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J.Jill, Inc. (JILL)

Q2 2021 Earnings Call

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CORPORATE PARTICIPANTS

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OTHER PARTICIPANTS

Dana Lauren Telsey
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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Rain, and I will be your conference operator today. At this time, I would like to welcome everyone to the J.Jill Second Quarter Fiscal 2021 Earnings Conference Call. On today's call are Claire Spofford, President and Chief Executive Officer; and Mark Webb, Executive Vice President, Chief Financial and Operating Officer. All lines have been placed on mute to prevent any background noise. After the speakers' remarks there will be a question-and-answer session. [Operator Instructions]

Before we begin, I need to remind you that certain comments made during these remarks may constitute forward-looking statements and are made pursuant to and within the meaning of the Safe Harbor provision of the Private Securities Litigation Reform Act of 1995, as amended. Such forward-looking statements are subject to both known and unknown risks and uncertainties that could cause the actual results to differ materially from such statements. Those risks and uncertainties are described in a press release in J.Jill's SEC filings. The forward-looking statements made on this recording are as of September 9, 2021, and J.Jill does not undertake any obligation to update these forward-looking statements.

Finally, J.Jill may refer to certain adjusted or non-GAAP financial measures during these remarks. A reconciliation schedule showing the GAAP versus non-GAAP financial measures is available in the press release issued September 9, 2021. If you do not have a copy of today's press release, you may obtain one by visiting the Investor Relations page of the website at jjill.com.

I will now like to turn the call over to Claire.

Claire Spofford
President, Chief Executive Officer & Director, J.Jill, Inc.

Thank you, and good morning everyone. Our second quarter results reflect the encouraging progress we've made against operating model changes and strategic initiatives we laid out earlier this year, with a focus on gross

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margin expansion and healthy growth of the company. We're seeing strong full price selling and margin recovery, and we're confident that we're laying the groundwork for profitable growth moving forward.

Before I dive into our results for the quarter, I'd like to share my perspective on the element of this brand and business that provide a strong foundation and platform for sustainable growth. J.Jill is a brand with great heritage and equity. It's something I understood and recognized from my prior tenure as Chief Marketing Officer and now deeply appreciate having returned as CEO. There is a relevance and authenticity to the brand that really resonates with our customer. This results in a deep level of loyalty and allows us to engage with our customers season after season through our unique proprietary product offerings.

Our balanced omni-channel business model is also a strength that we continue to advance. We have the benefit of strong direct-to-consumer capabilities and practices, coupled with a store fleet that has a footprint in prime locations in most of the key markets for our demographic. This balance provides optionality for our customer in terms of how she likes to shop and allows us to be agile and responsive to business and selling dynamics. We can assess response to our assortments quickly and react and respond accordingly, resulting in optimized sell-throughs and improved margins.

The portfolio of our core J.Jill brand and our sub-brands, Pure Jill, Wearever and Fit serves different end uses and style preferences for our customer, all under a value proposition grounded in offering her premium casual clothing that is easy and versatile and made of the finest fabrics. For example, Pure Jill is the ultimate expression of the brand and a great example of how we provide her products with a fabric-first approach and a focus on natural fibers and artisanal details. And our customer understands that quality. She's affluent, well-educated and discerning when she chooses where to shop. She values quality and uniqueness and is willing and able to purchase at full price when she is inspired.

This quarter, our customers responded really well to both our core and novelty products as evidenced in our strong full price penetration. We've also been focused on providing her a regular flow of new product, which has driven engagement and purchase frequency.

Mark will dive deeper into the quarter's results. But plainly stated, we were pleased. We recognize that the retail industry as a whole benefited from tailwinds due in part to the reopenings we witnessed across the nation and an increase in consumer sentiment. Store sales, direct sales and gross margins were up meaningfully as compared to the same quarter last year. Importantly for J.Jill, direct sales for the quarter were approximately 46% of total sales, reinforcing our belief in the balanced omni-channel and nimble business model that we have and continue to build.

While we continue to be optimistic about the back half of the year and going forward, we acknowledge that there are macroeconomic headwinds that could affect our business in the near and medium term. Similar to the rest of the industry, we're exposed to rising supply chain and component costs. And while we've done work building relationships with suppliers, we are likely to see the impact of these rising costs through the second half of this year and into the early part of next year.

I want to emphasize that we are driving recovery in our business, and we are positioning ourselves for sustainable, profitable growth going forward. Our focus remains on growing our customer base, ensuring the health of the business through gross margin expansion by inventory management and promotional strategy and delivering a steady flow of newness in our products, which altogether drive customer engagement and full price selling. We're rebuilding the health of the customer file by focusing on servicing our core customers while laying

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the groundwork for the next cohort and appealing to a larger audience of customers with similar lifestyle needs and aesthetic sensibilities.

As evidence of our tighter inventory management, inventories at the end of the quarter were down double digits as compared to last year. This is another data point that supports the lower markdown and higher full price penetration model we're pursuing. Another advantage of our model is our direct to consumer side's ability to gather useful data and develop insights based on our customers shopping behaviors and patterns. Our digital penetration enables us to respond to business changes, making our business model more dynamic and driving our ability to meet changing consumer demands.

We're proud of our work, and the results we've achieved thus far are encouraging. I want to thank the team for their dedication and hard work. And so before I turn this over to Mark, I'd like to reiterate our continued confidence in our business model, our brand and in our team.

And with that, I'll turn the call over to Mark.

Mark Webb

Chief Financial Officer & Executive Vice President, J.Jill, Inc.

Thank you, Claire, and good morning, everyone. As Claire mentioned, we are pleased with our performance in the second quarter as momentum continued to build in the store channel and customer response to full priced product showed continued strength in both channels. Inventory levels remained well under control, and gross margins in the quarter reflect strong product acceptance and renewed discipline to keep buys tight, sell full price at no or low promotions and manage markdowns in season through pricing and promotional action.

Total company sales sequentially improved compared to prior quarters, with total sales up 72% versus Q2 2020 and down 12% to Q2 2019. Approximately 250 basis points of the decline versus 2019 was due to the lower store count in 2021 compared to 2019. Store sales were up over 220% versus Q2 2020 as most stores were closed through June of last year due to COVID-related lockdowns and we opened to lower traffic as restrictions and customer apprehension were still prevalent. Store sales were down 18% compared to 2019 levels of which approximately 400 basis points is related to stores closed since 2019. Similar to what we saw in Q1, store sales in each month of the second quarter of 2021 were sequentially better than the prior month when compared against 2019.

Direct sales were up 11% versus 2020 and down 4% to 2019. Direct sales as a percentage of total sales were 46% in the quarter. Q2 gross profit was $109.4 million, up $54 million compared to Q2 2020 and up $4 million compared to Q2 2019. Q2 gross margin was 68.7%, up 930 basis points over Q2 2020 and up 1,040 basis points compared to Q2 2019. The improvement in gross margin was driven by better full price selling, fewer and lower global promotions and reduced third-party liquidations associated with better, tighter inventory buys and positive customer response to collections.

SG&A expenses were $86 million, up $8 million versus prior year. Increases to last year were driven by selling costs due to stores open and operating the full quarter this year, higher marketing investments and management incentive. We expect costs such as these to continue to build in the back half as we continue to support sales growth and as we return to more normalized store operating schedules. Compared to 2019, SG&A expenses in Q2 were down $17 million driven by selling costs on fewer stores, refined and reduced marketing investment and the impact of our new operating model on G&A overhead, all of which were partially offset by higher management incentive.

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Adjusted EBITDA was $32.7 million in the quarter compared to a loss of $6.5 million in Q2 2020 and adjusted EBITDA of $12.6 million in Q2 2019. Please refer to today's press release for a reconciliation of adjusted EBITDA.

Turning to cash flow. For the quarter, we generated $32 million in cash from operations. We ended the quarter with total cash of $18 million and had zero borrowings against our ABL. Total liquidity as defined in the priming term loan agreement measured as ending cash balance plus check float, plus ABL availability, was $56 million at the end of the second quarter.

Also as disclosed in a previously filed 8-K on August 27 of this year, we exercised a PIK paydown option on the priming term loan, paying down $25 million or over 10% of the outstanding loan from cash on hand. In line with our goal to manage inventory tightly to support full price selling, inventories at the end of the quarter were down 24% compared to the end of Q2 last year.

As previously disclosed, warrants related to the subordinated credit facility and the embedded derivative associated with the priming term loan were marked to market for the final time during the second quarter due to the increase in J.Jill stock price since the end of first quarter 2021, resulting in a noncash charge to the income statement of approximately $39 million. Associated with this, we issued approximately 272,000 shares to the priming lenders as of May 31. The value of the warrant and embedded derivative liabilities are now considered equity rather than liabilities and classified as such on the second quarter balance sheet.

Capital expenditures in the quarter were about $1.1 million versus $800,000 last year. We now expect to spend about $8 million in capital for full fiscal year 2021, with investments focused on maintenance and technology specifically related to enhancing and upgrading our e-commerce site. We closed four stores in the second quarter, ending with 261 stores, and we still expect to close about 20 stores for the full year 2021.

Looking at the balance of the year. Barring any major disruption from the evolving COVID-19 situation, we expect revenues to continue to rebound from 2020 levels though at a slowing pace as store sales have improved back closer to 2019 levels.

With respect to gross margin, the fundamentals of inventory management, full price selling and reduced promotions should continue to support strong margins. But supply chain disruption is increasing, resulting in both elevated shipping costs and delays. We expect this disruption to continue at least through the back half of the year and are working with our supplier base and logistics providers to prioritize and expedite product shipments to ensure as many on-time deliveries as possible. Our focus on driving full price selling at lower promotional discounts should help mitigate some of this pressure and support gross margin expansion compared to 2020 through the end of the year, though at moderating levels compared to year-to-date performance.

In summary, the second quarter results demonstrate the ability of our operating model, fueled by healthy gross margin recovery, to drive adjusted EBITDA and strong cash generation. While the macro tailwinds experienced in Q2 will likely abate somewhat in the back half of 2021, we believe the principles and approach of our operating model should continue to drive meaningful progress.

Thank you. And I will now hand it back over to Claire.

Claire Spofford

President, Chief Executive Officer & Director, J.Jill, Inc.

Thanks, Mark. I'd like to end the prepared remarks by reiterating three key things that make us optimistic about the potential for our business moving forward. First, we continue to make progress against strengthening our

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foundation and executing against the operating model changes and strategic initiatives we laid out earlier this year. Second, as a result, we're seeing healthy full price selling and margin recovery, leading to expanded EBITDA margins. And third, we're confident that our strategic approach is laying the groundwork for profitable sustainable growth built on a great brand and a loyal customer base.

We're committed to creating value for our shareholders, and thank you for your time and appreciate your interest. That concludes my prepared remarks. I will now turn the call back to the operator for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Your first question comes from Dana Telsey from Telsey Group. Your line is open.

Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC

Q

Good morning, Claire and Mark. Congratulations on the nice progress that you've had. Couple of questions. As you talked about the Pure Jill line and Fit, can you give us an update on what you're seeing in the sell-through, either direct or in stores? Is it the same? Is there a differentiation in terms of the product? And then can you expand on supply chain? We've been hearing call after call that it's expected potentially to last through mid-2022. How are you positioned? And what do you see in terms of port issues? Are you using air freight? And what percentage of goods comes from Vietnam? And then I have a follow-up.

Claire Spofford
President, Chief Executive Officer & Director, J.Jill, Inc.

A

Thank you, Dana. Yes, we're seeing strong – in Q2, we saw strong full price sell-through pretty much across the board. There was some difference across the sub-brands. There was exceptional strength in Pure Jill and also exceptional strength in Fit, although Fit is off of a small base. And we also saw strength in knits and in novelties across the board and in our core basics programs as well. So lots of sort of broad-scale strength, and we feel really good about the potential of a lot of the business. But there is a great emphasis on Pure Jill as well.

Mark Webb
Chief Financial Officer & Executive Vice President, J.Jill, Inc.

A

And Dana, I'll just jump in on supply chain. First of all, the issues clearly are real being reported on in the media, by our competitors, by everybody. I would first probably need to call out that we have a bunch of team members inside the business that are working very, very diligently to work around the problems and make the best of the situation that we can and doing so with great attitudes and a lot of progress as well. I think at this point, it's anybody's forecast as to when we expect it to abate. We're certainly expecting the issues to continue through the deliveries through the back half of the year and into early next, as Claire said in her remarks. We're hearing out there maybe Chinese New Year, maybe a little earlier, maybe a little later. We're planning as if it continues and working our way to manage both the country risk that exists and then just specifically supply chain risk. So a lot of progress going on there but a lot of work as well.

You mentioned Vietnam. It's the hottest topic right now probably just due to some of the shutdowns that are happening in the country. I would say that we have indicated that Vietnam is one of our top three countries of origin. Vietnam and India are probably right close to each other at the top. Vietnam, of our product that we're sourcing in Vietnam right now, there is the north of the country and the south. The south is the one experiencing

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unfortunately most of the issues right now. That's about a third of our Vietnam product that we're sourcing. The other two-thirds are in the north and not subject to the specific issues but still subject to supply chain disruption on a more macro level.

Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC

Q

Got it. And then I think CapEx is moderated to $8 million from $10 million. What's changing or being adjusted timeframe wise? And then the gross margin, the adjusted EBITDA were very impressive. Is the gross margin benefit, how much of it is coming from product margin improving? Are there anything else under the hood that we should be noticing on the gross margin that can allow the solid gross margin to sustain?

Mark Webb
Chief Financial Officer & Executive Vice President, J.Jill, Inc.

A

Yes. So I'll jump in on both of those. So CapEx, Dana, really when we came out of 2020 into this year, we had planned on maybe a bit more maintenance coming back into the business and that's really the extent of the change in our guidance for this year. We're still committed to making investments, as we indicated in some areas of technology, particularly related to the website, and that's really the primary change related to the CapEx guidance reduced to $8 million from $10 million previously.

With respect to the gross margin, it's predominantly full price driven. It's predominantly product margin driven. That said, when addressing the future of the gross margin, I think you're seeing now the operating model benefit before much of the disruption from the elevated cost to ship, et cetera, are factored in. So really, as we look forward, there are a couple of factors that we would look at and it's mostly related to shipping costs, both ocean and air, and probably more products shifting to air in the near term just given the delays and the disruption.

And then obviously we're always watching the promotional environment at large. We feel like the inventory levels that we have, as we exit the quarter, are in good shape and supportive of our strategies to drive full price selling. But that's another factor that we'll just keep in mind and make sure that we're competitive around.

Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC

Q

Thank you. Nice to see the progress.

Mark Webb
Chief Financial Officer & Executive Vice President, J.Jill, Inc.

A

Thank you.

Operator: Your next question comes from Janet Kloppenburg from JJK Research Associates. Your line is open.

Janet J. Kloppenburg
Analyst, JJK Research

Q

Good morning, everyone. I was – first of all, congrats on the improvement. I was wondering if you could talk a little bit about the store productivity levels. I think you said, Mark, maybe they're down about 12% versus 2019 and how we should think about progress there and what you think it will take to get back to that level. And I know that you said your inventory levels were comfortable. But are you confident that your holiday deliveries will be timely and afford you an opportunity to continue to enjoy this strong momentum?

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Mark Webb
Chief Financial Officer & Executive Vice President, J.Jill, Inc.
A

Thanks, Janet. I'll jump in. The second part of your question first. I would say that the holiday shipments are something we're actively working on, probably pulling similar levers to most others out there in the industry. We hope getting on some of those levers earlier rather than later and also leveraging our supplier relationships, which we take great pride in, should help us mitigate. That said, likely to be delays, and we will be flowing new products along the way as we get it and are kind of expecting some level of that in the industry as we progress through holiday. Right now, no other news to update on that but working to make sure that we get the goods at a port of origin as early as we can and get them in the shipping lanes as soon as we can.

Janet J. Kloppenburg
Analyst, JJK Research
Q

But could that...

Mark Webb
Chief Financial Officer & Executive Vice President, J.Jill, Inc.
A

With respect to the store productivity – I'm sorry, go ahead.

Janet J. Kloppenburg
Analyst, JJK Research
Q

Mark, could that boost the – or crimp your gross margin opportunity as we look forward?

Mark Webb
Chief Financial Officer & Executive Vice President, J.Jill, Inc.
A

I think there's two elements, Janet, that I would look at. The first is there certainly will be elevated freight to get that product to land. And that will certainly play right against the margin in a way that it hasn't year-to-date. The second is as we get our product in and flow it where the promotional environment is and whether or not we can continue to flow newness and flow it at ever more full price, which could be a mitigating factor. I would say in Q2, you kind of got the best of the inventory positioning and the strategies. And from that point forward, it's how do we manage the inbound shipping impact as well as the strategy to maintain full price selling. But feel good about where we are in Q2 as a starting point now as we look forward.

The first part of your question was related to stores and productivity, right?

Janet J. Kloppenburg
Analyst, JJK Research
Q

Productivity, yeah.

Mark Webb
Chief Financial Officer & Executive Vice President, J.Jill, Inc.
A

So there's – the metrics underlying the store growth and really the business growth, we mentioned that it's full price driven and on lower promos. So you can imagine that AUR, or average unit retail, is the driving metric. That's true in the stores. I would say that traffic, while it's been improving in the stores and showed meaningful improvement in Q2 relative to where it was in Q1, that's a metric that's still lagging. And as we continue to assess where that traffic lands, the opportunity along with the strong and stronger AURs should help us get back, if not to historical productivity, perhaps even a little better.

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Janet J. Kloppenburg
Analyst, JJK Research

Q

Okay, great. And Claire, could you talk a little bit about underlying demand trends? I mean we all know that women haven't bought clothes for a couple of years and that inventories throughout the industry are quite low, and it's driving much more full price selling across the industry. So what gives you confidence that once this pent-up demand wanes a bit in the industry and inventory levels get back in stock, that J.Jill can be a market share gainer as we go into more normalized demand and pricing periods?

Claire Spofford
President, Chief Executive Officer & Director, J.Jill, Inc.

A

That's a great question. Thank you, Janet. We have a great team in our design and product area that I think has a real beat on who our customer is. The team has been in place – the leader of the team has been in place for two years. Unfortunately, his first collections came out under the cloud of COVID. But since COVID has been lifting, we're seeing just really strong response to the product, excitement about the product. I think we have a modernized sensibility about color palettes and novelties and we're giving her the right level of fashion balanced with a strong basics program. So I feel really good about the balance of our products assortment and the response that we're seeing from our customer.

Now obviously, we have to pay attention to what's going on in the environment competitively from a promotional standpoint, but I feel like that strengthen in our product capabilities are our underlying knowledge of our customer. We've been a direct-to-consumer business since our origins, and so we have a lot of great customer data that we always mine and develop insights around that help us stay in touch with her and continue to figure out how we delight her in her experience and with the product that we offer her. So those strengths are things that aren't going to go away. And I feel like having been around the block for a while myself, I think we have just really strong capabilities there on a relative basis so.

Janet J. Kloppenburg
Analyst, JJK Research

Q

And just my last question, are you able to discuss as we move into a more normalized environment, let's say, second half 2022? Are there new product extensions or categories that J.Jill has an opportunity to exploit to keep the momentum going?

Claire Spofford
President, Chief Executive Officer & Director, J.Jill, Inc.

A

Yeah. We will continue to use those insights and knowledge of our business and our customers to evaluate that. I think because we already have a pretty developed portfolio, we have opportunities within the current portfolio to drive growth and then we're always assessing those opportunities for line extensions or category growth, distorting things that are especially relevant at any given point in time.

Janet J. Kloppenburg
Analyst, JJK Research

Q

Okay, great. Lots of luck.

Claire Spofford
President, Chief Executive Officer & Director, J.Jill, Inc.

A

Thank you.

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Mark Webb
Chief Financial Officer & Executive Vice President, J.Jill, Inc.

A

Thank you, Janet.

Operator: Thank you. There is no further question at this time, and this concludes today's conference call. Thank you all for joining. You may now disconnect.

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