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J.Jill, Inc. NYSE:JILL

Earnings Call

Tuesday, December 5, 2023 1:00 PM GMT

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Call Participants

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Presentation

Operator

Good morning. My name is Krista, and I'll be your conference operator today. At this time, I would like to welcome everyone to the J.Jill Third Quarter 2023 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. The forward-looking statements made on this press release -- on this recording are as of December 5, 2023, 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 5, 2023. 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 joining us this morning. I will begin our discussion by reviewing highlights from our third quarter performance and will then provide an update on a few of our strategic initiatives before turning the call over to Mark to review our financial performance and outlook in more detail.

We are pleased with our third quarter performance and our continued strong execution of our disciplined operating model, which enabled us to deliver sales and adjusted EBITDA above our expectations. We saw particular strength earlier in the quarter, supported by solid customer reception to our transitional product as we entered the fall season.

Throughout the quarter, we continued to deliver collections that were versatile, modern and that appeal to our loyal customer base. This product flow drove nice growth in our core assortment in the third quarter, highlighted by particular strength in sweaters as well as wovens. As a result, we saw full price perform well across both our retail and direct channels, and we were pleased with the sequential top line improvement we delivered within direct compared to the prior quarter.

As we have discussed on prior calls, we're leveraging aspects of our assortment to not only celebrate the totality of women everywhere and fuel their journey with joy and ease, but to build strength and momentum across our customer file. In Q3, we continued to see growth in new-to-brand customers across both channels with particular strength in direct.

Our size inclusivity initiative and Wearever sub-brand are continuing to support our acquisition of new-to-brand customers who are younger than our average customer, but consistent with our target demographic.

During the third quarter, we successfully anniversaried the launch of our size inclusivity initiative from last year and delivered growth across all extended sizes despite the tougher comparison. We were also pleased with our Wearever Works capsule collection, which launched right after Labor Day and highlighted versatile pieces that customers could wear to work and that would carry them throughout their day.

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As we look ahead, we will continue to periodically launch capsules to lean into opportunities both from a top line growth perspective as well as providing an avenue for broadening our brand awareness and fueling the health of our customer file.

Throughout the quarter, we successfully leveraged our digital and influencer strategies and are pleased with the efficiencies these tactics have driven as well as giving exposure to new customer audiences. These marketing efforts, along with the benefits from the enhancements we made to the online customer experience earlier this summer helped support the sequential improvement in our direct channel this quarter compared to Q2.

While we're seeing an impact again from elevated return rates as the customer has become more discerning with her spend, particularly in certain categories, we believe through the actions we have taken with our updated fit guide and Shop The Model features, we have been able partially to mitigate the impact by ensuring that our customer understands and can find the right fit for her.

While we cannot control all external factors, we continue to operate with discipline in order to effectively manage all elements within our control and we are investing in both channels in order to drive balanced growth.

As mentioned previously, we implemented a new POS system this year, which is already yielding a more efficient and positive customer experience in stores. We are also embarking on an OMS project that we expect will enable more productive omnichannel capabilities. We look forward to updating you on this important initiative in the future.

In summary, we continue to operate with discipline, which has yielded better-than-expected results this quarter and supported our strong cash flow generation. We have a great brand with a wonderful loyal customer, and we are continuing to invest across our channels to enhance our experience wherever and whenever she chooses to shop with us.

We've continued to say that our customer is resilient but not impervious to macro uncertainty. And as I mentioned, we did see her pull back her spend later in the third quarter, which continued into the start of the fourth quarter, with some strengthening over the promotional Black Friday Cyber Monday period.

As a reminder, the fourth quarter is historically our smallest period from a sales and profitability perspective, positioning us differently from many of our retail peers. And while we are maintaining a prudent outlook for the remainder of the year, given the current trends and our recent customer survey work, we believe we remain well positioned to achieve our objectives for this year.

I will now turn the call over to Mark to review our results and outlook in more detail. Mark?

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

Thank you, Claire, and good morning, everyone. Our results again show the strength of the J.Jill brand and the benefits of our disciplined, purposeful operating model, especially amidst a dynamic macro environment.

Sales and adjusted EBITDA both actualized above guided levels as customers responded well to new floor sets, particularly early in the quarter. In addition, cash flow was once again strong in the quarter and disciplined inventory management resulted in clean end of quarter inventory levels.

Total company comparable sales for the third quarter increased 1.9% compared to last year's negative 1.2% comp. Total company sales for the quarter were $150 million, flat compared to Q3 2022. Store sales for Q3 were flat versus Q3 2022 on about 1% fewer stores.

Higher average unit retails in the channel were offset by lower units sold per transaction driven primarily by fewer markdown units sold. Direct sales as a percentage of total sales were 45% in the quarter. Compared to the third quarter of fiscal 2022, direct sales were down 0.5%, representing a sequential improvement compared to Q2.

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Q3 total company gross profit was $108 million, up $2.8 million compared to Q3 2022. Q3 gross margin was 71.8%, up 190 basis points versus Q3 2022 as favorability in freight costs and underlying first cost AUCs, strong full price selling and lower promotions all contributed.

SG&A expenses were $85.7 million compared to $84.9 million last year as increases in selling costs and general overhead, primarily due to wage inflation, were partially offset by lower depreciation and amortization. Adjusted EBITDA was $28.3 million in the quarter, up 3% compared to $27.5 million in Q3 2022. Please refer to today's press release for a reconciliation of adjusted EBITDA.

Turning to cash flow. Third quarter marked another strong quarter, generating $21 million of cash from operations and ending with $64 million in cash and 0 borrowings against the ABL. Inventories at end of Q3 were down 6% compared to the end of Q3 2022.

As mentioned last quarter, we have now anniversaried the supply chain disruption experienced in the first half of 2022. And as a result, our year-over-year comparisons are more normalized.

That said, as we look forward to the end of the year, we expect the 53rd week to impact reported inventory levels as we shipped spring goods that week, resulting in higher in-transit inventories at the end of the year. As a result of this impact, we expect total reported inventory at the end of Q4 to be up compared to last year.

Capital expenditures in the quarter were about $4 million compared to about $3 million last year. We neither closed or opened stores and ended the quarter with 245 stores. We are pleased to have completed the rollout of our new POS system during the third quarter.

The new system will improve the efficiency of transactions in store, add mobile line-busting capabilities and is the first step in a broader plan to enhance enterprise omni customer fulfillment opportunities. The next step in that plan is kicking off now with a project to replace and upgrade our legacy order management system, or OMS. We continue to train our staff on the capabilities of the new POS and are excited to begin work on OMS.

I want to take a moment and congratulate and thank the incredible team that executed the POS replacement. They worked hard with professional pride and dedication to make this project a success. So to the IS, corporate and store teams, thank you, and congratulations.

Turning now to our outlook. We continue to operate in a dynamic environment. As Claire mentioned, we saw softness at the end of the third quarter that carried into the start of the fourth quarter before strengthening somewhat on Black Friday Cyber Monday, albeit at elevated levels of promotion. Given this, we believe it's prudent to take a cautious approach with respect to our outlook for the remainder of the year.

For fourth quarter, we expect sales to be approximately flat versus Q4 2022 and adjusted EBITDA to be in the range of $11 million to $13 million. And for the full year, we are maintaining our outlook for adjusted EBITDA to be down in the low single digits compared to last year. As a reminder, fourth quarter and the full year include an approximate $2 million adjusted EBITDA benefit from the 53rd week.

Regarding store count, we still expect to close 2 stores in the fourth quarter to end 2023 store count flat to last year. And with respect to full year capital, we expect to spend about $18 million with investments focused on technology, stores and facilities capital and the POS and OMS projects.

In summary, we continue to operate a very disciplined operating model and remain on track to deliver another strong year of cash flow generation, positioning us well to continue investing in the business and evaluating opportunities to drive profitable growth and total shareholder returns.
Thank you, and I will now hand it back to the operator for questions.

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Question and Answer

Operator

[Operator Instructions] Your first question comes from Jeff Lick from B. Riley Financial.

Jeffrey Francis Lick
B. Riley Securities, Inc., Research Division

Congrats on a nice quarter. Guys, I was wondering if you could just -- you referenced the third quarter -- the end of third quarter weakness and then obviously into the fourth quarter, but the Black Friday pickup. I wonder if you could unpack that a little bit and then also you referenced the customer survey work. Maybe you could wrap what you've learned there with the observations you're seeing at the end of the third quarter, into the fourth quarter and then the Black Friday kind of promotional period?

Claire Spofford
President, CEO & Director

Sure. Thanks, Jeff. We did see sort of a slowdown coming out of Q3, which we attributed to sort of more discernment on the part of the customer. We do, do every quarter at least this pulse survey just to understand kind of where our customers mind is relative to purchase intent macro environment, how she's feeling about things in general.

And we did see that there is a level of concern there, which is understandable given the macro uncertainty. So we pay attention to that, and we did see softness coming out of Q3. As we entered Q4, we continue to see that trend.

We held our powder on the promotional levels, unlike I think some of the macro -- or some of the competitive environment where people were initiating their Black Friday level promotions earlier, we did not do that, and we did continue to see some softness coming into Q4 as we moved into the promotional period over the Black Friday Cyber Monday weekend, we did see her respond to those promotions.

So that's just a little bit more color, and we're obviously continuing to watch her behavior very carefully. And I think that cautiousness is reflected in our guide for the fourth quarter.

Jeffrey Francis Lick
B. Riley Securities, Inc., Research Division

And then one for Mark. With the gross -- Q3 gross margins continue to kind of shine especially if you look at it relative to 2 and 3 years ago, your guidance would imply -- your 4Q guidance would imply you have less of room there for the promotional environment that we just talked about. I was wondering if you could comment on that and then also just wrap in anything with the POS that's now in place and the OMS that's getting in place to where there might be some benefits in the P&L from that.

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

Sure, Jeff. Thanks. Yes, I think the drivers of the gross margin in Q3, and it continues to be another hallmark of the operating model, just the strength in the gross margin, and we are pleased with it in Q3. The drivers were freight, though we've indicated that freight is a diminishing benefit throughout this year. So that will continue to be less of a benefit -- a small benefit, but less of a benefit into Q4.

We cited underlying first cost AUCs that's really cotton, which we've talked a bit about, that the price broke on cotton late last year, and we're starting to see that benefit come in. That is going to be a tailwind for us as we go forward. Then the other 2 drivers really were a function of the operating environment with full price selling and a lower promotional environment.

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Again, happy with how that played out over the course of Q3, though, obviously, as Claire just mentioned in response to your question, the end was a bit softer than the start. But that AUC benefit does create the opportunity for us as we go forward to continue to deploy some of it if needed into promotions.

And I think as we've mentioned in the guide and the cautious approach, we're expecting it to be a promotional environment. It's certainly has started to be with Black Friday Cyber Monday, and this is the time of the year for promotions. So we stand ready to do that.

And then you mentioned POS, OMS. Sorry, do you want to follow up?

Jeffrey Francis Lick
B. Riley Securities, Inc., Research Division

Yes. No, go ahead. I was going to ask about that. And then also, it would be great if maybe you could just compare and contrast some of the lessons you had in your previous life at the Gap who's done all this because I think maybe what you're doing here is underappreciated.

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

Well, let me -- so POS, OMS, super happy to have gotten the full fleet deployed in Q3. When you roll out a new system, it's -- it is a great thing. The store staff, the customers have noticed the new technology. We are still learning a new technology. So that's going to continue.

We're excited for the opportunities that it presents for us to really take an existing customer experience and enhance it and improve it, drive conversion by really making it a more seamless transaction within the store, with respect to returns, with respect to exchanges and then initially with POS with respect to store purchase of an online good, an in-store purchase of an item from our website, right? So that is all enhanced with the new POS rollout.

Excited to get OMS underway. OMS sort of completes the rest of the enterprise inventory picture and does enable us to be more efficient in the operations just because the technology that we're replacing is aged and getting new technology in will help streamline some of the technology handoffs.

And then it also enables omni capabilities with respect to shipping from store and buying online, picking up in store, all of those things that are out in the marketplace that we feel we are a fast follower on and a good place for us to be and looking forward to getting those benefits in the years to come.

Jeffrey Francis Lick
B. Riley Securities, Inc., Research Division

Congrats on the great quarter.

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

Thanks, Jeff.

Claire Spofford
President, CEO & Director

Thanks, Jeff.

Operator

Your next question comes from Ryan Meyers from Lake Street Capital Markets.

Ryan Robert Meyers
Lake Street Capital Markets, LLC, Research Division

First one for me, obviously, another quarter of really strong cash flow generation. Just wondering if you guys can provide us with some detail on what your capital allocation strategy is going forward?

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

Sure, Ryan. We've been pretty consistent. We were super pleased to be able to refinance our debt earlier this year, tough market to do so, but I feel like we got a good piece of paper in place with tenor and lowered quantum and feel like that was a good result for us. As we continue to execute our operating model, that cash flow generation is a big part of the story.

And we feel like that cash creates the opportunity for us to invest in the business and drive profitable growth. Claire mentioned several examples of that in her remarks and has spoken before about it. And it allows us to enhance the foundational systems of the company, which we're doing with POS and OMS. And then there's still cash left over.

So what we've said before and we continue to evaluate is how best to deploy that cash to obtain the ultimate objective of driving total shareholder returns. More to come on that as time progresses, I would imagine, but nothing more to say at this point on that other than that is our objective.

Ryan Robert Meyers
Lake Street Capital Markets, LLC, Research Division

Okay. That makes sense. And then obviously, you kind of talked about that sort of Q4 margin. A lot of that's going to be coming from the promotional environment. Obviously, we've kind of had one month here of this running promotions in this environment.

Have you seen some increased spend from the customers as you ran some of these promotions? Or how has this push of this more promotional environment in Q4, how have you seen customers respond to that so far?

Claire Spofford
President, CEO & Director

Yes. Thanks, Ryan. We -- as we mentioned, reflected in our guide is the room to promote appropriately in order to achieve our objectives of driving the sales, moving through our inventory and coming out of the year in the position we want to from an inventory perspective. Obviously, we are a brand and a business that tries to not promote more than we have to. And so we tried to toe the line as much as we can, but recognize that the fourth quarter is a very promotional quarter.

As I mentioned in my remarks, it is also our smallest quarter from a top line and EBITDA standpoint. So we're navigating. We're staying close and we're pulling the levers that we need to pull to achieve those objectives of the sales and the clean inventory position while maintaining our margin profile to the extent possible. But all of that is rolled into our guide for the fourth quarter.

And we -- as always, feel great about our brand, feel great about our product and feel great about our customer, and we're just navigating but consistent with the way we've been managing the business all year.

Operator

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

Dana Lauren Telsey
Telsey Advisory Group LLC

Good morning, everyone, and nice to see the progress. As you think about on the gross margin side, the AUC opportunity going forward, where are we in that path of AUC? And how does that look? And then you mentioned, Claire, about some of the categories, anything you saw on the Pure Jill or wherever collection as compared to the core categories and what you saw the customer responding to or how the return rates differing by category? And lastly, you've talked about capturing the younger customer. Anything that you saw this quarter from the young customer and their buying preferences compared to the core?

Claire Spofford

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President, CEO & Director

Sure. I'll answer the latter 2, Dana, and then I'll hand it over to Mark to address the AUC question.

So from a category standpoint, in Q3, we really saw a nice strength in our core assortment. We saw growth there. I think a couple of things, in particular, we had a robust refresh in August, which performed very well, and we had a really nice transition into fall and saw a nice response to our transitional product, which we feel like we got right from a silhouette standpoint, from a color pallet change standpoint and saw a nice response to all of that.

In the core assortment in particular, we saw strength in sweaters and in wovens, particularly woven tops where print and pattern were very strong, and we saw some strength in denim as well.

From a sub-brand standpoint, this was a quarter where Wearever was really the shining star from a sub-brand standpoint. As you know, we've been leaning into Wearever for the work usage occasion for our customers, and we've been seeing nice traction there in attracting new, younger -- as I say, younger but still consistent with our target demographic customers.

Post Labor Day, we had a capsule called Wearever Works, which was kind of the ultimate expression of that, slightly higher price points. A little bit more kind of waist interest and a little bit more sophistication and refinement, which we really aimed at the wear-to-work usage occasion, and we saw a really nice response to that as well. So that's a concept and a capsule that we will continue to lean into over the course of the coming months and quarters.

And that Wear-to-Work Edit as well as our size inclusivity initiative were both continued to be great avenues for us in terms of new-to-brand customer acquisition and new-to-brand customers that were a little bit on the younger side of our target and also from a size inclusivity initiative that we lapped in Q3 versus the launch last year, and we continue to see the acquisition of really valuable customers on to the file.

So all of that, we felt some nice traction in Q3 and our initiatives that we will continue to lean into as we go forward.

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

And Dana, with respect to the AUCs, as I mentioned previously, it's really the go-forward tailwind that I would point to is related to raw materials and cotton. And I would expect that tailwind to continue. It started a little bit last quarter. So probably continue forward for maybe through the first half of next year, where are some on the horizon pressures coming from other crops that are out there, flax and linen, et cetera.

So we're always watching the crop reports that can have tugs and pulls on AUC for us. But overall, I expect that cotton-based benefit to continue. We've said before that the margin rates that we're achieving are very healthy for us as a business. We don't necessarily need to expand them anymore for our business model.

And so view those tailwinds while it's good to have them as an opportunity for us to -- within our disciplined operating model, comfortable making the investments that we've talked about, which inherently do carry in their inception a little bit more risk and allow us to go into those with a bit more comfort.

So that's how we're thinking about the underlying AUCs right now.

Dana Lauren Telsey
Telsey Advisory Group LLC

Got it. Just any thoughts or breaking down by channel stores and online, what the drivers were this quarter? And lastly, any thoughts on store openings for next year as you're beginning to dip your toe in the water a little bit?

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

Sure. We've said, Dana, that we expect next year to be a year where we would return to some level of store growth. That's, of course, dependent upon successful negotiations with our landlords and getting the right deals. But we've worked through much of the fleet and feel like we're in a place where we can start to think about returning to some net store growth.

As far as in the quarter, the channels and the drivers, we were pleased to see direct improve sequentially. The channel has had some investments Claire mentioned in her remarks that have helped to drive that channel and it's one that we feel good about.

The stores, there wasn't a lot of geographical difference in the drivers through the quarter. The lifestyle centers continue to perform better from a traffic perspective than malls. And then no real differentials on a large scale across the rest of the geographies.

Operator
And we have no further questions in our queue at this time. And with that, that concludes today's conference call. Thank you for your participation, and you may now disconnect.

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