Destination XL Group, Inc.

Fourth-Quarter 2014 Conference Call Prepared Remarks

Operator:

Good day, ladies and gentlemen. Welcome to Destination XL Group's fourth-quarter Fiscal 2014 financial results conference call. Today's call is being recorded. At this time, all participants have been placed in a listen-only mode. There will be an opportunity for questions and comments after the prepared remarks. (Operator Instructions). I'll now turn the call over to Mr. Jeff Unger, the company's VP of IR, for opening remarks and introductions. Please go ahead, sir.

Jeff Unger:

Good morning, everyone. Thank you for joining us today on Destination XL Group's fourth-quarter fiscal 2014 call. On our call today are David Levin, our President and Chief Executive Officer, and Peter Stratton, our Senior Vice President and Chief Financial Officer.

During today's call, we will discuss some non-GAAP metrics to provide investors with useful information about our financial performance. Please refer to our earnings release, which was filed this morning and is available on our website at investor.destinationxl.com, for an explanation and reconciliation of such measures. Today's discussion also contains certain forward-looking statements concerning the Company's operations, performance and financial condition, including sales, profitability, EBITDA, expenses, gross margin, capital expenditures, sales per square foot, earnings per share, store openings and closings, and other such matters. Such forward-looking statements are subject to various risks and uncertainties that could cause actual results to differ materially from those assumptions mentioned today, due to a variety of factors that affect the Company. Information regarding risks and uncertainties are detailed in the Company's filings with the Securities and Exchange Commission.

Now I would like to turn the call over to our President and CEO, David Levin.

David Levin:

Thank you, Jeff, and good morning everyone.

Before I get into the details of the quarter, I want to put our performance into perspective. These results were outstanding and represented a true breakthrough for Destination XL by a number of measures. We have reached a new level of performance with the DXL concept, and we are excited about what this success means for us as we move into Fiscal 2015.

Highlighting our performance this quarter was a 16.4% comparable sales increase in our 93 DXL stores that were open at least 13 months. It's important to note that this was a very strong comp *on top* of a solid double-digit comp in the prior year's fourth quarter. We also achieved our seventh consecutive quarter of double-digit DXL store comps – a very impressive result in what has been a challenging overall retail environment. Perhaps most importantly, we executed well against the plan we laid out for investors at the beginning of the 2014 fiscal year and achieved our financial targets -- even as many other retailers were forced to reduce their expectations for the year. Our financial performance demonstrates the success of our DXL transformation strategy.

One aspect of the DXL strategy that has been a big success recently is our decision to keep Casual Male XL stores open for several months in markets where we have opened new Destination XL stores. This initiative is really paying dividends, as our Casual Male stores are serving as brand ambassadors to direct existing shoppers to the new DXL stores. In these markets, we are seeing a higher rate of Casual Male customers transitioning to the DXL brand. In fact, 44% of Casual Male customers have now become DXL customers, compared with 37% at the start of Fiscal 2014. Overall, our 2014 conversion rate is up 19% from the prior year.

Our strong Q4 sales also benefited from the strategic timing of our fall marketing campaign and a successful bounce-back promotion. We began the marketing campaign three weeks later this year, in order to cover the peak of the season, and this led to a surge in holiday sales. DXL comparable sales continued to be strong throughout January following the end of the campaign in mid-December. This was in contrast to Q4 2013, when the fall campaign ended in mid-November. We also chose higher-quality ad placements, running ads during NFL and college football games on weekends, when our customers were more likely to go shopping. Our marketing and promotional efforts helped increase traffic at DXL stores from the same quarter last year, and we converted that traffic to top-line sales, resulting in an increase for the quarter of 13.9% in the total number of transactions.

Meanwhile, our Destination XL customer base continues to grow, both overall and on a per-store basis. The total number of DXL customers in

2014 increased 124%, while the average number of customers per store was up 9% year-over-year and up 88% from the average count at legacy Casual Male XL stores.

We also are seeing a substantial increase in our end-of-rack customers. We believe that these younger, smaller-waisted, more brand-conscious shoppers make up nearly two-thirds of the total big-and-tall market. They also tend to spend more per transaction, so this is a desirable target market for us. We have focused on increasing our reach with the end-of-the-rack guy, and that work is really paying off now. These customers represented 45% of our bottoms business in the fourth quarter – our highest rate to date. For comparison purposes, end-of-the-rack customers make up only 33% of bottoms sales at our Casual Male stores.

Another metric that we are particularly proud of this year is sales per square foot. At the beginning of the year, we set a goal of reaching $160 in our DXL stores for 2014. I'm very pleased to report that we not only achieved that goal, but we exceeded it and finished the year at $165 in sales per square foot, compared with $150 at the end of Fiscal 2013. Our long-term expectation is that DXL stores will reach $200 to $220 in sales per square foot as each store reaches maturity. In fact, during Fiscal 2014, 27 DXL stores have already achieved this target, with sales greater than $200 per square foot.

It's also worth reminding everyone that sales per square foot calculations may differ among other retailers in the industry and, therefore, are not necessarily comparable to those at DXL stores. At DXL, we measure sales per square foot based on the store square footage that is built out during construction. This includes non-selling square footage such as break rooms, stock rooms and tailor shops. Our new, smaller-footprint DXL stores will help drive this metric. The economics of the smaller stores – which range between 5,000 and 6,500 square feet – are similar to those of our larger DXL format stores, but with lower occupancy and capex costs. This results in the same return on investment of our larger stores but on a smaller base. We now have 7 of these smaller DXLs in operation, and we expect to open 16 additional smaller stores in Fiscal 2015.

In addition to our brick-and-mortar DXL expansion, we are also making a substantial investment in technology to drive online sales. One example of this investment was the launch in 2014 of our "ship from store" technology, StoreNet. Since we rolled out StoreNet at the beginning of the year, we've seen a tremendous new paradigm, both for our customers and for

Destination XL. This technology enables our stores to fulfill online orders that cannot be fulfilled by our distribution center. In effect, it expands our available online inventory and gives our Internet customer visibility to all the inventory in the chain, including merchandise that is only available in a small number of stores. This investment is improving the customer experience and allowing us to capture increased sales at higher merchandise margins. Our goal has been to provide a seamless customer experience whether he shops at a brick-and-mortar store or via computer, smartphone or tablet.

To further enhance the customer experience, we are excited to announce that in May of this year, we are on track to launch “shop online, pick-up in store.” This will allow our customer to make a last-minute purchase online and pick up items in the DXL store closest to him. This feature enhances the customer relationship by bringing guests into our stores, where sales associates can then recommend additional items at the point of sale.

For the past 3-1/2 years, we have been perfecting our DXL stores and redefining the men’s big and tall shopping experience. We have now created several store formats that are both economically successful and have the ability to satisfy all big and tall customers from waist 38 inches and up. The Casual Male or Rochester store was never able to satisfy the breadth of the big and tall customers' wardrobe needs. We made minor changes and adjustments along the way, and these have only strengthened our enthusiasm for the DXL concept. We have now opened more than 140 stores and expect to open another approximately 100 stores by the end of Fiscal 2017. We opened our first DXL store in Manhattan last week on Sixth Avenue and 23rd Street, and we'll be holding an analyst and investor store tour on Thursday, April 16. And we hope to see many of you there.

We are clearly excited by our outstanding fourth-quarter financial results and very positive key DXL performance metrics for the year. Going forward, we are building on this success by driving strong sales growth at existing DXL stores and opening an additional 40 DXL stores this fiscal year. As we scale our business through increased volumes, we expect to further expand operating margins through a more advantageous cost structure. Our solid strategic execution in 2014 gives us great optimism for continued broad-based success in 2015.

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

Peter Stratton:

Thank you, David, and good morning, everyone. There are a few different topics that I'd like to talk about today. First, I'll start by highlighting the Company's results for the fourth quarter of Fiscal 2014. Then, I'll go through our new guidance for Fiscal 2015. Lastly, I'd like to talk a little bit about our long-term outlook for the company, and more specifically, our expectations for Fiscal 2016.

First, let me start with telling all of you how extremely pleased we were with our fourth quarter performance as sales exceeded our expectations. For the quarter, we reported a total comparable sales increase of 8.9% vs. just 4.2% in the fourth quarter of Fiscal 2013. At the heart of this improvement were our 93 DXL stores that have been open for at least 13 months. These stores delivered a comparable sales increase of 16.4%, which is the highest quarterly comp we've seen in the DXL stores since the second quarter of 2013, when we launched our first DXL television and radio commercials. This quarter also represents our seventh consecutive quarter with double-digit DXL comp sales growth. Sales for the quarter were propelled by a 13.9% increase in transactions. Both Traffic and Conversion, which we define as the percentage of visits that resulted in a transaction, contributed to this increase. The growth in Traffic and Conversion is a very positive indicator for our business, because it proves that not only are we building customer awareness with the DXL concept, but we are also improving our sales productivity.

Moving on to Gross Margin … For the fourth quarter, Gross Margin including occupancy costs was 47.9%, versus 44.8% for the fourth quarter of Fiscal 2013. The 310 basis point improvement was largely due to a gain on the termination of our lease at our former Rochester San Francisco store. The termination fee was $2.5 million and was based on approximately 2 years that was remaining on the lease term. As a result, total occupancy costs for the quarter declined 370 basis points. This decline was partially offset by a 60 basis point decline in merchandise margins, which was due to our aggressive promotions to convert our Casual Male customers to the DXL store format. Together, these two components account for the 310 basis point improvement for the quarter.

SG&A costs for the fourth quarter increased by $0.7 million, in large part due to the shift in the timing of our fall marketing program, as well as an increase in payroll costs for our 41 new DXL stores. However, these increases were partially offset in a quarter-to-quarter comparison by the fact that the fourth quarter of Fiscal 2013 included a charge of approximately $2.3 million for severance costs. As a percent of sales, SG&A improved, declining 380 basis points from 44.1% of sales last year to 40.3% of sales this year.

Next, I'd like to talk to you briefly about EBITDA. We follow EBITDA very closely, because we believe it provides a good representation of the underlying business fundamentals and therefore is a meaningful indicator of financial performance. Cash management is important for us during our transition to the DXL concept, and we believe EBITDA is a key component in evaluating free cash flow. For the fourth quarter of Fiscal 2014, EBITDA from continuing operations was $9.1 million, compared to $800,000 in the fourth quarter of Fiscal 2013.

Now let's turn to the bottom line. Net Income for the fourth quarter was $1.6 million, or $0.03 per share, compared to a net loss of $55.1 million, or a los of ($1.14) per share in the fourth quarter of Fiscal 2013. Keep in mind that last year we established a tax valuation allowance, which resulted in a $51.3 million non-cash charge to the GAAP loss last year. On a non-GAAP basis, adjusted income from continuing operations for the fourth quarter

2014 was $0.02 per share, compared to a fourth-quarter loss last year of ($0.04).

Next, just a few quick comments on Capital Expenditures….CAPEX for Fiscal 2014 was $40.9 million, down from $54.1 million in Fiscal 2013. The reduction in CAPEX was due in large part to the decision we outlined at the start of the fiscal year to open approximately 40 DXL stores in 2014, versus the 51 DXL stores we opened in 2013. CAPEX, net of tenant allowances, was $30.9 million in Fiscal 2014 and $44.2 million in Fiscal 2013. We opened 39 DXL stores and two DXL outlet stores, meeting our original plan to open 40 stores. We now have a total of 138 DXL stores and 2 DXL outlets open across the country.

Turning to the balance sheet, inventory at the end of the year was up $9.6 million, or 9.2%, from the fourth quarter last year. The reason for this increase is two-fold: First, with 41 additional DXL stores, we carried a greater percentage of branded apparel. Second, we made a conscious effort in 2014 to take early receipt of merchandise to ensure sufficient in-stock inventory positions in advance of the spring selling season. Our inventory is in excellent shape. As David described earlier in the call, we now have the capability of offering our in-store merchandise to our online customer. This has created a tremendous opportunity for us to sell through our clearance merchandise at a much higher rate than in the past. Our clearance inventory now represents 8.4% of total inventory, compared with 10.3% in Q4 last year. This puts us in a much cleaner position as we head into 2015. Total Debt as of year-end was $53.5 million, which includes borrowings under the revolving credit facility of $19.4 million, with excess availability of $77.9 million.

And now, I'd like to discuss our 2015 guidance, which we are introducing today. For the 2015 fiscal year, we expect:

- Total sales to be in the range of $438.0 to $443.0 million.
- A total comparable sales increase of approximately 5.6%.
- Gross profit margin of approximately 45.9%.
- SG&A costs of approximately $181.5 million.
- Depreciation and amortization expense of approximately $28.5 million.
- EBITDA in the range of $19.0 to $23.0 million.
- Operating margin to be between negative 2.2% and negative 1.2%.
- And we expect a GAAP net loss of $(0.20) to $(0.27) per diluted share, or a loss of $(0.12) to a loss of $(0.16) per diluted share on a

non-GAAP basis, assuming a normal tax benefit of approximately 40%.

Our net capital expenditures for 2015 are expected to be in the range of $33.0 to $35.0 million, after expected tenant allowances contributed by our landlords on the new DXL sites. These expenditures will be made largely on our planned opening of DXL stores, as well as technology projects to continue to improve the e-commerce site and the in-store customer experience.

Total Borrowings at the end of Fiscal 2015 are expected to be in the range of $72.0 to $76.0 million, consisting of a range of $45 to $49 million under the credit facility, $14 million under the term loan and approximately $13 million in equipment financings.

Lastly, I’d like to talk for a few minutes about our long-term outlook, specifically as it relates to Fiscal 2016. Traditionally, we have only given detailed guidance one year at a time. And it’s very difficult for a retailer to project beyond one year, because the second year is so dependent on the first year. However, 2015 is going to be a transformational year for Destination XL, and we believe it’s important to share our current high-level outlook for 2016 with you.

Our Total Sales outlook for 2016 is approximately $470 million. We expect the company will have opened approximately 210 DXL stores by the end of 2016, and we will be approaching a more normalized pace of DXL openings. Our EBITDA outlook for 2016 is approximately $35 million. This is a significant lift from our EBITDA guidance for 2015 of $19 million to $23 million. Two important factors are contributing to this significant improvement. First, the incremental SG&A expense in 2016 will be very modest. And second, we will begin to see slightly more Occupancy leverage on our Gross Margin rates once we move into 2016. Over the past two years, we have seen a clear acceleration in EBITDA from $7.3 million in 2013 to $15.2 million in 2014. We believe that that acceleration is going to continue in 2015 and into 2016.

To summarize:

- We are very pleased with our fourth-quarter and full-year financial results;
- These results demonstrate the success of our DXL concept and the solid execution of our strategy;
- And we expect even better results in 2015, with accelerated revenue and EBITDA performance in 2016.

With that, operator, we will open the call for questions.

Q&A Session

Operator:

And gentlemen, it appears we have no further questions at this time.

David Levin:

Okay, thank you all for joining our call today. As I always do, I'd like to end by inviting you to visit one of our DXL stores. As I stated, on April 16, we're going to have an investor / analyst day at our new store in Manhattan. We encourage all of you to come for a nice tour. We are very proud of the store we've put there.

And again, if you would like to visit about any other store, please let us know, and we will give you a tour. We look forward to speaking with you next quarter. Thank you very much.