

J.Jill, Inc. NYSE:JILL

Earnings Call

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CALL PARTICIPANTS 2

PRESENTATION 3

QUESTION AND ANSWER 6

Call Participants

EXECUTIVES

Claire Spofford
President, CEO & Director

Mark W. Webb
Executive VP and Chief Financial & Operating Officer

ANALYSTS

Dana Lauren Telsey
Telsey Advisory Group LLC

Daniel James Lupo
Jefferies LLC, Fixed Income Research

Presentation

Operator

Good morning. My name is Rob, and I will be your conference operator today. At this time, I would like to welcome everyone to the J.Jill Third Quarter 2022 Earnings Conference Call. On today's call are Claire Spofford, President and Chief Executive Officer; and Mark Webb, Executive Vice President, Chief Financial Officer and Chief Operating Officer.

[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 provisions 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 actual results to differ materially from such statements. Those risks and uncertainties are described in the press release and J.Jill's SEC filings. These forward-looking statements made on this recording are as of December 6, 2022, 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 December 6, 2022. 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 turn the call over to Claire.

Claire Spofford
President, CEO & Director

Thank you, operator, and hello, everyone. Thank you for your interest in J.Jill. For today's call, I'll review highlights of our third quarter performance and provide an update on our strategy before turning the call over to Mark to review our financial performance and outlook in more detail.

Our disciplined approach to executing our strategy helped to support our better-than-expected third quarter performance as we navigated a volatile consumer backdrop and absorbed planned strategic investments. We delivered adjusted EBITDA of $27.5 million, up modestly from a very strong Q3 last year on expanded margins of 69.9% and sales down 1% versus the prior year.

While we did begin to see some hesitancy from customers as inflation and macroeconomic concerns increased, she continues to find pieces she liked and remained willing to pay full price for unique and special items, which we flowed regularly throughout the quarter. She continued to respond very well to our unique pieces, and especially our assortment of dresses, leading to a third consecutive quarter where dresses were a standout category.

Our Wearever sub brands benefited from her gravitating toward restocking her wardrobe with versatile and beautiful pieces for work, travel and occasions.

Also of interest, we continue to see real strength in our best customer segment with both shopping rate and spend per customer up driven by increased average order value.

With that said, we continue to stay close to her to keep a pulse on how the inflationary environment is impacting her purchase intent on an ongoing basis and to ensure we continue to deliver the products and experiences she wants and expects.

Now I'd like to provide an update on the Welcome Everybody and inclusive sizing initiative which we launched on August 4. Welcome Everybody and inclusive sizing marked a significant enterprise-wide initiative to modernize the J.Jill brand and value proposition to be more relevant for our core customer and to welcome the next cohort of customers to the brand. And I'm pleased to report that the campaign successfully engaged with both existing and new customers.

We checked in with our customer following the launch to ensure they were responding positively to the campaign and to learn how we can continue to improve their experience. They told us they recognize that representation is important in fashion, believe the same price for all sizes is the fair approach and that inclusive sizing either personally impacts them or their friends and family.

I want to thank the team for the expertly-led rollout and continued execution of the initiatives. This is an ongoing strategic initiative and the team's disciplined approach to inventory management, ability to create a fully inclusive shopping experience and relentless focus on the customer enabled us to carry out a successful launch this quarter.

In addition to the Welcome Everybody and inclusive sizing initiative, we continue to leverage our customer research and testing new and different opportunities within our assortment where we see potential for growth over time. One such example is a recent test of a small capsule collection called Pure Jill elements that we are piloting in 7 stores and online. This collection features special artisanal pieces designed for the customer who is a fabric enthusiast and who values unique details that can command a higher price point. Early reads from this pilot have already provided helpful insights into opportunities where we can potentially stretch our value proposition over time.

The small capsule also did a great job of interesting prospects between 35 and 55 years old and was the subject of the top-performing social and digital communication efforts to that audience. We will continue to use an ongoing test-and-learn approach as we continue to leverage data and insights to support our strategic growth initiatives.

I look forward to sharing more on the learnings as we continue to focus on modernizing the J.Jill brand, explore opportunities within our sub brands and make progress against our other strategic initiatives.

Before I close, I want to acknowledge all of our team for their continued dedication to J.Jill and for delivering our customers the products and experience they love and expect from our brand. Our teams have continued to execute against our initiatives and our results year-to-date are a testament to their hard work as we continue to build a strong foundational platform for the long-term profitable growth of the company.

Now looking to the remainder of the year. While we continue to take a conservative outlook based on today's macro headwinds, we remain excited about continuing to delight our customers with beautiful styles and luxurious fabrications as she shops for the holiday and winter seasons.

Now I'm going to turn it over to Mark, who will go into detail about our financial performance.

Mark W. Webb
Executive VP and Chief Financial & Operating Officer

Thank you, Claire, and good morning, everyone. The third quarter again demonstrated the merits of our disciplined approach to managing the business with a profit-focused business model. The third quarter represented a difficult comparison to last year as we lapped the significantly lower full-price promotional performance in Q3 last year. Despite this difficult comparison, we maintained a low level of promotional activity and we're pleased to deliver gross margins and adjusted EBITDA above prior year.

Now for an overview of our financial results. Total company sales for the quarter were $150 million, down 1% versus Q3 2021. Total company comp sales were down 1.2%. Store sales for Q3 were down about 2.2% versus Q3 2021 on 5% fewer stores as higher average unit retails partially offset lower traffic from fewer stores. Direct sales as a percentage of total sales were 46% in the quarter. Direct sales were up 0.4% compared to the third quarter last year.

Looking at the rest of the P&L. Reflecting our continued focus on driving profitability, gross profit was $105 million, up $500,000 compared to Q3 2021. Q3 gross margin was 69.9%, up 100 basis points over Q3 2021, driven by moderating freight costs. We also benefited from the impact of strategic price increases, which offset product cost inflation.

SG&A expenses were $85 million compared to $86 million last year as increases in selling costs from store operating hours and shipping and strategic investments in marketing were offset by savings in occupancy costs and management incentives. SG&A was essentially flat as a percentage of sales compared to the prior year.

Adjusted EBITDA was $27.5 million or 18.3% of sales for the third quarter of 2022 compared to $27 million or 17.8% of sales in Q3 2021. Please refer to today's press release for a reconciliation of adjusted EBITDA.

Turning to cash flow. Results continue to demonstrate the strong cash generation of the business. Cash flow from operations was $31 million in the third quarter and $67 million year-to-date. End of third quarter cash was just over $90 million.

As will be noted in the 10-Q expected to be filed later today, we received an $8 million payment from the IRS late in the third quarter that was subsequently identified as an error. Following quarter end, that payment was repaid to the IRS.

Separately, in November, we received the expected remaining $9.2 million tax refund from the IRS associated with our fiscal 2020 tax filing.

As noted in our press release today, we continue to explore options to refinance our remaining outstanding term loan credit facilities and stand ready to execute when the market is supportive.

We ended the quarter with inventory up 5.7% compared to the end of third quarter 2021. This increase is driven by the timing of holiday for set receipts which we shipped and received earlier than last year to ensure on-time delivery of this important floor set. As we enter the fourth quarter, we are cautious on the consumer and stand ready to take promotional pricing action as necessary over the holiday period to ensure a clean end-of-year inventory position.

Capital expenditures in the quarter were approximately $3 million and were primarily related to the POS project as well as repairs and investments in the store environment. Capital spend will continue to ramp in the fourth quarter as we progress with the POS project and new store investments.

With regard to store count, we did not close or open any stores in the quarter, ending with 247 stores.

With respect to our future outlook for fiscal 2022, for the fourth quarter of fiscal 2022, we are projecting sales to be flat to down 3% versus Q4 2021 and adjusted EBITDA to be between $9 million and $11 million. Included in this outlook is an expectation that gross margins will be about flat to last year as any necessary pricing actions will be offset by the benefit from lower year-over-year freight costs.

The resulting expectation for full year 2022 is annual sales will grow between 4% and 5%, gross margins will be up about 100 basis points versus prior year and adjusted EBITDA will be between $103 million and $105 million compared to $92 million last year.

Regarding store count, we will close net 4 stores in the fourth quarter of fiscal 2022, including the opening of 1 new store late in the fourth quarter, ending the year with 243 stores.

And finally, we now expect capital expenditures of about $13 million for the year.
Thank you, and I will now hand it back to the operator for questions.

Question and Answer

Operator

[Operator Instructions]

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

Dana Lauren Telsey
Telsey Advisory Group LLC

Congratulations on the nice progress. Can you expand just on the top line, what you saw as you went through the quarter, any -- given that you had mentioned the slowing down in the second half of the second quarter, anything that you saw during Black Friday?

And when you think about your buckets of product categories, Claire, anything to note in terms of acceptance given the Welcome Everybody campaign?

And then, Mark, the moderating freight expenses, what magnitude of moderating freight are you thinking about as we move through 2023? And I think the CapEx reduction, is that delays in any stores? Or anything to note of, I think it was $2 million, a little bit lower than it had been, what we should be looking for?

Claire Spofford
President, CEO & Director

Sure. Thanks, Dana. We did see sort of an up-and-down cadence over the quarter. And we did see some resistance in terms of sort of basic categories. As you know, we stay close to the customer, and we have a tracker that we put in the field and to really get an understanding of how she's feeling, her consumer confidence, her purchase intent and how she's feeling kind of about the macro environment as well as how she's feeling about our brand and our products. And we did see an increase in sort of her hesitancy and her awareness and some caution around the macroeconomic environment.

That said, we continued to see very little price resistance for products that were truly unique and special. I mentioned on the -- in my remarks about the strength of dresses. We had a small capsule collection called Pure Jill elements, which is actually slightly higher price points, products with a lot of making them beautiful fabrics, artisanal details. We had a nice response to that and very little price resistance. So it really was a combination and, as I said, some ups and downs over the quarter.

With regard to Black Friday, obviously, that's this quarter, we are sticking to our strategies and our intent. And while we are certainly paying a lot of attention to what's happening in the macro environment and the competitive environment from a promotional cadence and level standpoint, we are -- we continue to try to minimize our promotions in full recognition of the fact that Q4 is just a little bit of a different animal. But we anniversaried the same promo level over that weekend as we did last year. And that's the product piece is really what I said. The special pieces, the unique pieces, the newness, standout categories like dresses. Wearever was strong in the quarter as well. Those are really the big callouts.

Mark W. Webb
Executive VP and Chief Financial & Operating Officer

Great. And Dana, I'll take maybe the second question first related to CapEx. Yes, you're right, it's a couple of delays in store -- new store openings that did move into the first quarter of next year. So pushed out.

And then I would just call it a couple of other delays. The supply chain for our particular part of the industry is much improved, and I'll talk about freight in a second. But with respect to procuring some technology assets, et cetera, there's slight delays still there. So nothing other than mostly shifting of expense or capital related to projects that are underway.

With respect to freight, we mentioned that there was about 100 bps of benefit in the Q3 margin related to freight costs moderating and that really is 2 factors right now. Remember, last year when things started to get complicated in the freight world, in the supply chain world, we made the decision to air goods in, and we're no longer really airing at elevated levels. And then we also were seeing ocean rates increase fairly dramatically late last year which carried over into this year. We are seeing those ocean rates moderate, but we're not back to pre levels yet. I think there's still room to go as we roll forward, with ocean rates continuing to come down. And we will continue to use air freight as we sort of normally like to use it, which is more strategically, for getting goods in a little bit of chase, et cetera, versus just securing goods on time.

The on-time deliveries, the reliability of the shipping lanes has improved dramatically. The rates are coming down, that should now turn to a tailwind. And we indicated it would in Q4 and then a little bit into the first half of next year as well.

Operator

[Operator Instructions]

Your next question comes from the line of Daniel Lupo from Jefferies.

Daniel James Lupo
Jefferies LLC, Fixed Income Research

Nice quarter. Just kind of diving in further to the store comps. Can you break out how we should think about price versus traffic mix?

Mark W. Webb
Executive VP and Chief Financial & Operating Officer

So Daniel, with respect to what's driving the revenue pricing, we've taken strategic price increases. We've spoken a little bit about it the last several quarters. Those strategic price increases are sort of in the system now. We also are still experiencing raw material, first-cost inflation in our goods. And we indicated on the third quarter that those strategic price increases essentially offset the inflationary pressures in our first cost. Our primary driver of inflation is cotton, and we're a heavy user of premium cotton or pima cotton, and that is a crop that we're watching and hopeful will start to come back down from its peak levels in the coming quarters.

The other factor we've had year-to-date, and it's worth noting, that our business model really has been to become much more focused on the full price promotional line. And that has been contributing on a year-over-year basis AUR or positive increases in AUR above and beyond the ticket price increases. And Q3, we mentioned on the call that it was the most difficult comparison, and that's because last year was really the first quarter of Q3 that we obtained a really low healthy level of full price promos where we want to be. So that year-over-year gain kind of went away, but now we're ticket full price mix, et cetera. As we continue to move forward, that will continue to drive the AUR.

Daniel James Lupo
Jefferies LLC, Fixed Income Research

Got it. That's helpful. And then just looking at the cash balance quarter-over-quarter, can you maybe talk about some of the puts and takes outside of the margin benefits that you saw year-over-year? Were there any kind of abnormalities in working capital? And maybe how you think about uses for cash? And maybe do you think that there's potentially you could use that for further delevering to help effectuate a refinancing?

Mark W. Webb
Executive VP and Chief Financial & Operating Officer

I think on the second front, we would say, yes as one of the potential uses for cash is addressing the balance sheet as well as fueling growth initiatives, et cetera.

The -- with respect to the quarter, I would say it's primarily gross margin-driven. We did call out, and it's a little bit complicated, but we did call out that there was, right at the end of the quarter, we've been awaiting a tax refund from our 2020 filings and we did receive a significant portion of what we expected late in the quarter. We subsequently identified that, that was an error, which we then repaid and then received immediately, almost simultaneously received the actual refund which is slightly more, it's about $1 million more than we had sitting in cash at the end of the quarter. In those, the balance sheet that you see, you'll have the cash that reflected that payment, again. Then you'd have a receivable that was for the entire amount, the $9.2 million amount. And then you'd have a payable that reflected the payable obligation to repay that $8 million up in cash. So it's more noisy than it needs to be. At the end of the day, net $1 million is better but just timing cusp through the quarter which is why we called it out in my script.

Daniel James Lupo
Jefferies LLC, Fixed Income Research

Got it. That's helpful. And then last question for me here. Looking at the fourth quarter guidance, on the top line, flat to down 3%. You said gross margin is expected to be flat year-over-year. It still looks like there's pretty significant kind of EBITDA margin compression. Given kind of the outperformance in the third quarter, can you maybe talk about the puts and takes into the 4Q margin guide and how you think about maybe some onetime kind of investments in G&A that could be leading to that compression, if that makes sense?

Mark W. Webb
Executive VP and Chief Financial & Operating Officer

Sure. Yes, there's a couple of things going on in SG&A. We've been alluding to them along the way, that kind of ramp into the fourth quarter, we have holiday operating hours for stores which does add pressure to SG&A in the fourth quarter relative to where we've been. We also have our strategic investments in marketing that we continue to make. And those really are, in our view, intended to address current business but also to build the pile and support future growth. So those continue.

What we mentioned on the Q4 guide behind the margin and the sales is that we are taking a cautious view of the consumer just given the macro uncertainty and noise, inflation, et cetera, and indicated that the gross margin will be flat, even though tailwinds are expected from freight. And those tailwinds in the fourth quarter, we've indicated will offset any additional promotional activity that arises as a result of the holiday promotional time period.

Operator
And there are no further questions. This concludes today's conference call. Thank you for your participation. You may now disconnect.

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