middle East. In 2017, we opened 49 points of distribution, including 6 openings in Indonesia in Q4 with our newest franchise partner. We expect to add 45 to 50 points of distribution in 2018.

Some wholesale highlights. We see a clear path to expand our already successful relationship with Amazon. Amazon basic replenishment has been a success, so we are now going to test fashion replenishment for back-to-school '18. And in the brick-and-mortar segment of our wholesale business, our largest partner has committed to significant new categories of business, and we'll also be adding our brand to their e-commerce assortment in 2018.

And our fourth pillar, fleet optimization. Our fleet optimization initiative will continue to drive our operating margin and our ROIC higher. Let's recap where we ended 2017 with our fleet. For full year 2017, we closed 27 stores, and we have 1,014 stores remaining at the end of full year 2017. Of the 886 stores in the U.S., 524 or 59% are in malls, 135 are in A, 282 in B, 105 in C and 2 are in D malls. The remaining 362 of our 886 U.S. stores are in outlet centers, strip centers, lifestyle centers or street locations. And I would like to point out that only 15% of our fleet is located in outlet centers.

On our Q2 call, I mentioned that research firms projected as many as 260 out of the approximately 1,060 malls in the U.S. will close within the next 5 years. We internally refer to these 260 targeted malls as dying malls, and I'll update you how our real estate portfolio was positioned at year-end with respect to these 260 malls. First, of the 260 malls that have been identified by the real estate research firm as closure candidates, we are not in 75% or 195 of them. Second, of the remaining 65 dying malls that we are located in, our average lease term is approximately 1 year, and combined, these 65 stores make up only approximately 3% of our total U.S. revenue.

If you assume that the 260 dying malls were to close, that would leave approximately 800 A, B and C malls in the U.S., and they break out as follows: A and A+ is 37%, B is 51% and C is 12%. So of the remaining 800 U.S. malls, 88% of them are designated A and B centers. So now let's look at how this compares to our remaining U.S. mall-based portfolio. Of the remaining 800 U.S. malls, The Children's Place is in 459 or 57% of them. A+ and A are 29%, B is 62% and C is 9%. So of the 459 malls we are located in, 91% of our stores are located in A and B malls.

Key elements of our fleet optimization strategy have been: first, a sales transfer rate in excess of 20%; second, our ability to successfully negotiate rent reductions for a significant percentage of our expiring leases; and third, lease flexibility with majority of the lease renewals being 1- and 2-year deals, which has resulted in a significant reduction of our average lease term to less than 3 years. We realized several years ago that a strategy that relied on opening brick-and-mortar stores would not be a winning one. We were well ahead of our competition on fleet optimization and our fleet optimization program.

The closure of 300 stores through 2020 will ultimately result in a decrease in total fleet square footage of over 1 million square feet or 20%, along with an expansion in operating margin of 200 basis points. With respect to the 300 store closures, we have already closed 169 stores, and we will be accelerating closures in dying malls to fund our outsized e-commerce growth. In addition, based on our accelerated digital transformation time line, we will use 2018 to assess whether there are potentially even more opportunity above the 300-door closure number.

Shareholder returns. We have an outstanding track record of consistently rewarding our shareholders. To date, we have repurchased nearly $870 million in stock, with $245 million remaining on our current authorization. Today, we announced a 3-pronged strategy that not only continues to reward our shareholders but accelerates shareholder return: first, a $125 million accelerated share repurchase program, which we expect to be completed no later than the second quarter of this year; second, a new $250 million buyback authorization; and third, a 25% increase in our dividend to $2 per share. This 3-pronged approach, coupled with our consistent history of rewarding our shareholders, best exhibits our continued confidence in our business and our ability to deliver.

So in closing, our strong execution of our long-standing strategic growth plans has been responsible for our industry-leading results. We are industry leaders with respect to our product offering. We are industry leaders with respect to our fleet optimization strategy by actively reducing our store count since 2013. We are industry leaders with respect to our early relationship with Amazon, and we are now industry leaders with respect to our international objective. Now it's time for us to leapfrog our competition and become industry leader with respect to digital and personalization capabilities. We are excited about the next phase of growth, and we look forward to continuing to deliver industry-leading results for our shareholders.

Now I'll turn it over to Anurup.

Anurup Pruthi - *The Children's Place, Inc. - CFO and SVP*

Thank you, Jane. Good morning, everyone. In the fourth quarter, we delivered adjusted EPS of $2.52 compared to adjusted EPS of $1.88 last year, a 34% increase. For the full year 2017, we delivered adjusted EPS of $7.91 compared to adjusted EPS of $5.43 last year, a 46% increase. These full year results include a $0.93 benefit resulting from the income tax impact on share-based compensation. Excluding this benefit, adjusted EPS increased 29%.

Details for the fourth quarter are as follows. Net sales increased 9.4% to $570 million, inclusive of the impact of the 53rd week. Comparable retail sales increased 8.2% on top of a positive 6.9% comp in the fourth quarter of 2016. U.S. comp sales increased 8.2%. Canada comp sales increased

8.4%. We achieved positive comps in all channels and geographies and continue to see a significant increase in the penetration of our e-commerce sales. Our e-commerce business grew to 22.7% of total sales in fiscal 2017.

Adjusted gross margin leveraged 90 basis points to 37% of sales. This was driven by our 12th consecutive quarter of merchandise margin expansion and the leverage of fixed expenses resulting from the strong comparable retail sales. This was partially offset by the increased penetration of our e-commerce business, which operates at a lower gross margin rate due to higher fulfillment costs.

Adjusted SG&A deleveraged 30 basis points to 23.6%. The deleverage was primarily a result of the investment in our transformation initiatives, partially offset by the impact of the positive comparable retail sales and lower credit card fees. Depreciation was $19.7 million for the quarter. Adjusted operating income was $57 million, an increase of 14.1% compared to last year, leveraging 40 basis points to 10% of net sales.

Our adjusted tax rate was 20.7% for the quarter versus 30.7% last year, primarily due to the mix of U.S. and foreign income, additional tax credits and partial year impact of the lower corporate tax rate. As a result of the new tax legislation, the company recorded onetime tax charges of $52 million in the fourth quarter, primarily consisting of tax expense related to undistributed foreign earnings and profits, a revaluation of deferred assets and other charges associated with the implementation of this legislation. These charges are not included in our adjusted results. Details related to these charges can be found in our press release.

Moving on to the balance sheet. Our cash and short-term investments at the end of the quarter were $260 million compared to $243 million last year. We ended the quarter with $21 million outstanding on our revolver compared to $15 million last year. Inventory was up 13.3% at the end of the quarter. Excluding the timing impact of in-transit, inventory was in line with our guidance of mid- to high single digits. We believe our inventories are well positioned as we entered the first quarter.

For the full year 2017, we generated $214 million in cash flow from operating activities in fiscal 2017 compared to $199 million in fiscal 2016. We repurchased $119 million in stock in fiscal 2017 or over 1 million shares. This includes the repurchase of shares surrendered to cover tax withholdings associated with the vesting of equity awards. We also made dividend payments of $28 million in 2017, nearly double the level of 2016.

I will now outline our financial goals for 2020 before providing specific guidance for the year 2018. We are extremely proud of our long and consistent track record of delivering industry-leading results. We delivered an operating margin of 9.6% in 2017, up 110 basis points over last year and 400 basis points since 2014, driven by the successful execution of our strategic plan, which has resulted in 4 consecutive years of positive comp sales and 3 consecutive years of merchandise margin expansion, while e-commerce penetration of total sales has grown almost 700 basis points since 2014. During this period, our adjusted EPS has increased to $7.91 from $3.05, a compound annual growth rate of 37%.

Our consistent strong cash flow generation has resulted in significant capital returns to shareholders as we have repurchased approximately 4.9 million shares over the last 3 years and tripled our quarterly dividend over that time. This has resulted in a return on invested capital of 30% in 2017 versus 11% in 2014. We are operating from a position of strength and market leadership, which gives us confidence in our ability to execute the next phase of our strategic growth initiatives.

For the period 2018 through 2020, given the significant runway ahead in each of our 4 strategic pillars, we are targeting an operating margin of 12% and earnings per share of $12 by the end of 2020.

Over the past 5 years, we significantly reduced our SG&A from 28% of sales to 24.9%, a reduction of 310 basis points, while funding our transformation investments. During the 2018 to 2020 period, we expect to invest approximately $50 million in incremental 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. While this incremental SG&A investment represents a relatively small portion of our total expenses, we expect that it will generate significant returns for our shareholders. We expect CapEx to be in the $75 million to $85 million range annually over this period, with the majority of this attributed to our transformation initiatives. This compares to $59 million in CapEx in 2017.

The capital and SG&A investments are focused in 4 key areas: digital and omni-channel capabilities; supply chain and inventory management enhancements, including the requirements 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 today, along with the continued growth of our wholesale business. The $30 million incremental SG&A investment in 2018 breaks down as follows. We expect to invest $17 million in incremental SG&A on digital technologies, which includes enhancements to our e-commerce and mobile sites, customer analytics and personalization. We expect to invest $5 million in incremental SG&A on supply chain and inventory management enhancements. We expect to invest $5 million in incremental SG&A on our connected in-store experience to deliver customer personalization, primarily focusing on the areas of loyalty and couponing. We expect to invest $3 million in incremental SG&A, growing our partnership with Semir in China and continued growth of our wholesale business.

In 2019, we expect to make significant progress towards the 12% operating margin milestone and expect operating margins to be in the range of 10% to 10.5%. We expect total net sales to be in the range of $2.05 billion to $2.075 billion by 2020 based on low single-digit comp sales growth in 2018 and mid-single-digit comp sales growth in 2019 and '20. 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 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. This significant shift in digital penetration will make gross margin and SG&A comparisons less relevant, so we will no longer provide guidance on gross margin and SG&A as we are focused on operating margin expansion.

Based on our continued strong cash flow generation, consistent shareholder return program, further aided by the ability to repatriate excess cash with the new tax legislation, we project to repurchase approximately $500 million in shares over the next 3 years. Based on these initiatives, we are targeting an operating margin of 12% and EPS of $12 by 2020, a compound annual growth rate of approximately 15% from 2017.

Now let me take you through detailed full year 2018 and Q1 guidance. Full year 2018 guidance. We expect total net sales for the year to be in the range of $1.905 billion to $1.925 billion, with comp sales growth of 2.5% to 3.5% 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 these 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 project adjusted operating margin in the range of 8.7% to 9% in fiscal 2018. We expect our adjusted tax rate to be approximately 18% to 19% 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-based compensation deduction and ongoing planning -- tax planning initiatives. This new tax rate represents our best estimates and will be subject to change as we evaluate the many aspects of the new tax law in future regulatory updates. In addition, the benefit of stock-based compensation is significantly dependent upon our share price at the time of share vesting. We expect weighted average shares for 2018 to be approximately 17 million shares.

We are introducing fiscal 2018 EPS guidance of $7.95 to $8.20 per share compared to adjusted EPS of $7.91 in fiscal 2017. Let me discuss the key components of our EPS guidance for 2018. The operating results associated with our planned 2.5% to 3.5% comp excluding the impact of our accelerated investments are expected to generate $1.08 to $1.33 in incremental EPS. We expect a $0.54 EPS benefit from the shares we expect to repurchase associated with the accelerated share repurchase program and other share repurchases. A lower expected tax rate will generate an incremental $0.22 in EPS due to the new tax legislation, and we expect EPS resulting from the income tax impact on share-based compensation to be $0.13 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 EPS guidance of $7.95 to $8.20 for fiscal 2018.

The deemed repatriation tax that we incurred as part of the recently enacted tax legislation enables us to repatriate $380 million in past earnings and profits from outside the U.S. We have repatriated the first $175 million in cash, which we will utilize to enter into an accelerated share repurchase program of $125 million and deploy approximately $50 million for working capital purposes. Further, this legislation allows us to repatriate an additional $200 million in cash, tax-free, in the future. With the ability to continue to repatriate cash, we also would not expect any significant borrowing on our revolver at year-end 2018. In addition, our board has authorized a new $250 million share repurchase program and increased our quarterly dividend by 25% to $0.50 per share from $0.40 per share.

Let me now discuss some additional key metrics. The 53rd week in 2017 is resulting in a calendar shift in 2018, whereby Q1 ends 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 will be included in our Q1 inventory compared to 2017, but the majority of our back-to-school receipts were included in Q2. This will result in a onetime Q1 inventory increase of approximately 25% to 30% compared to 2017. We expect this calendar shift to impact Q2 to a lesser extent, with Q2 inventories up mid-teens compared to Q2 2017. We expect inventory increases in the second half of 2018 to be in line with sales.

Our CapEx is expected to be approximately $75 million to $85 million for the year. We expect to open 2 stores and 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.

First quarter guidance. For Q1, we are guiding to EPS in the range of $2.12 to $2.22 compared to adjusted EPS of $1.95 in Q1 2017, with comparable retail sales projected to increase low single digits. We project operating margin to be in the range of 7.7% to 8.2% in Q1 compared to 11.1% in 2017. We expect our tax rate to be slightly negative in Q1 compared to 26% in 2017 due to the benefit related to stock-based compensation and the lower federal tax rate.

Let me discuss the key components of our EPS guidance for Q1 2018. The operating results associated with our planned low single-digit comp excluding the impact of our accelerated investments and higher depreciation are expected to generate $0.03 to $0.13 in incremental EPS. We expect a $0.68 EPS benefit due to the accounting rules related to the income tax impact on share-based compensation or an incremental $0.49 compared to Q1 2017. The majority of this benefit will fall into the first quarter in 2018 versus the second quarter last year due to the impact of the calendar shift.

We expect a $0.16 benefit from a lower tax rate associated with the new tax legislation. We expect a $0.09 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 $2.72 to $2.82 in EPS in Q1 2018, an incremental $0.77 to $0.87 over last year. This will be partially offset by the negative $0.60 impact in Q1, resulting from $13 million in incremental SG&A investments in our transformation initiatives and $2 million in higher depreciation compared to last year, resulting in EPS guidance of $2.12 to $2.22 for Q1 2018.

In summary, we are excited about the significant opportunity we have to increase shareholder returns as we execute the strategic initiatives outlined today. Our 2020 EPS target of $12 represents a 15% compound annual growth rate from our adjusted EPS of $7.91 in 2017. And our operating margin target of 12% represents a 240 basis point increase from the 9.6% level achieved in 2017. We expect to continue to deliver strong operating cash flows and consistent shareholder return in terms of share buybacks and dividends and continue to deliver industry-leading return on invested capital.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from the line of Susan Anderson.

Susan Kay Anderson - *Citigroup Inc, Research Division - Research Analyst*

Good to see the initiatives for the next few years. I was wondering if you could maybe talk about, I know you're not giving gross margin and SG&A guidance anymore, but kind of the puts and takes of the drivers, you don't necessarily have to bucket into those 2 categories, but driving to the 12% op margin by 2020. And then also, how much of that -- the $12 in earnings is below the op margin line by 2020?

Anurup Pruthi - *The Children's Place, Inc. - CFO and SVP*

Sure, Susan. It's Anurup. I'll take the -- I'll take that question. As our digital penetration has continued to grow, as we've mentioned, our gross margin and SG&A comparisons have become less relevant, so we are no longer going to break that guidance out in those buckets out going forward. I would think of SG&A, as we spelled out today, about a $30 million incremental investment in 2018, and that's really driven by the digital initiatives, supply chain optimization, our in-store experience and our continued expansion in wholesale and international. As we've talked about today, we expect our operating margin to be in the range of 10% to 10.5% in 2019 and about 12% by 2020. In terms of buybacks, in addition to the over $800 million we bought back in the last few years, we've also talked about -- today about buying back up to about $500 million in shares through the 2020 period. We would expect at this point in time to buy back, including the ASR, in the range of about $225 million to $250 million this year, which is a combination of our ASR and our continued open-market repurchases. So in terms of gross margin, again, we've had now 12 quarters of merchandise margin expansion. We continue, in our models, to expect continued strong product acceptance. And I would also expect from an SG&A perspective, while we continue to invest on our transformation initiatives, these will inflect downwards in 2019 and '20 and anticipate that expense culture and management of expenses continues to be very strong, and we will continue to drive efficiencies throughout the business.

Operator

Our next question comes from the line of Adrienne Yih.

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

I guess my question is really on kind of the investments that you're making. It probably is for Anurup. The SG&A, the $13 million in the first quarter, what -- how much of that is going to be wages -- wage increases, so store, apparel and your human infrastructure versus the capital infrastructure? And then help me understand -- the depreciation is higher by $2 million, I think, per quarter, but you're closing a lot of stores so that should be net beneficial. So where is this extra D&A, the shorter depreciable life of the digital investments? A little help there would be great.

Anurup Pruthi - *The Children's Place, Inc. - CFO and SVP*

Sure, Adrienne. The second half of the question on useful lives, yes, we are investing the majority of our capital on transformation and technology, which carries with it shorter useful lives. Therefore, it has a consequential impact on depreciation. So -- and as far as the transformation expense goes, the $13 million in Q1 is, as you -- we've talked about accelerating $30 million for the year. Logically, obviously, we want to front load it into the year to move as quickly as possible on the acceleration front. Therefore, $13 million falls into Q1. It's a combination of getting the best external resources to enable our transformation initiatives, along with various models and tools and analysis to drive these initiatives forward. So the capital you would expect to be heavily weighted towards transformation, which carries with it shorter useful lives. And Adrienne, the point about wages, we have been dealing with that for the last several years. We've rolled out multiple initiatives through our very experienced store team to be able to mitigate those effects, so that really doesn't play into this in any material way.

Operator

Our next question comes from the line of Janet Kloppenburg.

Janet Kloppenburg

Just a couple of questions on the SG&A spend -- or one question on the SG&A and one question on gross margin. For '19 and '20, it says $15 million and $5 million, respectively, in incremental SG&A. Are there any offsets to that? Or should we just be building our models based on adding '18, '19 and '20? And secondly, on the gross margin line, I'm wondering what the opportunity is for ongoing product margin improvement through improved AUR, et cetera, and more disciplined inventory management.

Anurup Pruthi - *The Children's Place, Inc. - CFO and SVP*

Sure, Janet. As we've talked about today, given the change in our business where additional penetration continues to increase, we're not going to get into specifics on SG&A and gross margin levels going forward. However, to your question, we are very focused on operating margin expansion. As we've talked about on the call today, we expect 2019 operating margin to increase to 10% to 10.5% and 12% in 2020. And as you know, having followed us in 2017, we recorded operating margin of 9.6%, 400 basis points over 2014. So very happy with our results to date. We believe we have a tremendous amount to runway ahead in our digital work. We are accelerating initiatives and the investment because it is the right time in our transformation road map to do so. We have a leader in place and a detailed digital road map laid out, and we look forward to continuing to drive our operating results as we go forward.

Operator

Our next question comes from the line of David Buckley.

David Loughran Buckley - *Cowen and Company, LLC, Research Division - Associate*

In the digital side, can you talk about some of the personalization opportunities that you see happening near term? Will the launch of the new Apple contribute to these opportunities? And then some of the differences in transactions that you see online versus in-store with AUR, UPT.

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

Sure. It's Jane, and thanks for the question. As far as the digital strategy, as we talked about this morning, we think we have a huge runway ahead of us with respect to digital transformation and personalized customer contact. We strongly believe that digital technology as a core competency for companies going forward is going to separate the long-term winners, and now is the right time within our strategic transformation to take on digital. We set the foundation over the past several years, and now it's really time to take the next leap into digital and into personalization. And when we think about it, we think about the opportunity in 4 buckets, and each one has a pretty substantial incremental sales associated with them. The first one is really around the digital platform that allows us to engage our mom. This wraps around improvements in foundational features like optimized checkout, enhanced search, easier access to accounts, easier access to rewards and then a streamlined sign-up for our private label credit card and MPR, and we've started to work on improved product recommendations. This initiative also impacts the rollout of the new mobile app, to your point. And the digital architecture really sets the foundation for the advanced personalization capabilities we spoke about earlier on the call as far as predictive analytics. The second piece is really greater conversion through predictive analytics and personalized marketing. I think this is probably the largest opportunity of the 4 buckets, and this is where customer analytics marries up with the customer database and the customer segmentation work. Once we have a contact strategy in place and the corresponding technology to enable the triggered dynamic marketing, that's when we can start really communicating one-on-one with mom through vehicles like triggered e-mails, personalized recommendations, targeted promotion, personalized offers at POS, things like digital display marketing, et cetera. So the foundation of this work is really a test-and-learn culture that we've been able to develop by implementing the tools we spoke about in Q4 of 2017. Third prong is really growing the penetration of our PLCC and myPLACE rewards loyalty program. We have found that this will significantly increase the lifetime value of our customers who are enrolled in the program. And the early results from our segmentation and customer analytics work show a very strong ROI in this initiative, and the insights that we're working on now are really helping us understand how to best accelerate the opportunity around PLCC and myPLACE reward. And then the last piece of the bucket is really the omni-channel capabilities. Kind of as we detailed on the call, we just scratched the surface of omni-channel. We've launched BOPIS and ship from store (sic) [ship to store], so that's behind us in 2017. And now we really need to invest in moving on to the benefits associated with some of the other important omni capabilities like Save the Sale. And based on -- well, we talked about our core customer being a millennial, digitally savvy, mobile mom that we need to really advance these omni-channel capabilities quickly to put the foundation in place for the success of the personalized customer contact strategy. As far as your questions online, we have a higher basket size online, a higher AUR online. And as we've spoken about many times, our e-commerce business is accretive to operating margin. We're unique in that in retailers as we have such a large basket size and a very low return rate.

Operator

We have time for one final question, and that question comes from the line of Stephen Albert.

Stephen Albert - *BofA Merrill Lynch, Research Division - Research Analyst*

I was wondering if we could talk more about the private label credit card. What was the sales penetration of the private label card for the full year 2017? How does that compare to sort of '16? And then what are the expectations embedded within your 2018 guide? And then if you could give us -- remind us on the difference of the LTV of the cardholder versus the non-cardholder. And then a follow-up on that is, I guess, switching to gross margin. Any updates you can give us on input cost, AUC environment heading into 2018? With cotton kind of creeping up a little bit, any sort of pressure on that side?

Anurup Pruthi - *The Children's Place, Inc. - CFO and SVP*

Steve, it's Anurup. On PLCC, the program has been very, very successful for us. Penetration was approximately 20.5% of U.S. sales in 2017, up about 500 basis points of penetration. I think, as importantly, it's a fundamental lever within our overall customer marketing and engagement program. Our loyalty program also increased about 200 basis points off a very big base in 2017 versus '16. In terms of LTV, frankly, we have seen both recency, frequency and average spend for PLCC to be -- and our loyalty program to be higher than -- much higher than our average customer. We don't go into more specifics than that. And frankly, we are still discovering what the true LTV is, given that our relaunched loyalty program and our relaunched credit card program are only just about a year old. So a lot more on that to come, but we're be very excited about the progression of that. We do have benchmarks from the industry that says PLCC penetration could be in the mid-20s. Obviously, we are not there yet. We haven't -- I'm not going to give you specifics of our 2018 plan, except to say that we have significant runway ahead in our PLCC penetration. In terms of AUC and your -- second part of your question, we continue to see tailwinds in apparel AUC. We have a very diversified sourcing base, as you know, and a very, very experienced sourcing team and have been direct sourcing for many years. So AUC continues to be favorable for us.

Operator

This does conclude today's Q&A session. Thank you for joining us today. If you have further questions, please call Bob Vill at (201) 453-6693. You may disconnect at this time.