08-Jan-2018

Francesca's Holdings Corp. (FRAN)

ICR Conference

CORPORATE PARTICIPANTS

Pamela Mia Quintiliano
Analyst, SunTrust Robinson Humphrey, Inc.

Steven Paul Lawrence
President, Chief Executive Officer & Director, Francesca's Holdings Corp.

MANAGEMENT DISCUSSION SECTION

Pamela Mia Quintiliano
Analyst, SunTrust Robinson Humphrey, Inc.

Good afternoon, everyone. I'm Pam Quintiliano, I'm the special key retail and apparel analyst from SunTrust, and I'm here today to introduce Francesca's. And we have with us here CEO Steve Lawrence, and CFO Kelly Dilts to tell you a story.

Steven Paul Lawrence
President, Chief Executive Officer & Director, Francesca's Holdings Corp.

Thanks. Thanks, Pam. I have a lot to run through so I'm going to try to be quick about this, and then obviously we have a breakout session right after this. So first here is our Safe Harbor. Obviously, we posted it to the website so please make yourself acquainted with it. If you don't get a chance to read it, you can always find it on our website.

First, we want to give you guys a quick update to Q4 and full-year guidance followed up by a quick little background on the company, as well as moving on to an update on our long-range plan. So hopefully you saw our announcement from last week where we now see net sales being somewhere between down 15% to 17%, EPS for the year coming in at about $0.50 to $0.55. And clearly, holiday was challenging for us. We didn't get the improvement that we'd expected to from the Q4 trend. And when you think about holiday, the shape of it, how it played out, we came in to Black Friday, had a good Thanksgiving week, we're pretty pleased with that. Obviously pretty excited about cyber week, that first week of December, but then we saw [ph] will (01:14) happen in the business where we've seen in prior years where Christmas moves out a day and we expected this big ramp-up the last weekend. We really didn't get that ramp-up which is why we came back with adjustment to guidance for Q4.

And clearly, as you think about 2017, really, we've lost momentum with our consumer, right? We saw some of that happen in the first half of the year where we were down negative 5 in Q1, negative 3 in Q2, and then that culminated in what we saw happen in Q3 in the back half of the year. And so we've really been working hard on actions to improve the business, and I'll touch on a lot of those as we go through today.

So moving on a little bit of company background, some of you guys are familiar with the story, but for those who aren't, I'll try to keep this brief. Our mission statement: surprise and delight every guest, every time. And as I said, I don't think we did a great job at this during 2017. We spent a fair time in our Q2 and Q3 earning calls talking about some of the merchandising missteps we thought. But one of the things that really kind of jumped out at us as we're looking at the business in the back half of the year was we saw a big bifurcation between our brick-and-mortar and online business. And what's interesting is the online piece continued to pump along in double-digit increases. Meanwhile, the brick-and-mortar business got a little tougher. And when you think about it, it's the same assortment, the same pricing, pretty much the same strategy. So clearly there was something we are doing online to surprise and delight that we weren't doing a good job of in brick-and-mortar. So we're spending a lot of time trying to split that apart and figure out, how can we replicate some of those successes?

So when you think about that, what are those things? First, newness. We started pivoting on the assortment bringing in a lot more newness as we headed in the Q4. And online, it's easier to get credit for that, right? We can bubble that up into the [ph] tops (02:52) presentation, product pages, et cetera, but couldn't do as good a job of it in brick-and-mortar where we still had residue from the old assortment hanging out.

So finding a way to get more credit for more newness in our assortment is something we're going to be focused on going forward, whether that's front mannequins, phase-outs within the boutiques, et cetera. And then another idea that really we did a better job of in online that we didn't do in brick-and-mortar is telling stories. We could curate and pull together vignettes. And so you're going to see us do more of that going forward as we move into 2018.

Moving on to who our core guest is, here's a world cloud that kind of describes it. There's a lot of words so I'm not going to read them all to you but I'll just hit on a couple. She's a woman who's 18 to 35. She's either in school or early in her career. She loves to travel, and that's kind of key to who she is. She wants to be on trend but not on the edge of the trend or the bleeding edge of the trend. She's digitally savvy and she's very connected to her family and friends, and in a lot of cases, she thinks of her friends as her family, so she shops with them. So if we can hit her, we can pick up her sister and mother and her friends shopping with her.

And as we diagnosed some of our problems when we're talking about our merchandising missteps, one of the things I think the team had done is they've lost the myopic focus on who's our customer was. They kind of started fragmenting it and we're thinking about an older customer, younger customer. And one of the things a lot of you guys know, we just hired a new chief merchant. She started first week in December. What she's really going to help us with is getting this one-eyed point of view of who our guest is, creating a customer brief that everybody can communicate off of a no, and we'll have that kind of unifying theme around how we assort going forward, and we're going to refer that as our edit point.

In terms of merchandising guiding principles, I think we've, ever since we've been public, espoused some of these principles, but we haven't always done a great job over the past, I would say, six to nine months of living up to them.

First, we want to be on trend. And as I mentioned before, we were targeting a little too junior, a little too young from a trend perspective, so a little too fast, so moving back to somebody who is on trend. We also probably over-engineered a product too much where we had too many trends on a product, so simplifying that and giving a great style, great fabric, great quality, but with one or two fashion twists to it.

Teams are also very focused on delivering unique product that's unique to us. About 80% to 85% of the stuff that we sell in stores is not available on other places. And over time, the teams have started to migrate our vendor base away from our West Coast San Pedro market to more of an East Coast vendor mix which in some ways is easier for the team but also open us up to having more commonality of products with the big box and other specialty store retailers.

So we're moving that back and going back to the traditional San Pedro vendors who are the strength of our so we can have a special and unique product. That's what we value. So adding value is another big one for us, right?

The team is making sure that we're putting in the right quality, the right hand, the right fabric, those special details that make something just not another shirt but a great, great value.

We're also re-embracing our merchandising principle of broad and shallow merchandising. Over time, the teams have started to narrow the focus a little bit and to buy a fewer items and go deeper into those items. And really what we want is we want is we want the guests to come in and to want to buy it today because it won't be here tomorrow. And as the teams have narrowed it and instead of buying more items, narrowed down the focus here of buying more piece of the same item. So instead of having six or something, might have had 12 or 18 or 24 in a boutique.

And really, the guests are smart. They can wait us out. They understand that if they wait till clearance, it's going to go clearance. And so we've dialed that back and are reducing the quantities we're buying behind styles and broadening that out, and we're broadening the assortments out by about 20% to 30% going forward. So we think that's a big move as well.

In terms of merchandising categories, we really break it up into four big buckets. First is apparel accounts were 54% of the total business. This is a key driver for us. We have to win in apparel if we want to win, and so that's why we spend so much time talking about this. And really, one of our core competencies is dress business. And dresses, I think there's some secular trends there that are working against us, but at the same time, we've had some missteps in dress.

And so one of the things we've done to fix that business is we had a dress buyer who've worked for us for many years, delivered great results for us in 2014, 2015, and 2016, and she left the business early in 2017. In the last couple of months, we convinced her to come back, and we think that she's going to give us an eye towards fixing the dress business going forward because she really has a connection with who our core guest is.

Jewelry is a second base category at 22%. This is where our business started. Very important business for us, also a traffic driver, a position front and forward in every boutique as you walk in. Here, what I think you're going to see us work on from an improvement perspective is getting better connectivity between color palette and the types of jewelry that we're putting in.

In the past, I think it wasn't as connected. And so one of the things Ivy is really working on is making sure that we're having cross-merchandising functional teams and that the jewelry we're sorting to works back to the clothing that we're buying.

Accessories, they're our largest category, 13% of the total. Once integrated, opportunity here to reinvent a couple of categories, particularly handbags where I think we're a little too stale and have held on to certain fabrications and silhouettes too long. Look for us to repurpose some of that space even as we go forward.

And then gift and home, even though the smallest category, 11%, this is a key differentiator for us. Part of our sense of discovery is having those wow items and categories that she doesn't expect from us. And this is the category where we do that. We had a great success everywhere we had newness at holiday, such as kids or tech and where we had assortment that is [ph] longer and the truth had (08:05) been out there for a while and we hadn't reinvented, didn't do as well. So look for us to move faster to go after and distort some of these new categories on a much more rapid basis than we have.

From a marketing perspective, being a relatively new company, most of our marketing is digital and focused on social media. But as we go forward, one of the things that we're really focused on is the marketing team acting as stewards of the brands, these are the people who are going to be the key touch point to make sure that all of our brand marketing is personalized on brand and has a focus on story telling.

We're on our game, and I talked about this broad and shallow merchandising, we traditionally haven't had to be very promotional. Our standard discount is somewhere between 20% to 25% off, generally expressed as a BOGO, buy-one-get-one. So generally we're promoting at BOGO 40%, BOGO 50%. One of the things that we try to do even in the tough business we went into is resist the urge of going 40%, 50% off the entire store. Most of the markdown activity was targeted at the trouble merchandise. So we don't set that new dynamic or paradigm that we're a 40% or 50% off store. So we expect this once we get back on track from a merchandising perspective to continue.

In terms of our boutiques, they average around 1,400 square feet. We talked a about treasure hunt merchandising approach, what does that mean? We don't hold big key item statements together. We tend to merchandise by color and apparel that surrounds boutique. We tend to cross-merchandise ideas or categories together, and really we think that creates kind of a sticky shopping environment that encourages the guests to shop the whole boutique and kind of cross-shop the whole thing . And [ph] where again (09:29) that really works for us.

We also pride ourselves on having outstanding customer service. This is probably one of our strong suits. We have a high-touch customer service environment. And this is something that even in the tough business trend we've been in, we have not eroded or taken anyway from that. And so I think as we get this front and back on track, this will once again be a strength for us.

If you look at our footprint, we right now are sitting on 723 boutiques in 47 states. And because we've started off in Texas, we have a pretty strong suit in some of the southern states of California, Texas, and Florida. They represent about 25% of our boutique count. You'll notice though that we also have not a lot of boutiques in the upper northeast.

So if you look at populous states such as New Jersey, New York, and Pennsylvania only represent about 12% of our boutique count. So when you hear us talk about opening up new boutiques, there's still a lot of places particularly in the northeast where we think there's an opportunity to go into some really strong centers up there, and I'll touch on that in a second.

We're also about 50% mall, 50% off-mall, so we have a very balanced approach. We're not locked into malls. We tend to be somewhat agnostic whether it's mall or off-mall. We just want to go into high-traffic centers that are experiential and we believe we're going to be relevant going forward.

E-commerce, for us, represents 7% of the business. It's grown from 1.4% over five years ago. We came a little bit late to the game from an e-commerce perspective, but we're picking up ground there fast. As we laid our long-range plan, we'd really made sure that we've tried to have our e-commerce business position all the things in place, and I'll touch on that in a second. But one of the things I want to hit on is this year was the first year we got to 100% concurrency between brick-and-mortar and online.

And so going forward then, it's really going to be driven by assortment expansion. And one of the guiding principles we're going to work off of is if we did have a bigger boutique footprint, let's say we had a 7,000- or 8,000-square-foot boutique, what would fit into that? And if we think that we'd fit into that, we'll put it online. Now I'm not telling you there's any chance for plans that we're building a 7,000- or 8,000-square-foot boutique but that's more of a guiding principle for us.

Moving on, to give you a quick update on our long-range plan, here are the five pillars. These are the same five pillars we espoused a year ago when we talked to you guys. They're virtually the same, and I'm going to cover each one on the slides so I won't read them to you. I will point out that we did have, last year, a sixth pillar that we've talked about. It's centered on continuous process improvement, and we haven't backed away from that. That's more of an internal-facing pillar for us, and it's really embedded in a lot of the work that we're doing against these five.

So why don't I start with the first one which is growing e-commerce penetration and omni-channel capabilities? We did [ph] resequences (12:02) and we put – this is number one because this is far and away our number one long-range plan or opportunity. And our goal is to grow the penetration here from 7% this year to in the high teens over the next couple of years. Couple of ways we're doing that, first, we're going to increase our investment in site functionality by 20% a year. So we know we have to continue to find ways to streamline and make the shopping experience online seamless and connected to what's going in brick-and-mortar. You're going to see us continue to do that. We're also looking for ways to increase the traffic to the site on a regular basis. So we have embedded in our long-range plan an increase in marketing spend by about 20% a year with a lot of that driving digital traffic to drive site door traffic.

And the thing I want you guys to leave with is it's not we're just setting a goal out here and saying we're going to grow to the high teens, there is concrete plans built throughout the whole organization. We've got the merchandising team who's laid out over the next five years, what does the SKU growth need to look like and what are the categories we need to go into to achieve that growth? We bounced that up against our distribution center and said, do we have the physical space and all the things in place that we need to do that? And fortunately, with the DC we have today will house and sustain all these volume. We do need to make some investments in sortation equipment, things like that. So we believe we can get to this level with our existing DC. And then from a marketing perspective, can we drive the demand to the site to drive this level of volume? I mean, that's where driving the marketing and growing our customer file really is important to us.

We also just rolled out and we'll continue to roll out some key omni-channel capabilities. I know a lot of people have done this but this is new for us. We just rolled out buy online, ship to boutique and buy in boutique, ship to home, which are two key functionalities that I think you have to have to be successful these days, and we're seeing great results from that, but we're in the very, very early innings to this. It's,

I would say, top of the first on that one. And then we're always looking for ways to add more efficiencies.

From an invigorate merchandising perspective, I'd already kind of covered a lot of the things we're working on here in the overview, but I did want to hit on kind of the bottom half of this slide because as we've been growing and adding capabilities, one of the big unlocks we've had over the past year has been introduction of some really robust planning and allocation disciplines.

We really didn't have a great team there. So we hired somebody from outside the company who joined us back in early summer and he's put in place a lot of great disciplines looking at assortment planning. We talked about this broad and shallow assortment mix, how do we quantify, how broad that should be, what's the sell-through we need, what's the depth behind items? So there's been a lot of work and rigor put around that to ensure we can hit the sell-throughs we need to hit, as well as hit the margins that we're trying to hit.

Better seasonal transition. Do we start and stop cold weather products earlier for northern stores, work around [ph] Climate Ben and (14:41) things like that? Once again, all rudimentary things a lot of people have done, we really haven't done a lot of work of, and P&A is really helping us unlock this. As well as better receipt flow, we talk about this constant flow of newness and wanting to always put something new before the customer. We've done a lot of work around space planning and really nailing down what our capacity is by boutique, as well as by area of the boutique, and then working out a weekly receipt flow. So we're constantly flowing newness and we'll really kind of operationalize that door-to-floor kind of mentality we like to drive on our boutiques.

In terms of cultivating branding and expanding marketing, as I mentioned before here, our plan is to really expand our marketing efforts by about 20% a year. This is really key to us. I don't know if I mentioned this earlier, but we did a lot of customer research this year.

One of the things that really jumped out at us was over half of the people who shop with us decided to shop with us just because they're walking by. So we don't really drive our own traffic. Currently, we feed off of our traffic and we see building our customer file and spending more money in marketing as a way to start taking control and owning our traffic. So as we invest in more marketing efforts, you're going to see us put it in more digital media which is Facebook Live. We just launched Facebook Live for the first time this back fourth quarter, really good results off that. We're pretty excited about it. We'll first expand opportunities in traditional media such as radio on a more localized level, as well as direct mail, as well as expanding on brand-building efforts. A lot of our marketing today, I'd say, is transactionally focused, and we need to start building our brand as well and not just focus on transactional marketing.

Second is an opportunity for us to utilize our CRM capabilities. We've talked a lot about in previous meetings on our calls that we just rolled out a new POS. We spent the better part of this past year getting a new POS rolled out to all of our boutiques.

One of the key unlocks for that is we now for the first time have the ability to start capturing customer information at point of sale where we've never been able to do that before. And we think this is going to be a huge unlock for us and there's a lot of permutations and ways that just kind of impacts our business. But the biggest one is we think we can more than double our customer file over the next year through this new POS rollout and by capturing customer data on a more robust fashion. And we think if you think about next year having the ability to send out an e-mail or a text or some of the marketing efforts two or three times as many people as we did this year, that's going to be a big deal.

Third, to help enable that, that customer information capture, one of the things we do believe in the world today is people are pretty private with their personal information. It's hard to get people to give you their phone number or e-mail, and we think the way to get that from them is to give them something, and we think that something is a loyalty program.

So we've been piloting a loyalty program locally in Houston over the past quarter. It's been very successful. Our plan is to roll that out in Q2 in advance and going into back-to-school. Since we've had a chance to kind of start from scratch on this thing, we're not making this loyalty program something that's transactionally you're discount-based. It's more experiential. So it's going to be about getting free gifts several times here. It's about getting a gift on your birthday. It may be early access to commercial events. So, for example, for Black Friday, we might invite our loyalists in early versus having to kind of go on shop on Black Friday like everybody else. That's something that we also see as a big unlock for us in terms of customer acquisition.

The second last strategy, differentiate and personalize our guest experience. I already talked a lot about our high-touch service environment and our guest experience that we think we think we give. Another big focus for us really is how do we take workload off of the team, non-customer-facing workload off the team so we can repurpose those hours back towards customer-facing activities? So to that end, we've got a new POS that I mentioned we rolled out, some capabilities that we're going to add as kind of phase two as we get into spring or we're going to send out handheld scanners to all the stores which is going to make taking markdowns and transfers a much more efficient and effective process for us.

We also have rolled out a new schedule optimizer which should be a big deal for us. It's really looking at sales needs by hour by boutique and giving us the ability to more fine-tune our scheduling and really get more customer-facing hours. And then we're also automating promotions going forward as part of our new POS rollout. So when a customer comes in there, they're going to buy something right now, the boutique team has to key it in, going forward that will be automated which should also make the checkout much more seamless and easy.

Okay, last strategy I want to touch on briefly is optimizing real estate. We continue to see opportunities open up in boutiques, and we see that for a couple of reasons. First, it's a really good investment for us. We get a very, very high four-wall contribution on our new boutiques and they tend to pay for themselves [ph] in under (19:10) 18 months.

Second, as we've talked about we're still in an expansion mode, we see a lot of opportunity in certain region of the country where we really don't have any brand awareness or footprint.

Third, we also think that the brick-and-mortar piece of the business helps drive the dot-com piece of the business. We see our dot-com business in zip codes we're putting new boutiques increase dramatically.

And finally, there's an opportunity out there right now with all the disruptions that's happening in retail and real estate to get into some places we've never got into before. So, for example, in Houston Galleria, it's the number one shopping [ph] node (19:42) in our hometown, we've never been able to make the economics work, and we recently opened up a new store there and it's on pace to be one of our biggest and best stores. It's right across from the Apple Store. So we see an opportunity again in these places we've never had that.

But to that end, we're not just blindly opening up stores. We have a three-pronged plan of attack in terms of how we're attacking real state.

First, we're only going to open up new boutiques in A- and B-rated centers. Since we've worked with a company out there called Green Street Advisors, who does a lot of work around grading all the centers, using that, we're identifying all the A and B centers we're not in, and only going into A and B centers going forward.

Second, we're looking at our existing fleet of stores, and we are going to proactively close anything that's in the C and D as it comes up unless it makes a ton of sense to keep it open. So about 20% of our fleet comes up for renewal each year. So we have this opportunity over the next five years [ph] to very (20:30) proactively shut down the C and D centers. So we're going to drive that number to under 10% of our total from about 20% today.

And then lastly, with where we're at in terms of the growth for our company, we've been very focused on opening up new boutiques, a lot of focus on keeping our existing fleet open. We're about to embark upon a pretty aggressive remodel plan. We're going to touch 90 boutiques a year depending on the new format. We tested this new format locally in Houston in three stores, one mall, one off-mall, and one outlet. The results relative to any peer group have been fantastic, and so we see this as a great opportunity for us to start refreshing our stores and embarking upon that going forward.

And so kind of one of the exciting things about this is as we open up new stores, they'll be this new format, coupled with touching roughly 90 stores a year from a reformatting perspective. When you waterfall that over five years, we can stick with that. We can get over 80% of our stores in this new format going forward, and we think that could be the huge comp store driver for us.

So I ran through a lot here. Just wanted to summarize it and give you kind of the sense of what we're trying to accomplish here. Our goal is to return to growth, high-single-digit store growth each year, and that's a combination of new store, as well as comp store growth. We're going to drive e-commerce into the high teens from a penetration perspective.

From a footprint perspective, we end up somewhere between 900 to 1,000 boutiques, with 90% of those in A and B centers. And lastly we're going to steadily improve our operating margin each year over the next couple of years.

So with that, I think I'm running out of time. I will point out we do have a breakout session right after this at 3:30 if anybody wants to come and ask questions for that. So, thank you.