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Caleres, Inc. (CAL)

Q4 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon and welcome to the Fourth Quarter 2020 Caleres Earnings Conference Call. My name is Erica and I will be your conference coordinator. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] As a reminder, this conference is being recorded.

At this time, I will turn the call over to Logan Bonacorsi, Vice President of Investor Relations. Please go ahead ma'am.

Logan Bonacorsi

Vice President, Investor Relations, Caleres, Inc.

Good afternoon. I would like to thank you for joining our fourth quarter 2020 earnings call and webcast. A press release with detailed financial tables as well as our quarterly slide presentation are available at caleres.com.

Please be aware today's discussion contains forward-looking statements which are subject to a number of risks and uncertainties. Actual results may differ materially due to various risk factors, including but not limited to, the factors disclosed in the company's Form 10-K and other filings with the US Securities and Exchange Commission.

Please refer to today's press release and our SEC filings for more information on risk factors and other factors, which could impact forward-looking statements. Copies of these reports are available online. The company undertakes no obligation to update any information discussed in this call at any time.

Joining me on the call today is Diane Sullivan, Chairman and CEO; Ken Hannah, Senior Vice President and CFO; and Jay Schmidt, President of Caleres. We will begin the call with brief prepared remarks and, thereafter, we will be happy to take your questions.

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I would now like to turn the call over to Diane. Diane?

Diane M. Sullivan

Chairman & Chief Executive Officer, Caleres, Inc.

Yes. Thanks, Logan, and good afternoon, everyone. We appreciate you joining us on today's call as we review our fourth quarter results, provide a little color on what we're seeing in the marketplace and share how we are planning for 2021. Even with the impacts of the virus on the economy, our business and our personal lives during the last year, the Caleres team remain focused, dedicated and determined.

Over the last year, our associates drew on their creativity and their great optimism to drive the organization through the protracted economic lockdown and to shift towards a recovery and our future. I would like to thank our entire global workforce for rising to this unprecedented challenge in a quick and agile manner. I couldn't be more proud.

As a result of these efforts, the organization was able to make tremendous progress on a wide range of strategic objectives on both the operational and the financial fronts. To start, we intensified our focus on driving down costs, streamlining the organization to align with the ongoing needs of the business and rightsizing our expense base. Through these efforts, we expect to realize $100 million in ongoing annual expense and capital savings beginning in 2021.

In addition, we leveraged our previous capital investments in digital to drive an approximately 40% year-over-year increase in e-commerce sales from our own.com sites. This pivot enabled the brands to adjust swiftly to changing consumer behavior and priorities in the wake of the pandemic. I'll discuss more specifics on our digital progress in just a few moments.

We also continued to generate significant levels of cash, particularly as our e-commerce business accelerated and our stores and the stores of our partners reopened and we used that cash to restore our overall debt to below pre-pandemic levels by the end of fiscal year 2020. In fact, since the end of the first quarter of 2020, we have proactively paid down approximately $190 million of debt.

Even as we paid down significant levels of debt, we simultaneously drove forward with our ongoing shareholder return efforts. In total, we returned approximately $34 million to our shareholders, maintaining our long-running dividends throughout the course of the crisis, while employing our opportunistic share repurchase program during a time of significant downward pressure on our share price. Ken will talk more about our capital allocation priorities for 2021 later on.

Additionally, we continued the strategic rationalization of our real estate portfolio, ultimately closing 104 doors in our brick and mortar fleet and proactively renegotiating more than 1,100 leases, resulting in approximately 35% reduction in lease expense.

More recently, we continued to execute the exit of our Naturalizer retail fleet. This effort will result in improved profitability going forward and will more closely align this important brand with the accelerated consumer shift toward digital.

During 2020, we have successfully closed 60 Naturalizer stores, with 73 more stores slated to close by the end of the first quarter, leaving seven flagship locations in the US and Asia, and approximately 150 partner stores around the world.

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We also moved forward with the strengthening of our leadership structure. Most significantly, we announced the alignment of our operating divisions under one President, Jay Schmidt, who is with us here today, as well as supplemental enhancements to the leadership team that will ensure continuity going forward and that will focus our top talent on our highest return growth opportunities.

Finally, we continued our work to enhance the Caleres culture, both internally and externally. We implemented new diversity, equity and inclusion initiatives company-wide, including mandatory unconscious bias training and the creation of a DE&I advisory council of representatives across all areas of our business and at all levels.

Additionally, we accelerated our ESG efforts and we will have our inaugural Corporate Social Responsibility Report, which is set for publication next month. This report will detail our ESG strategy, highlight our accomplishments and our progress to date, provide key disclosures and set our intermediate to long-term goals, while providing a really good baseline for future reporting.

Now, I'd like to turn to our business segments starting with Famous Footwear. We continued to execute at a very high level at Famous, which rebounded quickly following the extended store closure period. In fact, we capped off 2020 by delivering better than anticipated sales in the fourth quarter and a significant increase in fourth quarter earnings.

The segment generated $346.7 million in revenues for the period, which equated to just over a 6% year-over-year decline. Most notably, Famous' fourth quarter operating earnings totaled $14.8 million and was on an adjusted basis 43% greater than last year despite the sales decline. This outstanding performance is a direct result of the strength in our e-commerce business, aggressive expense control and tight and rigorous inventory management.

As we have detailed in the past, our e-commerce business at Famous experienced a significant increase during 2020 and remains strong even as our fleet began to reopen. All in, Famous' e-comm business increased 75% in 2020, with its e-commerce penetration rising to 22% of net sales, up from just 10% in fiscal year 2019.

Now, looking ahead, we expect Famous Footwear to be an important and strong driver of our improved performance in 2021 as we continue to leverage our inherent competitive advantages, many of them you know. A strong offering of highly demanded brands for the family, a great leadership position in athletic and sport, and a nationwide footprint and omni-channel experience that provides the consumer with the convenience to shop when and where and how they want to shop.

Now, as the vaccine rolls out and as consumers return to whatever the more normal shopping and travel behaviors are going to be, we expect to see an acceleration in those high density areas and tourist markets where economic activity has been slower to recover. Beyond the expected uplift due to ongoing market improvements, we're executing on a three-pronged approach. We're focusing on merchandising, marketing and consumer experience to maximize our momentum here.

First, when it comes to our products, we will continue to offer what the consumer wants through that balanced assortment of athletic sport and seasonal styles. We're also going to continue to leverage our sport and athletic leadership position, the part of the business we've always been known for, to capitalize on the ongoing demand for these versatile and active styles. We expect the consumer to continue to gravitate toward well-known brands in these categories and Famous is situated exceptionally well to benefit on this trend. Further underscoring this fact is that our top 15 brands represented approximately 77% of our sales during the year.

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There's a few new things on product that I think I'd like to highlight that really should lead to even broader consumer acquisition and improved retention. First, we witnessed strong momentum in a number of our key non-athletic brands over the last 12 months and expect continued growth here as more consumers recognize us as a destination for these brands. And to further this effort, we will be testing new aspirational brands and elevated offerings that include the outdoor category.

Second, we plan on expanding our vertical integration and exploring all of the possibilities within our Brand Portfolio to drive greater profitability for the organization. We are strategically testing Caleres brands where we see the greatest overlap between the consumers of our portfolio brands and the Famous Footwear consumer. I think that Dr. Scholl's is just an excellent fit with the millennial family.

Finally, we see a significant opportunity in our kids' business which comped positive in the fourth quarter of 2020. We fully expect to see that momentum to continue this year as we lean into our kids' assortment and leverage our convenient, flexible and family-friendly experience.

Turning to marketing, we're thrilled that our Famously YOU Rewards program was recognized in Newsweek's list of America's Best Loyalty Programs. We've certainly seen the benefits of the program and are happy to receive the external recognition.

This year, we're going to be even more focused on our consumer database and are increasing our efforts to enhance and grow our rewards members through the acquisition of new consumers, retention of those high-value consumers and importantly going back and reactivating some past consumers who have stepped away in recent years. This effort is always looking at optimizing our marketing mix, looking at expanding personalization across our communications channels and, of course, establishing and building strong emotional connections with the Famous brand overall. We are highly aware of the lifetime value that these customers bring and believe that this to be a long-term value generating opportunity for Famous.

Finally, the third portion of our 2021 strategy is maximizing the consumer experience, an area where we're always striving to do better. This will consist of leveraging our new digital platform to drive increased engagement, conversion and retention, evolving our systems to optimize the cross-channel experience including BOPIS, curbside and ship from store optionality, and test in-shop concepts and refresh high-traffic and high-potential locations. So there's a lot going on and, in summary, we're excited about the opportunities that we see for Famous and look forward to driving the full potential of this business as we progress through 2021.

Now, let's turn to the Brand Portfolio. Fourth quarter net sales for the portfolio as a whole declined by approximately 32% when compared to the fourth quarter of 2019. Ongoing improvements in brands with a greater penetration in wellness, comfort and sport styles were offset by outside sales declines from the brands you may expect, specifically Allen Edmonds and Naturalizer who experienced ongoing pandemic-related effects and dampened store performance.

However, even with lower sales, we recorded positive adjusted operating earnings of $1.2 million, further underscoring the effectiveness of our rigorous cost control initiatives. Despite the mix recovery in this segment, we really are very enthusiastic about the Brand Portfolio's potential to drive value and we expect an overall recovery in the footwear market to act as a tailwind for our portfolio.

It's important to point out that the global health crisis acted to accelerate certain trends that were already in motion in the footwear market, trends that were reflected in a lot of the works that we were doing as it relates to the modernization of our distribution centers and the replatforming of our branded websites.

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As just a couple of examples, Caleres was also in the process of repositioning its brand focus and assortments to really focus on the shift towards digital shopping as well as wellness, comfort and sport categories. So while the shift in consumer preferences will likely continue in the near term, the successful and ongoing rollout of vaccine should spur a steady return of more social lifestyles, particularly as consumers head back to work and school and once again attend events.

This return to more social work life balance and routines and the resumption of more normal buying patterns should provide a nice supplemental uptick in demand for seasonal, occasion and event styles as we move throughout the year.

With this backdrop in mind, in aggregate, we believe our Brand Portfolio is well positioned for a recovering and evolving footwear market, but by design and by definition, our brands are at differing stages of their development at present. So let me share a little color and give you some insight into how we're thinking about a few of our brands.

Among the brands with terrific potential for growth in market share revenue and margin as we progress through 2021 is our Sam Edelman brand. As you know, Sam serves as the cornerstone offering of our portfolio and it's grounded by its inherent shift, ability to shift with the consumer.

In fact, the brand made significant strides during 2020 to adjust, align and position itself to growth. Looking ahead and as we all know, customers are reacting to what's new right now and Sam has ambitious plans that leverages past consumer favorites and new silhouettes, a combination that should restore its well-established market positioning.

Beyond the introduction of new, fresh and compelling product [indiscernible] (00:16:08) penetration has increased significantly. This plan focuses heavily on digital growth, which has seen a nearly 20% increase in conversions since moving to the new platform and expanding its international business.

In addition to Sam, there are several of our other brands in the portfolio that due to their foundation in wellness, comfort and sport are exceptionally well aligned as well with the current tenure of the marketplace and we think they're very well positioned to further their momentum. They include Vionic, Dr. Scholl's, Ryka and Blowfish.

Let's look at just a couple of these brands in a little more detail. Dr. Scholl's has a strong existing brand identity, fierce customer loyalty and a sharp focus on healthy living, workplace comfort and increasingly notable sustainability execution that is really positioning it for improved profitability and success. Furthermore, Dr. Scholl's has the potential for accelerated e-commerce growth as well as increased penetration with our Famous Footwear customers.

In addition, Vionic proved – really further proved its resiliency and agility during the pandemic and holds great promise for the future. The brand's e-commerce business delivered significant year-over-year increases across key metrics in 2020, underscoring the strong connection consumers have with the brand. In fact, Vionic, which is still quite new, experienced strong digital increases, including a more than 36% increase in web visits, approximately 30% improvement in online conversion rates, more than 50% growth in digital revenue and a 28% increase in email list size.

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Vionic plans to target high-growth channels and leverage its comfort technology, new product offerings which are going to reach into new categories and marketing plan to build on its e-commerce momentum and sales growth in 2021.

Now, as excited as we are about those already high-performing brands that really have some momentum, we're equally excited about some of our high-potential brands that have been underperforming in the wake of the massive changes that have occurred in the footwear market since the advent of the pandemic. These brands offer tremendous upside potential as we work aggressively to restore alignment with consumer preferences.

The brand that stands out as offering late and future value creating potential is Allen Edmonds. So as you know, Allen Edmonds has been a powerful and premier brand in the men's category for decades. And even before the onset of the global health crisis, we were shifting to add new sport and casual styles to the assortment to address the shift in consumer preferences that was already underway.

However, as you can imagine, the economic lockdown and the changing workplace and travel behavior has really hit AE in a disproportionate manner. We believe there is still significant unlock potential with this brand and we are continuing to adjust our positioning accordingly.

In fact, we have leveraged some of our best-selling traditional styles like the Strand and the Park Avenue to create casual, customizable products for our consumers, products that we believe will fit quite nicely into their personal AE collections. We expect that about 50% of our assortment will be in the casual and sport this year. And as we move through the first quarter of 2021, you'll hear some more exciting news around future collaborations and partnerships.

There is no doubt that the rebound in our Allen Edmonds business will take time due to its store base being largely located in high-density areas and the ongoing work-from-home trend. However, we are confident in the brand's ability to leverage its loyal customer base and growth strategy to capitalize on opportunities in the marketplace and return to a stronger contributor in the organization.

So, all in, as we've discussed many times in the past, we take a very active and continuous approach to managing our portfolio of brands. We will always be working to identify ways to optimize value from this portfolio, driving growth in some, harvesting cash in others and making adjustments in others in order to stay in step with the consumer.

Before I turn it over to Ken, I want to underscore that while the future feels brighter, the first half of the year will continue to be constrained by ongoing pandemic-related impacts, supply chain disruptions and port congestion. No new news there. I think everybody has been feeling this. And keeping with these challenges for our total company, we are currently have between $60 million and $70 million of delayed receipts.

Even with these macro challenges, there are signs of stabilization in the marketplace. There is no doubt Caleres is a more agile and focused organization than it was at the start of 2020 and we believe we are well positioned to capitalize as the market rebounds, more likely in the second half of the year as the world returns to a greater degree of normalcy.

As we plan for future success, we will focus on maintaining our strong momentum at Famous, driving enhanced consumer alignment and improved performance in the Brand Portfolio, continuing to take a careful and disciplined approach to cost control and capital spending, absolutely reducing debt level still further and returning excess cash to shareholders.

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And with that, I'd like to turn the call over to Ken for a financial review.

Kenneth H. Hannah

Chief Financial Officer & Senior Vice President, Caleres, Inc.

Thank you, Diane, and good afternoon, everyone. Before I walk through our fourth quarter and fiscal year financials, I'd like to echo Diane's comments and express how extremely proud I am of what our team was able to achieve during a time of such unprecedented challenge. We've remained intensely focused on appropriately managing expenses and reducing working capital throughout 2020. Through these ongoing efforts, we are confident we have positioned the organization to weather the uncertainties that persist and take full advantage of the opportunities we see in the marketplace.

I would like to start by providing a brief update on our liquidity position and capital structure, then discuss our fourth quarter and fiscal year results, and finally, provide some color on the outlook for the first quarter of 2021.

As we communicated over the last several quarters, we believe deleveraging to be the most value-creating use of cash given the marketplace. To that end, we once again made debt reduction a priority in our capital allocation process. We generated approximately $25 million in cash from operations in the fourth quarter and paid down an additional $50 million in revolver debt, reducing the outstanding balance to $250 million at the end of the quarter, $25 million below our pre-pandemic debt levels.

$126 million in cash generated from operations in 2020 clearly demonstrates the actions taken to manage working capital. All told, we ended the year with a solid liquidity position consisting of approximately $88 million in cash and $350 million of capacity on our asset-based revolving credit facility.

In addition to our progress on debt reduction during the year, we also returned approximately $34 million to shareholders during the year through our long-standing quarterly dividend and our share repurchase program. Overall, we bought back approximately 7% of our shares outstanding in 2020 at an average price of $8.05. Looking ahead, we expect to reduce our debt level still further, while at the same time continuing to return cash to our shareholders through investing in our business, our long-standing dividend and opportunistically buying back shares.

Now, moving on to a review of our financials, we had a number of non-recurring and, for the most part, non-cash adjustments in the quarter. I will walk through those adjustments and you can also find a full presentation of our GAAP results and a reconciliation table to our adjusted results in the earnings release we issued earlier today.

Our adjusted earnings per share for the fiscal fourth quarter of 2020 was $0.03 per share, excluding a $1.03 of COVID-19 related expenses associated with non-cash impairments of property and lease right-of-use assets primarily for Allen Edmonds and tax valuation allowances associated with our deferred tax assets, $0.49 of non-cash intangible asset impairment charges for Allen Edmonds, $0.37 of expense related to the previously announced exit of a number of our Naturalizer retail stores, a fair value adjustment of $0.18 associated with the mandatory purchase obligation for Blowfish Malibu and Vionic integration-related costs of $0.07 as we completed the ERP integration in the fourth quarter.

For fiscal year 2020, our adjusted loss per share was $1.40. This loss per share excludes $10.40 of charges made up of $6.35 of non-cash goodwill and intangible asset impairment charges, $3.10 of COVID-19 related expenses associated with non-cash impairments or markdowns of inventory, property and leased assets and tax valuation allowances associated with our deferred tax assets, the total fair value adjustment of $0.48 associated

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with the mandatory purchase obligation for Blowfish Malibu, $0.40 of expense related to brand exits, and Vionic integration-related costs of $0.07 taken in the fourth quarter.

Again, we've provided a complete reconciliation of our GAAP results in the earnings release issued earlier today. And having said that, my remarks will focus on our adjusted results as we believe this represents our overall operating performance.

For the fourth quarter, we delivered consolidated sales of $571 million, down 18.3% from fourth quarter of 2019 levels. Our direct to consumer sales reached 75% of our total, while our owned e-commerce sales increased approximately 25% during the period. For the year, we reported $2.1 billion in sales, down 28% from 2019, reflecting the significant effects on our business due to the COVID-19 global health crisis and the associated economic lockdown. Our direct to consumer business reached 73% for the full year, up from 68% in 2019.

As Diane mentioned earlier, Famous Footwear total sales were $346.7 million, down 6.2% from the fourth quarter of fiscal 2019. Notably, the predictable sequential seasonal sales decline at Famous Footwear from the third to the fourth quarter was appreciably less, resulting in a smaller year-over-year sales decline, evidence that Famous continued its ongoing momentum driven by still strong athletic sales and ongoing strength in its e-commerce business.

Our comparable store sales were down 1.8% during the fourth quarter with our e-commerce sales up approximately 51%. For the full year, Famous Footwear sales were $1.3 billion, down 20.4% year-over-year, driven primarily by the temporary store closures earlier in the year and the non-traditional back-to-school season. Comparable store sales for the year were up 1.6% with our annual e-commerce sales up 75% over 2019.

Our Brand Portfolio fourth quarter total sales were $234 million, a decrease of 32.4% year-over-year. Full year Brand Portfolio sales were down 35.8%, reflecting steep declines in women's fashion footwear, temporary closure of our owned retail and wholesale partner stores, and weak consumer demand for certain footwear categories as markets closed and consumers became accustomed to a work-from-home lifestyle.

Our consolidated gross margin was 39.9%, down 20 basis points year-over-year. Famous Footwear had a gross profit margin of approximately 41% in the fourth quarter. The 168 basis point decline was driven by growth and increased penetration of e-commerce related business in the quarter. However, notably, e-commerce margins increased more than 400 basis points in the period, reflecting the higher e-commerce productivity due to buy online, pickup in store, curbside and ship from store initiatives.

Our fiscal year gross margin for Famous Footwear was 39.2%, reflecting a higher mix of e-commerce sales due to temporary retail store closures and increased promotional activity to liquidate seasonal inventory during the year. Our Brand Portfolio fourth quarter gross margin was 36.5% and was 107 basis points higher than the fourth quarter of last year, reflecting a lower level of promotion and our overall inventory position. The annual gross margin was 36.2%.

Our consolidated SG&A expense for the fourth quarter was $226.1 million, representing a decline of approximately $35 million compared to the fourth quarter last year. This year-over-year decline was driven by store selling productivity and actions taken to lower facilities, marketing and general corporate overhead expenses.

Our annual SG&A expense was $889.5 million, a decline of $176.3 million compared to fiscal year 2019. This decline was led by the reduction in variable cost, ongoing savings from the voluntary early retirement plan

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commenced in the fourth quarter of 2019 and lower lease expense from closing 104 total retail doors during the year. As we have stated, we expect to achieve $100 million or approximately $25 million per quarter of annual expense savings going forward.

At Famous Footwear, we posted operating earnings of $14.8 million in the fourth quarter, reflecting a $20 million reduction in expenses and improved e-commerce margin. This represents $4.5 million more in operating earnings on $23 million less sales than the fourth quarter of 2019. Operating margin was 4.3% in the quarter, up 148 basis points year-over-year.

In the Brand Portfolio, we're pleased to report an operating earnings of $1.2 million for the quarter, reflecting a $20 million reduction in expenses year-over-year. Our net interest expense for the quarter was $5.6 million and for the year was $24.4 million, excluding the Blowfish adjustment.

Our full year consolidated GAAP tax rate was 15.1%. This lower rate reflects the favorable impact related to the utilization of the Cares Act carryback provisions which allows us to carry back losses in 2020 to years with the higher federal tax rate.

The company's fourth quarter net income was $1.3 million or earnings per diluted share of $0.03. This compares to net income of $13.9 million or $0.34 per diluted share in the fourth quarter of last year.

Our inventory at year-end was down 21% and included an approximately 15% decline in Famous Footwear inventory and a 29% decline in inventory in the Brand Portfolio segment. Furthermore, we significantly reduced our overall operating working capital position by approximately 50% in 2020.

Our capital expenditures totaled approximately $22 million for the year, down from approximately $50 million in 2019. And looking ahead at 2021, given the ongoing disruptions related to the virus, supply chain dislocations and continued near-term uncertainty in the marketplace, we are not providing fiscal year 2021 guidance at this time.

That said, I'm happy to provide you with some high-level perspective regarding our outlook for the first quarter. To reiterate Diane's previous comments, we currently have between $60 million and $70 million of delayed receipts due to supply chain disruptions and the ongoing port congestion. We don't expect that to be resolved in the first quarter.

In addition, as a reminder, our sales in the first quarter are seasonably the lowest quarter of the year and we expect that to continue to be the case in 2021. With that being said, we expect Q1 2021 at the consolidated level to look a lot like Q4 of 2020, both in dollars of sales and dollars of earnings per share, with Famous Footwear sales expected to be between 5% and 10% lower than the first quarter of 2019 and Brand Portfolio sales expected to be between 28% and 30% lower than the first quarter of 2019.

Furthermore, as previously discussed, we plan to complete the Naturalizer restructuring during the first quarter and we'll take additional non-recurring charges during that period. Excluding the impact of Naturalizer closings and barring any further delays in the supply chain, we expect positive adjusted earnings per share in the first quarter and a continued reduction in our overall debt levels.

In closing, in the face of the unprecedented disruption in our business in 2020, the company acted quickly and decisively. Our nimble business model enabled us to adjust to the environment and prioritize cash flow and liquidity while still furthering our long-term strategic objectives, investing for future growth and creating value for our shareholders.

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With that, I'd like to turn the call over to the operator for questions. Operator?

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question is from Laura Champine with Loop Capital.

Laura Champine
Analyst, Loop Capital Markets LLC

Q

Thanks for taking my question. I'm hoping you'll dive a little bit more into the lost sales from the slowdowns at the ports and how long – how much of that do you think you get back eventually maybe in Q2? And also, Ken, if you could give us a sense of how you expect to manage inventories this year, would imagine you're going to have to rebuild at some point? Thanks.

Diane M. Sullivan
Chairman & Chief Executive Officer, Caleres, Inc.

A

Yeah. Hi, Laura; it's Diane. Let me start on the port congestion topic and supply chain, and it certainly is the big topic of the moment. So that $60 million to $70 million in receipts that are delayed, let me kind of split that out for you a little bit. Right now, there's about $50 million of receipts that are delayed for Famous Footwear and there is about $10 million to $20 million or so that's delayed on the Brand Portfolio side.

It's hard to tell yet exactly when we're going to be caught up fully with respect to all of those receipts. We don't have the visibility yet of what that looks like. So there is a number of actions that we're taking and we are, obviously, taking a look at this week to week. We're looking at making sure that we're placing orders on the Brand Portfolio side in advance of where our needs are going to be going into the back half of the year, so being proactive around that. We're looking at making sure that we continue our rapid response program and selling the inventory that we do have on our Brand Portfolio side.

With respect to Famous, the good news is they have been really operating at a lower inventory level throughout really 2020, obviously, and our expectation is that they will be down in the range of 5% to 10% on their inventory levels typically going through the rest of the year. So the good news and the silver lining in all that until we really see is that it allows you to really manage your pricing, manage your promotional cadence, hopefully take advantage of what margin improvement we might see, but it's really a little unclear yet about what the opportunity cost is going to look like in the short term. But again, believe that we are actively managing this and making sure that it – we get ourselves in position to take advantage of what we expect is going to be a pretty good rebound as we move into the second quarter and then more so even into the back half of the year.

I don't know, Ken, if you would want to add any additional points on the congestion and supply chain.

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.

A

Yeah. Thank you, Diane. I think when we look at that, obviously, there is a good portion of that that is timing and then a lot of that is supplying our at-once business which you've heard us talking about how hard we've worked on our speed programs and our ability to hold inventory and be able to fulfill consumer demand. So, obviously, the timing of that certainly puts a portion at risk.

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You'd asked on the inventory, obviously, we're very clean coming out of the year. I think the teams did a fantastic job really lowering the overall levels and really turning inventory into cash. We mentioned we generated $126 million of cash from operations in 2020 despite the reported earnings being much lower than that.

And I think what we learned is that we have the ability to turn our inventory a little faster than we have in the past. So while our inventory is expected to increase kind of throughout the year and really in anticipation for the back half, obviously, we're planning to turn that a little bit faster than we would have in prior years. So lots of work by the teams and then, obviously, disappointed in the delays and the congestion because we really feel like we could put that inventory to good use.

Operator: Your next question is from Steve Marotta with C.L. King & Associates.

Steven L. Marotta
Analyst, C.L. King & Associates, Inc.

Q

Hello, Diane, Ken, Jay and Logan. Diane, I would love your thoughts on, first, very high level, how you feel the cadence of this year is going to progress? And then on a more granular level, how do you prepare for that? In other words, if – I'm not holding you anything, it's just how I would love to hear or how you are thinking about from, again, how the year progresses and then a planning point from a product standpoint and a delivery standpoint, do you think that dress is going to be more popular in the back half of the year than it had been maybe in the last 12 to 18 months, product categories that could pop, just your high-level thoughts on the year.

Diane M. Sullivan
Chairman & Chief Executive Officer, Caleres, Inc.

A

Yeah, sure, I'd be happy to. I think when we entered this year and finished the fiscal year of 2020, we went into the total planning process and really keeping our mind on this idea that we were going to take a fairly conservative approach to the front half of the year and we expected a much stronger rebound in the back half of the year. And that was because it was really still unclear about how vaccine rollout was going to occur. And then as we saw a little bit more of the supply chain disruption, again, wanting to make sure we were fairly conservative on our viewpoint in the front half.

In terms of the categories of business that we feel that are going to continue to be strong, there is no doubt about it that this sport and active and wellness categories of business is going to absolutely continue throughout. We don't think that that's going to change significantly at all. We think that is going to continue to be important. But what we are starting to see a little bit is that how you define what's dress or what's casual and what sandals might sell or what boots might sell.

We're seeing already, Steve, the early signs that actually opened-up footwear is selling actually outstandingly well. And it's not only flat kinds of sandals and that sort of thing, but wedges and heels as well seem to be working. And there is that early distant light right now that we can see opened up footwear for going out occasions what we might have traditionally called a little more dress type of sandal, we're seeing that become a little more – a little bit more in demand. Now, how big that gets, how the women feel as they're able to go out, attend events, weddings and that kind of thing. But again, we think our Brand Portfolio is very, very well positioned to be able to take advantage of those kind of opportunities.

The other thing is we also – there's no doubt that we have really stepped back to try to make sure we rethink about our position and our portfolio at this moment. Where are our brands relative to the trend alignment, where are their growth potential – is their growth potential? And we really think we have the set of brands that sort of like

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I talked about this afternoon where we really want to maximize the momentum, things like Famous, obviously, because we think that's still extraordinarily well positioned, as well as Dr. Scholl's and Vionic. We think those are the kind of brands that where we really want to maximize the momentum and further their growth potential.

And we know that Sam Edelman is a great place to invest to grow as we see already some of the early signs of the consumer coming back to those iconic styles and what they've always loved Sam for. And then the work that we're doing are now on Allen Edmonds and Naturalizer, reinvigorating that I think we're going to be really pleasantly surprised with the improvement that we see in the back half of the year.

So it's a combination of a lot of things and maybe then just the other thing, why we feel pretty good about our position is our digital business. We've made those investments. We have the fulfillment capabilities, we have logistics capabilities, we have the platform now, we've got the content management system, we've got curbside, we have all of those things.

So as you even tie it back to Ken's comment about the capital investments this year being at $22 million versus kind of where it's been in the past, we've made those investments and we're really focused on making sure we get the productivity out of the investments we've made. So that's a little bit of a longer answer to your question. I hope I got to the key points you want to me to get to. But that's kind of how we see the shape of the year.

Steven L. Marotta
Analyst, C.L. King & Associates, Inc.

Q

Absolutely. No, that was very helpful, the insights. Ken, the $100 million in annualized savings, roughly $25 million per quarter, is that straight-lined year-over-year or do you anticipate there will be some reinvestment on an as-needed basis? In other words, from a modeling standpoint, you just look at last year's SG&A, about $25 million off and that's where the brackets are or are there offsets?

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.

A

Yeah. I mean, obviously, there is a variable component to that. So I think we have around $225 million, $226 million in SG&A expense in Q4. We would expect to be pretty much at those same levels on the same level of sales in Q1 and then, obviously, the seasonality as we get into Q3 and that's one of our larger quarters, there's a little bit more expense, but the savings is really expected to be throughout. I think the 2020 compared to 2019, we were down almost $175 million. So $75 million or so of that ties back to variable cost on our sales and the other $100 million is direct cost that has been taken out of the business.

Steven L. Marotta
Analyst, C.L. King & Associates, Inc.

Q

That's really helpful as well. Diane, I have one more question. I'm not sure you've had a public platform to expand on the management changes that were announced in early December. Maybe you want to talk a little bit about that, your thought process there, how that's going, if there is any other evolution through this current year that we can expect or be updated on. Thanks.

Diane M. Sullivan
Chairman & Chief Executive Officer, Caleres, Inc.

A

Yeah. Sure. No problem. Actually, just going back to your other question, too, I should have mentioned February was a little light, right. Everybody knows, the weather in February and what happened along those lines, so just wanted to get that out there that there were significant days lost in our Famous business as I'm sure every other

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retailer had faced as well. But – so a little bit more about the cadence of the year. So just [indiscernible] (00:48:05) out there.

With respect to our talent base and the organizational changes, I think we feel very highly confident with the team that we have. Jay's leading it, adding Lydia, promoting Keith Duplain, Mike Edwards is doing a heck of a job leading Famous Footwear. We have a high degree of confidence there. We've added other people in our digital portions of our business. You're going to see us add even more this year to make sure that our capabilities and our business continues to grow.

And then I would probably also add that we also believe that we really need to have that, the voice of the consumer directly sitting at our leadership team and so you will expect – should expect to see us appoint a CMO in the company in the relatively not too distant future. We think that's a critical component and ingredient of what is really going to help us accelerate our performance and our understanding and insight around the consumer as we go forward. So the biggest changes you will see are really in the marketing and the digital side of our business and the rest we feel, again, other than the normal ongoing things, we feel pretty good about where we're at at this moment.

Steven L. Marotta
Analyst, C.L. King & Associates, Inc.

Q

Very, very helpful. I'll take the rest of my questions offline. Thanks.

Diane M. Sullivan
Chairman & Chief Executive Officer, Caleres, Inc.

A

Thanks, Steve.

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.

A

Thank you, Steve.

Operator: Your next question is from Sam Poser with Williams Trading.

Sam Poser
Analyst, Williams Trading LLC

Q

Good afternoon. Thanks for taking my questions. A couple of things. I was just wondering, one, which like of the $50 million of Famous product, I mean, is there specific categories that are hurting you more than others [indiscernible] (00:49:59) right now and another retail...

Diane M. Sullivan
Chairman & Chief Executive Officer, Caleres, Inc.

A

No, it's pretty balanced across – really within the largest brand, pretty much as you would expect, right, the in-demand brands. That's where it mostly is spread across.

Sam Poser
Analyst, Williams Trading LLC

Q

Another retailer discussed it as sort of like Domino's. It was like what didn't come in in December, came in in January. What didn't come in January, came in at February. And what didn't come in February is coming in in

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March. So is the major problem here more seasonal product that's hurting you right now versus let's say sneakers? I mean, sort of in the scheme of things where you'd normally [indiscernible] (00:50:43) business?

Diane M. Sullivan
Chairman & Chief Executive Officer, Caleres, Inc.
A

Yeah. I would tell you it's a great way to describe it the Domino's because that is a bit of what's been happening and that's the key part of it. You don't know really when you're going to catch up and it's gone a little bit back and forth. One week, you might feel you've caught up. The next week, you are maybe a little further behind.

But your characterization is a good one. But again, it really is cutting across, it really isn't the seasonal goods as much as it is really against all the – all categories. It is on semi athletic, it is on a broad base of brands and on categories. So again, we'll see how it plays out. The team is doing a great job managing their way through it. There is no reason to believe that that we're not going to catch up at some point in time, but it's really we don't have the visibility yet from when that really is going to occur.

Sam Poser
Analyst, Williams Trading LLC
Q

Okay. And then within the color that you provided on the first quarter, the stimulus checks hit, is that included in the color that you're providing and can you give us some indication of maybe in the last few days how business may have accelerated given the stimulus at Famous?

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.
A

Yeah, it's included in our outlook and I think that's a little bit on the at-once business that we were talking about in terms of the stimulus is there. We've seen traffic coming through as people are receiving those checks and it's really just about inventory levels not being exactly where you'd like them to be to fully capture that opportunity. So I mean we know that's going to be timing and then we're hoping that we see that resolve itself as we get into the latter part of the second quarter. But, no, we have taken into consideration the early signs of the stimulus.

Sam Poser
Analyst, Williams Trading LLC
Q

Thanks. And then lastly, with Famous again, you sort of mentioned you can turn your inventory a little faster and all that stuff. I mean, does this mean that you are going to narrow your assortment and go deeper on key items, like, are you learning more about how to do key items through this crisis and realizing that that third move whatever may not be necessary, you can live with two – a lot more of two of them?

Diane M. Sullivan
Chairman & Chief Executive Officer, Caleres, Inc.
A

Yes.

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.
A

Yeah, absolutely. Skew rationalization I think Diane in her prepared remarks talked to the – those top 15 brands representing almost 80%. We learned a lot in 2020 and, obviously, as we're going through and looking a half a point of improvement in turn at Famous requires a 15% to 20% kind of delta on the inventory level. So we're working through all of that with the teams and hoping to find some good out of the learnings that we had in 2020.

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Sam Poser
Analyst, Williams Trading LLC

Q

I mean, then theoretically, when things come back, whatever it looks like and you're expecting much more productivity out of your inventory there. And then, Diane, lastly sorry, again, you sort of said that everything is going to go back to – you're expecting dress and some of that stuff maybe to come back in the back half of the year. I mean, are you looking – I mean are you in the worrying 2020s is coming camp or are you in the maturing 2020s, but better – everybody better be comfortable camp?

Diane M. Sullivan
Chairman & Chief Executive Officer, Caleres, Inc.

A

Exactly. I'm in the everybody is going to want to be comfortable camp that there is going to be a consistent improvement and the performance of the businesses going forward throughout the year and that I do think in some cases, it doesn't ever go back, Sam, to what was, but I definitely think that there is some pent-up demand for footwear that they don't already have in their closet. And this idea that social occasions and weddings and all of that at some point in time are going to matter and even just to feel good and put in a great pair of shoes on your feet that's a little different than the sneakers and the claws that you've been wearing is going to feel right.

So never getting to the scale and size it was much more occasion based. We're not going to chase it. But we're going to be prepared to take advantage of it as we begin to size what the opportunity might be. I think the biggest impact from that we won't see come back is what we might call career-oriented shoes. That's what's not coming back. But the rest of it, we think is going to be critical.

Sam Poser
Analyst, Williams Trading LLC

Q

Thank you very much and good luck.

Diane M. Sullivan
Chairman & Chief Executive Officer, Caleres, Inc.

A

Thank you, Sam.

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.

A

Thanks, Sam.

Operator: Your final question is from William Reuter with Bank of America.

William Michael Reuter
Analyst, Bank of America Merrill Lynch

Q

Hi. I just have two. So the first, you've been talking about the changing portfolio dynamics where there's going to be growth, changes to the assortment. Is there any thought that you believe that actually the portfolio's composition should change in that either there is something that you may be like to part with or maybe other acquisition targets out there that you see that looks attractive?

Diane M. Sullivan
Chairman & Chief Executive Officer, Caleres, Inc.

A

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Right. Thank you, William. It's Diane. We do continuously look at evolving the portfolio and really have, even as of last year, exited three brands and actually added two. So we are constantly evolving it. And again, to my comment a little bit earlier, we're really trying to look at, again, assess potential and kind of where we think the run – what the runway looks like against trend alignment and kind of the brand's growth potential and looking at where we really need to maximize momentum and drive it because the consumer and all the attributes of what success is going to look like kind of surround that segment of the portfolio.

We know there's a few that we have to reinvigorate which we're doing and there's a couple that we are really making sure that we're maintaining it. We're not investing in – over-investing in any of those things and trying to shift our investment back over to those brands that are in this growth mode right now and also back over to our digital capabilities to make sure that we don't miss those opportunities because that's part of the business that's growing significantly. So that's how I would say we manage the portfolio and our history kind of shows how we continue to add and subtract brands as we need to.

William Michael Reuter
Analyst, Bank of America Merrill Lynch

Q

Yeah. And then – that's helpful. And then just one follow-up, Ken, the 6.25% become – the call price steps down in August, markets are obviously incredibly hot. I guess how are you viewing the opportunity to potentially refinance those at this time?

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.

A

Yeah. I mean we're actually hoping that we can turn our inventory at the levels that we hope and can continue to generate enough cash from operations. We'll continue to pay the revolver down and would likely start to move some of those from a fixed to variable rate. And as you can imagine, they are at 6.25%. They're callable in August. And if we're able to continue to pay down the revolving credit, we could move those over at 3%. And so adjusting that a pretty significant reduction. So I think as we said, our capital allocation priorities are to continue to reduce the levels of debt and to try to make sure that the leverage is down where it needs to be.

William Michael Reuter
Analyst, Bank of America Merrill Lynch

Q

Yeah. Makes sense. Okay. All right. Thanks a lot. Thanks for taking questions.

Diane M. Sullivan
Chairman & Chief Executive Officer, Caleres, Inc.

A

Thank you.

Kenneth H. Hannah
Chief Financial Officer & Senior Vice President, Caleres, Inc.

A

Thank you.

Operator: And there are no further questions at this time. I'll turn the call back over to Diane Sullivan for closing remarks.

Diane M. Sullivan
Chairman & Chief Executive Officer, Caleres, Inc.

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Well, thank you, everyone, for joining us today. Before we disconnect, I just wanted to reiterate the progress we made during the year. We leveraged our previous capital investments to embrace digital, we effectively and efficiently managed our expense base, we reduced the amount of working capital to run our day-to-day business and we significantly paid down our debt levels.

So as we move ahead, Caleres is more flexible and focused with an even more vigorous commitment to connecting with our consumers and providing them with compelling and fresh product. We're extremely confident that we can leverage our talented and dedicated workforce, strong operating platform, powerful portfolio, and improved – and improving financial position to capitalize on the opportunities we see ahead in order to make sure we drive long-term value for our shareholders.

With that, we look forward to talking with you on our next update at the end of the first quarter. Thanks again.

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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