Destination XL Group, Inc.

First-Quarter 2015 Conference Call Prepared Remarks

Operator:

Good day, and welcome to the DXLG first-quarter Fiscal 2015 earnings call. Today's conference is being recorded. At this time, I'd like to turn the conference over to Mr. Jeff Unger. Please go ahead.

Jeff Unger:

Thank you, Jennifer. Good morning, everyone. Thank you for joining us today for DXL's first-quarter fiscal 2015 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 our first-quarter performance, I want to take a moment to explain where we are in the evolution of the DXL concept. Fiscal 2015 is a pivotal year for us, building on a highly successful finish to 2014. We expect great things throughout this fiscal year in our drive toward profitability in fiscal 2016.

There are three key factors that differentiate DXL from our direct competitors in the big-and-tall men's apparel sector that are helping to drive our success.

First, we dominate the big-and-tall industry. We are, by far, the largest specialty retailer in both brick-and-mortar and online sales. We have 357 stores among our three brands, and the next-largest competitor has four stores. That's a huge advantage for us. In online web traffic, we now have a 58% traffic share, and that figure has been growing steadily each month. We have all the major brands our customers want, including 22 exclusive brands for big-and-tall. Other chains with substantially greater resources have tried to enter this segment, and they have all left the space. We are playing offense now, and our future is extremely bright.

Second, between Casual Male and now Destination XL, we have spent years gathering a great deal of intelligence and proprietary knowledge about each individual market and each store within each market. This first-hand knowledge developed from our legacy stores continues to be a crucial success factor in the DXL store rollout. I can't tell you how much of an advantage this is: to have years of proprietary sales, sizing and customer data based on real experience. That's why, when you look at the performance of our 150 DXL retail stores, only 1 store has been identified to be shut down due to underperformance. Contrast that with other retailers who have a portfolio of underperforming stores that they are trying to close. We know the formula for where to put these stores, how many to place in a given market, the correct store footprint for each of our markets and which sizes of each product to stock. Along the way, our experience has enabled us to bring down our average build-out cost, as well. Where we used to spend $100 a foot, we’ve now reduced that to approximately $75 a foot. We’re very comfortable with our strategy, and this gives us great confidence in the future.

Third, our destination location model is driving long-term sales growth with strong multi-year comps. When specialty retailers open a store in a mall, these stores mature very quickly. Their growth is fueled by existing mall traffic that is highly dependent on co-tenancy. In contrast, the destination model takes several years to mature and is not dependent on mall traffic or co-tenancy.

Our stores continue to produce high sales comps for the first few years. That’s because with destination retail stores like DXL, shoppers don’t always know where the stores are until they see a commercial or drive by and discover the store. So, the store's customer base increases over time, and until the store matures after five years, we can expect strong multiple-year comps. Our goal for the average store in the first five years of comps – and this is based on several years' experience thus far – is 12%, 10%, 8%, 6% and then 4%. So, after five years in the comp base, our store sales grow approximately 45% greater than the first year the store was opened. This is the strength of the destination model – DXL stores we opened in 2010 are just now starting to average a mature sales growth rate of low single digits. Also, it is important to note that this is a larger comp sales base than our legacy stores.

In 2013, we opened 51 stores, and last year, we opened 40 stores. Those stores will continue to produce strong comps until 2018 or 2019. And this year, we expect to open 40 additional stores. So if you look at our financials in three to five years, you would see tremendous earnings power created by this highly differentiated model. No one else in retail is doing this, and it is important that investors take that into consideration as they look at traditional stores versus how they view Destination XL in 2016, 2017 and beyond.

As you can tell, we're excited about the progress we've made and the direction in which we are headed. We have truly created a unique experience for our customers, and this is driving our robust financial performance.

This leads me to our first-quarter results. We began fiscal 2015 with an excellent quarter. We continued to execute well and perform in line with our plan, and our success underscores the potential for the DXL concept.

Our sales for DXL retail stores continue to be strong. In the first quarter, we reported an 8.7% comparable sales increase in our 104 DXL stores that were open at least 13 months. And this was on top of a 12.8% comp in the prior year's first quarter. Putting our Q1 sales performance in perspective, we accomplished this in a very challenging retail environment where we believe an 8.7% comp is impressive. In fact, we believe that our Q1 comparable sales would have been even stronger if not for the historically severe winter weather in the Northeast.

Included in our sales results for Q1 was a strong performance from our new, smaller-footprint DXL retail stores. As we've discussed, 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 has resulted in the same return on investment as our larger stores but on a smaller base. Because we continue to tailor our store size, our ROI each year continues to get better. Our 5 year Internalized Rate of Return on our 2010-2012 DXL stores is 30-32%, 38% on our 2013 stores and 42% on our 2014 stores. Our ability to successfully roll out this smaller footprint model gives us optimism that we can build a store count greater than we had initially expected after 2017. We will now be able to go into smaller markets or add additional stores in certain markets.

In addition to our smaller-footprint DXL stores, our DXL outlet stores have also been a great success thus far. During the quarter, we opened two new DXL outlets. We are opening DXL outlet stores where we have an opportunity to expand or move into a space within the same shopping center that could accommodate the larger size of a DXL outlet, which is about 5,000 square feet, or about 1,500 square feet larger than a Casual Male outlet store. We opened two DXL outlets last year, and they are performing very well thus far.

In addition to our brick-and-mortar stores, we've also seen excellent success with our "ship from store" technology, StoreNet. This technology enables our stores to fulfill online orders that cannot be fulfilled by our distribution center, greatly expanding our available online inventory. 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. The second phase of StoreNet was to launch “shop online, pick-up in store.” This allows customers to make last-minute purchases online and pick up items in the closest DXL store. This feature enhances customer relationships by bringing guests into our stores, where sales associates can then recommend additional items at the point of sale. We launched “shop online, pick up in store” in a limited number of stores this month and will be rolling out to the balance of the chain by the end of the second quarter.

We’re excited about our new advertising flight, which began on NFL draft day on April 30 with an ad on ESPN and continues through Father’s Day in June. Our spring advertising includes three vignettes that focus on how men look and how they feel when they shop in our stores. Our marketing of the DXL concept has been highly successful and has been an important component of our steadily increasing performance.

There are a handful of key metrics that we follow very closely to ensure our transformation is on track. First, the number of active customers in our database has grown at a very impressive 6% in the past 12 months. Our DXL stores on average have 88% more customers than our Casual Male stores, and the retention rate for those stores is 32% greater than our Casual Male stores. Our End-of-Rack customer base continues to grow as well, representing 42.1% of our bottoms business for the first quarter as compared with 39.6% for last year's first quarter. These metrics are helping to drive a significant increase in transactions, which have grown 6.6% from last year's first quarter. And the amount customers are spending in the stores is also growing, with dollars per transaction up 2.1% from Q1 last year.

We are planning to spend approximately $23.9 million, or 5.4% of sales, on marketing this year, compared with $26.0 million or 6.3% of sales in 2014. We are becoming more efficient with our media purchases, and our marketing spend will continue to decrease on both a real-dollar basis and as a percentage of sales.

Before I turn the call over to Peter for the quarterly financial review, let me sum up with a few thoughts.

First, our financial performance in Q1 continues the strong momentum we achieved coming out of 2014. The DXL concept is working, and we are on track with our sales and earnings growth plan.

Second, we've had very good success with our smaller-footprint DXL stores, and now with our DXL outlet stores, as well. In addition to our brick-and-mortar stores, our StoreNet technology is enabling omni-channel growth, which is a tremendous new paradigm, both for our customers and for Destination XL.

And finally, we are very optimistic about translating this success into strong EBITDA and accelerating cash flow in 2016 and beyond.

With that, I'll turn it over to Peter for the financial review.

Peter Stratton:

Thank you, David, and good morning, everyone.

As you can tell from David's introductory comments, we have never been more confident in our ability to execute on our strategy. Once again, we are very pleased to report a very strong quarterly result to all of you today.

During the first quarter, we reported a total comparable sales increase of

5.5% versus 3.4% in the prior-year quarter. Driving this improvement were our 104 DXL stores that have been open for at least 13 months. These stores delivered a comparable sales increase of 8.7%, spurred by a 6.6% increase in the number of transactions. We're very pleased to see that sales continue to be driven primarily through traffic and conversion, which we know is much more sustainable long term than growth from average transaction value.

Moving on to Gross Margin … For the first quarter, Gross Margin, including occupancy costs, was 46.2%, versus 45.5% for the first quarter of fiscal 2014. The 70-basis-point improvement was largely due to a 70-basis-point reduction in occupancy costs as a percentage of total sales. Driving that reduction in occupancy costs was a $600,000 one-time reversal of a lease exit reserve. The reserve was reversed because we decided to open a Casual Male Outlet store in a previously closed location with a lease term that doesn't expire until fiscal year 2018.

SG&A costs for the first quarter were 39.7% of sales, compared with 42.9% in the first quarter of the prior year. Part of the reason for this 320-basis-point improvement is due to the fact that we started our spring advertising campaign much later in the season than last year. The shift in advertising costs is worth approximately $1.7 million quarter to quarter. As David mentioned earlier, we do expect that SG&A will continue to decrease as a percentage of sales as we continue to execute our strategy.

Now let's turn to EBITDA. As a reminder, we believe this metric 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 EBITDA is a key component in evaluating free cash flow. For the first quarter of fiscal 2015, EBITDA from continuing operations was $6.8 million, compared with $2.5 million in the first quarter of fiscal 2014.

Looking at the bottom line … Net loss for the first quarter was negative $600,000, or $(0.01) per share, compared to a net loss of $3.5 million, or ($0.07) per share in the first quarter of fiscal 2014. On a non-GAAP basis, assuming a normalized tax rate of 40%, our adjusted net loss for the first quarter of fiscal 2015 was $(0.01) per share, compared to a first-quarter 2014 loss of $(0.04) per share.

Next, on to Capital Expenditures….CAPEX for the first quarter of fiscal 2015 was $9.6 million, down from $11.1 million in the same quarter of fiscal 2014. The reduction in CAPEX was due in large part to the smaller average

DXL store footprint as compared to last year. We opened 11 DXL retail stores and 2 DXL outlet stores during the quarter, en route to our plan to open 40 total DXL stores in fiscal 2015. We now have a total of 149 DXL retail stores and 4 DXL outlets open across the country – right in line with our plan. We are also excited because 23 of our top 25 remaining Casual Male stores are slated for conversion to DXL over the next two years. Remember that the performance of the legacy Casual Male store is the best indicator we have for expected performance as a DXL store, and converting these top stores is a priority for us.

Turning to the balance sheet, inventory at the end of the first quarter was up $8.6 million, or 7.4%, from the fourth quarter of 2014. As our DXL store count has increased, our overall selling square footage is increasing, and we are also carrying a greater percentage of branded apparel associated with those stores. Second, as I discussed last quarter, we made a conscious effort to take early receipt of merchandise to ensure sufficient in-stock inventory positions in advance of the spring selling season. Because of this decision, our inventory was in excellent shape for the spring. Furthermore, our clearance inventory levels are in great shape, representing only 8.2% of our total inventory compared to 8.4% of our total inventory at the end of fourth quarter 2014 and 9.7% at the end of the first quarter last year.

Total Debt as of quarter-end was $71.8 million, which includes borrowings under the revolving credit facility of $40.1 million, with excess availability of $68.3 million.

Turning to our outlook, we are on track with our plan and our financial performance, and we are narrowing our previous EBITDA guidance for fiscal 2015 that we provided on our fourth-quarter call:

- SG&A expenses are now estimated to be approximately $180.5 million, down from $181.5 million reported last quarter.
- EBITDA is now estimated to be in the range of $21.0 million to $23.0 million, compared with $19.0 million to $23.0 million reported last quarter.

Net Loss is now estimated to be in the range of $(0.20) to $(0.23) per share, compared with $(0.20) to $(0.27) per share reported last quarter. Assuming a normalized tax rate, on a non-GAAP basis, the adjusted net loss for fiscal 2015 is expected to be in the range of $(0.12) to $(0.14) per share, as compared with our original guidance of $(0.12) to $(0.16) per share.

Once again, our results this quarter further prove that our plan is working. We continue to demonstrate our ability to execute to our plan, and we are growing more confident as we progress towards sales of $470 million and EBITDA of $35 million in fiscal 2016.

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

Q&A Session

Operator:

And at this time we have no further questions.

David Levin:

Okay, well thank you all for joining us on our call today. As I always do, I'd like to end by inviting you to visit one of our DXL stores and experience what we've built into this concept. It was great to see many of you at our tour of our Manhattan store recently. And if you would like to visit that store – which is convenient to many of you – or any of our stores, please let us know, and we will be happy to give you a tour. We look forward to speaking with you next quarter, and thank you very much for joining us today.