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Michael Kors Holdings Ltd. (KORS)

Q2 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and welcome to the Michael Kors Second Quarter 2019 Earnings Conference Call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Katina Metzidakis, VP of Investor Relations for Michael Kors Holdings Limited. Please go ahead, ma'am.

Katina E. Metzidakis

Vice President, Investor Relations, Michael Kors Holdings Ltd.

Good morning, everyone, and thank you for joining us on today's second quarter call. With me this morning are Chief Executive Officer, John Idol; and Chief Financial and Chief Operating Officer, Tom Edwards.

Throughout this morning's call, we will be referring to Capri Holdings Limited, which is the new name to be adopted by Michael Kors Holdings Limited upon the closing of the pending acquisition of Versace.

In addition to this morning's press release, we have posted a presentation, which provides additional financial information for Versace, to the Investor Relations section of our website. Before we begin, let me remind you that certain statements made on this call may constitute forward-looking statements, which are subject to risks and uncertainties that could cause actual results to differ from those that we expect. Those risks and uncertainties are described in today's press release and in the company's SEC filings, which are available on the company's website.

Investors should not assume that the statements made during the call will remain operative at a later time and the company undertakes no obligation to update any information discussed on the call.

In addition, certain financial information discussed today will be presented on a non-GAAP basis. These non-GAAP measures exclude certain items related to certain one-time costs associated with the Jimmy Choo acquisition and the agreement to acquire Versace and restructuring and non-cash impairment charges primarily associated with underperforming retail stores.

Unless otherwise noted, all information on today's call will be presented on a non-GAAP basis and all revenue and comparable store sales will be quoted on a reported basis. To view the corresponding GAAP measures and related reconciliations, please view the earnings release posted to our website earlier today at investors.MichaelKors.com.

Now, I would like to turn the call over to Mr. John Idol, Chairman and Chief Executive Officer.

John D. Idol

Chairman & Chief Executive Officer, Michael Kors Holdings Ltd.

Thank you, Katina, and good morning, everyone. I would like to begin this call by discussing the long-term strategic vision for Capri Holdings. With the announcement of the transformational acquisition of Versace expected to close in the fiscal fourth quarter, we have succeeded in building one of the world's leading fashion luxury groups in just over one year. This is a truly remarkable and historic moment for our company. We could not have possibly envisioned a better family of incredibly strong brands for our group.

Looking ahead, we expect the addition of Versace will drive accelerated revenue growth for Capri Holdings. The House of Versace is one of the most storied luxury brands in the world, rooted in Italian glamour and style. The Versace brand has a heritage spanning over 40 years. Fashion has always been at the core of the Versace DNA.

Since its inception, the House of Versace has had luxury craftsmanship as well as creativity and innovation at its foundation. For over 20 years, Chief Creative Officer, Donatella Versace, has forged the brand's iconic style, a true visionary with an intuition for how to blend fashion, design, and culture. Donatella continues to honor the rich and storied Versace heritage, while constantly evolving and adapting the luxury house to engage and excite consumers globally.

Its unique DNA and signature style has led Versace to become one of the most highly recognized fashion luxury brands in the world. Versace's unmistakable look, which is equal parts bold and refined, evokes both a rock and roll spirit as well as runway glamour. For over 40 years, Versace has built a unique, innovative and powerful communications message that continues to resonate with consumers around the world. The brand also commands a leading social media presence, with 14.5 million followers for Versace and 3.6 million followers for Donatella.

Versace and Donatella clearly capture the imaginations of consumers globally. Under the leadership of Donatella and Chief Executive Officer, Jonathan Akeroyd, Versace is expected to deliver double-digit revenue growth and an approximately 50% increase in EBITDA this year. We have already begun working with Donatella, Jonathan and the management team on the execution of our strategic vision.

We are confident that we can grow this brand from approximately \$850 million in revenue in 2018 to \$2 billion in revenues. We have identified a five-step plan to achieve this goal. First, we will build on Versace's luxury runway momentum starting with our recently announced New York show on December 2.

Second, we will enhance the brand's powerful and iconic marketing, adding significantly to the company's spend next year. Third, we will increase its global retail footprint, opening approximately 30 new stores next year. Fourth, we will accelerate e-commerce and omnichannel development. And fifth, we will expand Versace's accessories and footwear business with exciting new products that Donatella and her team have already created that will be introduced for fall of next year. We are extremely excited to have the opportunity to work with Versace's strong management team to significantly deepen our brand engagement. [audio gap] (24:09-24:16)

Now, I would like to provide a brief update on our strategic plans for both Jimmy Choo and Michael Kors. For Jimmy Choo, we continue to implement our strategy and believe that the brand is on track to achieve its \$1 billion revenue target. Since the acquisition, we have grown Jimmy Choo's store base from 150 to just over 200 stores. We see a clear runway to achieve 250 stores globally, with an emphasis in Asia.

Led by Sandra Choi's unique design vision, our footwear sales continue to grow at a double-digit pace. And we maintain our strategic focus on building out the fashion active category. Finally, our strategy to expand accessories penetration remains on track, with a plan to accelerate the pace of new collections in the next calendar year.

Turning to the Michael Kors brand, we continue to make progress on our Runway 2020 strategy. First, our focus on innovation has greatly improved. And our newness across all product categories is resonating.

Second, we have significantly deepened our brand engagement, capitalizing on Michael's leading social media presence. Third, we have enhanced our customer experience by expanding omnichannel capabilities and are moving forward on our store renovation program.

Overall, we believe that the company is on track to achieve \$5 billion in revenues at Michael Kors. Taken together, our three iconic founder-led brands position Capri Holdings to accelerate revenue to \$8 billion and deliver multiple years of earnings growth.

Now, I would like to turn to our results. We were pleased with second quarter performance, which exceeded our expectations. Revenues in the second quarter were \$1.3 billion and grew 9% year-over-year, driven by the addition of Jimmy Choo, which grew double digits.

Earnings per share of \$1.27 was \$0.22 above our guidance range. As a result of this solid performance, we are raising our earnings per share outlook for the year to a range of \$4.95 to \$5.05, which is a \$0.05 per share increase from our previous guidance. This new guidance reflects double-digit year-over-year EPS growth for our company.

Turning to the Michael Kors brand, consumers continue to respond to Michael's fashion leadership and engage with our lifestyle vision as we execute against our three Runway 2020 strategic pillars of product innovation, brand engagement, and customer experience.

Moving to our product performance, in accessories for Michael Kors Collection, we continue to see strong acceptance of our Bancroft group. The crimson tartan Bancroft satchel featured in our fall marketing campaign became a best seller during the quarter.

In our MICHAEL Michael Kors line, the new Whitney group, which was featured in our fall marketing campaign, became a top-seller during the quarter. Consumers responded particularly well to our new quilt pattern, as well as distressed shiny leather and mixed materials with studs.

Our special edition Whitney collaboration with brand ambassador, Yang Mi, resulted in strong sales and helped drive brand awareness in China. Our signature Michael Kors logo was also a key driver of growth, particularly in shoulder bags and backpacks. We experienced higher sell-throughs in this category due to greater than anticipated performance of our logo offerings. Overall, we remain encouraged by performance in new styles where we have infused fashion and design innovation.

Comparable store sales in accessories declined in the low single digits. This was primarily driven by a high single-digit decline in inventory levels. Looking ahead, we continue to focus on fashion and innovation with a higher emphasis on logo offerings for the holiday season. We anticipate accessories comparable sales to decline in the low single digits for the balance of the year.

Moving to performance in footwear, during the quarter we launched the Avery boot and Divia boot, both of which featured an effortless slouch look that resonated well with consumers. Kors styles, such as Dorothy pump and our Lena sandal continue to perform extremely well, driven by new design details. In fashion active, the newly launched Cosmo group, highlighted in our fall marketing campaign, was a success, particularly in sneaker and knit slip-on styles. Novelty details, such as new glitters and mesh combo metallic leathers and mixed fabrics created further excitement around our best-selling, Billie and Felix sneakers.

Overall comparable store sales in footwear increased double digits, showing further acceleration from recent solid results and setting the stage for a strong holiday season.

In women's ready-to-wear, we continued to leverage Michael's runway heritage with a focus on fashion, as we introduced new novelty fabrics, print mixing techniques and embellished details.

Our Kors style head-to-toe dressing platform continued to drive growth across the category. Bestsellers in the quarter included our oversized alpaca cable knit sweater and delicate bell sleeve paisley blouse in rich fall colors. Consumers continue to respond to our dresses in a seasonal jewel-toned pallet, which included marigold, maroon and teal blue. Comparable store sales in women's ready-to-wear increased mid-single digits. We anticipate this strong growth in women's ready-to-wear to continue for the balance of the year.

Turning to our men's business, in sportswear, novelty pieces such as our Sherpa-lined wool trucker jacket and leather varsity jackets were bestsellers during the quarter. In addition, our signature short-sleeved polo and lightweight layering merino wool sweaters in seasonal colors performed well.

In leather goods, we continued to see a strong response to our Henry collection. Luxurious hand-burnished suede accessories in rich cordovan and tobacco colors were bestsellers during the quarter. Backpacks continue to be our best-selling silhouette. Looking ahead, we anticipate continued growth in our men's business.

In our watch and jewelry segment, Access smartwatches outperformed the broader category. Our recently launched Access runway watch, which offers new features such as a heart rate monitoring and the ability to make payments using Google Pay, became a bestseller in the quarter. Overall, we remain pleased with the growth trajectory in our smartwatch category.

In fashion watches, we're encouraged by the performance in our slim profile watches. Our new [ph] tri-tone metal bracelet designed in a minimalistic slim profile piper group (15:05-15:11) resonated well with consumers, as did our new metallic colored watches. While, we are encouraged by these positive results, they are not yet large enough to offset the overall declines in the fashion watch category.

Separately, our new fine jewelry line has been well received by consumers and is expected to be a strong performing category during the holiday season.

Now, we'd like to provide an update on our first-ever #MKGO sport capsule collection, which is called Graffiti in honor of New York City's street art and its influence on fashion. The Graffiti capsule included exciting new designs for accessories, footwear and ready-to-wear. The combination of eye-catching on-trend product created more buzz than we had anticipated. In fact, we sold out of several Graffiti items across various categories.

In mid-October, we launched our second #MKGO capsule called Bold. This new athletic wear-focused collection is inspired by the current street style fashion trend and shows our new Kors signature logo product across all men's and women's categories. We are experiencing the same strong sell-throughs on this new capsule. Looking ahead, we will continue to support #MKGO with engaging marketing campaigns to help drive further sales momentum into the holiday season.

Now, turning to brand engagement, we have approximately 32 million customers in our database globally, a 25% increase over last year, which demonstrates the continued strength and desirability of the Michael Kors brand.

Moving to our loyalty program, KORSVIP now boasts over 1 million members in the U.S. KORSVIP benefits from early access to product launches, invitation to members-only events, and the opportunity to accrue points by submitting product reviews and creating wish lists. Members also show stronger engagement and transaction metrics as compared to non-members, a very encouraging sign.

We also continue to engage consumers through social media. In September, Michael Kors Spring 2019 New York Fashion Show content generated 367 million impressions, 16 million engagements, and 16 million video views globally.

With platforms such as Weibo and Twitter, impressions generated by Michael Kors' show increased double digits over his February show. Overall, during the second quarter, we grew our social media audience by 12% over last year to over 43 million followers, reaffirming Michael's position as one of the most followed fashion designers in the world.

Turning to customer experience, we continued to leverage our best-in-class digital marketing capabilities to complement in-store events and generate excitement around product launches. For example, in September, Michael Kors hosted brand ambassador, Yang Mi, at our Rockefeller Center flagship, an event which drew fans to the store and was live streamed on global social media platforms, generating 125 million impressions.

Our Kors Connect tool is another example of how we continue to focus on customer experience. Kors Connect provide sales associates with the ability to augment in-store selection with products available online and in stores and has driven a twofold increase in sales penetration versus our old technology.

Finally, we continue to expand omni and e-commerce initiatives to improve the experience for Michael Kors fans in new geographies. Just last month, we expanded shipping to 15 new countries, including strategic regions such

as Southeast Asia and the Middle East. Overall, we remain confident in our long-term outlook for the Michael Kors brand and continue to lay the foundation for accelerated growth in fiscal 2020.

Now, turning to Jimmy Choo, the brand continued its excellent performance during the quarter, delivering double-digit revenue growth. Comparable store sales grew in the low single digits, driven by strength in footwear, partially offset by weaker handbag performance as we continue to transition to our new accessories platform.

In footwear, the successful launch of the Cruz flat, coupled with strong performance from our Misty platform, helped drive performance in the fashion category. The Romy remained a bestseller in our core 24:7 line and was worn by Lady Gaga, Keira Knightley and Alicia Vikander, among others during the quarter.

In fashion active, the Oakland sneaker performed ahead of our expectations and the new Crystal Oakland launch supported momentum in this style.

In accessories, we continued to transition to new fashion groups, as this category remains a focus for our future growth. We introduced Marianne in the fall season. And heading into holiday, we are excited about the launch of [ph] Hillary collection, (21:34) which will feature Jimmy Choo's signature quilted letter star design.

The strength in Jimmy Choo's fall collection was supported by an exciting marketing campaign starring supermodels Joan Smalls, Lilly Aldridge and Rosie Huntington-Whiteley. This campaign achieved an incredible 22 million views and helped expand Jimmy Choo's Instagram followers from 8 million to approximately 9 million followers.

Also during the quarter, we appointed Jimmy Choo's inaugural Asian brand ambassador, Victoria Song Qian. Victoria is a Chinese singer, dancer, actress, model, television presenter and author. The announcement post on Weibo achieved over 230 million views, significantly outperforming our expectations. We look forward to updating you about our collaboration with Victoria on future calls.

Finally, during the quarter, we opened 13 net new Jimmy Choo stores and continue to see a strong runway to expand our presence, particularly in Asia. E-commerce also remained a key focus for Jimmy Choo and our investments in technology helped drive double-digit growth in the quarter.

Jimmy Choo's results demonstrate that we are successfully executing on our strategy and show our ability to integrate a new business into our global fashion luxury group. These strong results have continued to be ahead of our expectations.

In conclusion, we continue to make progress on our strategic initiatives and are excited about what the future for Capri Holdings will be.

Now, I'd like to turn the call over to Tom.

Thomas J. Edwards, Jr.

Executive Vice President, Chief Financial Officer, Chief Operating Officer & Treasurer, Michael Kors Holdings Ltd.

Thank you, John, and good morning everyone. We were pleased to report another quarter of results that came in above expectations, delivering net income of \$193 million and diluted earnings per share of \$1.27.

Total revenue of \$1.25 billion was in line with guidance and increased 9% compared to last year. This increase reflects \$117 million incremental revenue from Jimmy Choo and a 0.8% decrease in Michael Kors revenue compared to last year.

Starting with the Michael Kors Retail business, revenue was approximately flat compared to last year. This performance reflects 11 net new store openings and higher sales from stores not in the comparable sales base, offset by a 2.1% decline in comparable store sales, which was in line with expectations.

Global e-commerce benefited comparable sales by 190 basis points. On a constant currency basis, comparable sales declined 1.3%. For the Michael Kors Wholesale business, revenue declined 1%. This was ahead of expectations, reflecting stronger than anticipated growth in the Americas. Europe revenue was lower, reflecting our strategy in the region to reduce inventories and increase full-price sell-throughs.

Michael Kors Licensing revenue decreased 7% versus the prior year. This reflects continued growth of Access smartwatches and the successful introduction of our new slim fashion watches and jewelry, but this was not yet large enough to offset the overall declines in fashion watches.

Now, I would like to provide some regional highlights for the Michael Kors brand during the quarter. In the Americas, revenue increased in the low single digits. Americas Retail revenue increased in the low single digits as well.

Comparable store sales experienced a modest decline in the quarter. This was primarily driven by low double-digit declines in inventory levels and higher markdowns on certain seasonal fashion products.

Our signature logo designs sold well and resonated with consumers, but our inventory levels were lower than needed to meet consumer demand. Looking forward, we're working diligently to increase inventory in our logo offerings.

Wholesale revenue in the Americas increased mid-single digits. Footwear sales were particularly strong in the quarter, while accessories and women's ready-to-wear performed better than expected. Fashion active and updated logo details outperformed in all product categories.

In Europe, our sales declined double digits for the quarter, in line with our plans to decrease inventory and drive higher full-price sell-through. Europe Retail comparable store sales declined in the mid-single digits, which was better than expected. Wholesale revenues in Europe declined double digits in the quarter.

Turning to Asia, we continue to generate strong results, with revenue growth in the mid-single digits and positive comparable store sales. Growth in comparable sales was driven by high single-digit increase in Mainland China, partially offset by lower sales in Hong Kong and Macau. We also opened 17 net new stores, in line with our strategy to further expand our presence in this region.

Now, turning to Jimmy Choo, revenues were \$117 million, which is ahead of guidance and represents double-digit growth compared to last year. These results were driven by low single-digit comparable store sales growth, led by continued strength in footwear and the addition of 13 net new stores since last quarter, bringing our total global fleet to 204 retail stores.

Now, we'll speak to total company margin performance. Gross margin was 61%, an increase of 80 basis points over the prior year. This improvement reflects 110 basis point benefit from the inclusion of Jimmy Choo and lower Michael Kors brand gross margin, which declined 30 basis points compared to the prior year.

The Michael Kors brand gross margin performance reflects an increase in Wholesale gross margin of 130 basis points, driven primarily by lower product costs and the decline in Retail gross margin of 150 basis points, driven by higher markdowns on our end of season merchandise.

For perspective, I would like to highlight that the Michael Kors Retail gross margin was flat for the first half of the year compared to the prior year, and we expect second half and full year performance to be consistent with prior year as well. Total company operating expense increased \$95 million including \$92 million from Jimmy Choo.

As a percentage of revenue, operating expense increased 420 basis points to 43.7%, primarily reflecting the addition of the Jimmy Choo business. Michael Kors operating expense as a percent of revenue was 40.1%, a 60 basis point increase over the prior year. Total company operating margin was 17.3% compared to 20.7% last year. The primary driver of the lower margin was the addition of Jimmy Choo.

As we have mentioned in prior calls, Jimmy Choo's operating income is seasonally higher in the first and third fiscal quarters and lower in the second and fourth. Jimmy Choo's operating margin was negative 6% during the quarter, ahead of expectations.

Michael Kors brand operating margin was 19.7%, 100 basis point decline compared to the prior year. Michael Kors Retail operating margin was 12.4%, a 300 basis point decline reflecting lower gross margin. Michael Kors Wholesale operating margin was 29.3% a 200 basis point improvement, primarily driven by higher gross margin. Michael Kors Licensing operating margin was 29.7% compared to 30.8% last year, primarily reflecting lower revenues. Our tax rate for the quarter was 8.5% compared to 15.1% in the prior year, reflecting a tax benefit related to employee equity compensation and a lower U.S. tax rate.

Turning now to our balance sheet, we ended the quarter with \$155 million in cash and cash equivalents and \$760 million of debt. Inventory was \$768 million, including \$148 million associated with the acquisition of Jimmy Choo, compared to inventory of \$697 million in Q2 fiscal 2018.

Excluding Jimmy Choo, inventory for Michael Kors declined 11% compared to the prior year. Capital expenditures for the quarter was \$49 million and were primarily spent on new store development, renovations, IT and e-commerce enhancements.

Now, I would like to turn to guidance. We are raising full year EPS guidance by \$0.05 to a range of \$4.95 to \$5.05 per share. This increase reflects our better than anticipated second quarter operating performance. For the full year, we continue to expect total revenue to be approximately \$5.125 billion, including between \$580 million and \$590 million of incremental Jimmy Choo revenue.

We now expect Michael Kors Retail revenue to grow in the low single digits and reported comparable store sales to be down low single digits. Comparable store sales guidance is expected to be impacted by unfavorable foreign currency of over 100 basis points. We expect Michael Kors wholesale revenue to decline in the low single digits.

In Licensing, we now expect revenue to decrease in the low double digits. We are raising our operating margin forecast to approximately 18.2%, which includes 170 basis points of dilution from Jimmy Choo. We continue to expect Michael Kors brand full year operating margin to be in line with fiscal 2018 performance.

Our assumed tax rate is approximately 15.5% for the year, reflecting higher second half rates, including earlier than anticipated realization of equity compensation benefits and normal quarterly pacing.

We forecast weighted average shares outstanding of 152 million, resulting in diluted earnings per share range of \$4.95 to \$5.05, including dilution from Jimmy Choo of \$0.05 to flat. Our new capital expenditures guidance is approximately \$225 million, which includes the planned opening of approximately 60 Michael Kors stores and 30 Jimmy Choo stores, store innovations, and IT expenditures.

For the third quarter, we expect total company revenue of approximately \$1.46 billion, including approximately \$165 million of incremental revenue from Jimmy Choo. Q3 Retail revenue for the Michael Kors brand is expected to grow in the low single digits. We expect comparable store sales to decline in the low single digits, primarily due to an unfavorable foreign currency impact. We expect Wholesale revenue to decline in the high single-digits.

As noted in prior calls, we expect the largest reduction in Americas Wholesale revenues to occur in the third quarter as we focus on driving full-price sell-through. We expect Licensing revenue to decline in the mid-teens. We anticipate an operating margin of approximately 20.8%, including 140 basis points of dilution from Jimmy Choo.

Our effective tax rate is expected to be approximately 20%. We forecast weighted average shares outstanding of 152 million, resulting in diluted earnings per share in the range of \$1.52 to \$1.57, including anticipated Jimmy Choo accretion of approximately \$0.04 to \$0.06.

In conclusion, we remain encouraged by our second quarter performance, which helped drive results that were above our expectations for the first half of fiscal 2019. Our strategic growth initiatives continue to bear fruit and we look forward to delivering strong results in the second half of the year.

Now, I will open up the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And at this time, we will hear first from Erinn Murphy of Piper Jaffray.

Erinn E. Murphy

Analyst, Piper Jaffray & Co.

Q

Great. Thanks. Good morning. A couple of questions from me, I guess first on the Michael Kors brand, I would love if you could talk a little bit more about the accessory business trending down low single. I know you're still planning it down that level for the year. Inventory has been a big initiative to keep lean. But what do you need to see to really pivot that back towards growth? And then, when you just think about the business today, how much of the decline in unit versus pricing?

John D. Idol

Chairman & Chief Executive Officer, Michael Kors Holdings Ltd.

A

Thank you, Erinn. Good morning. So, the accessories business for Michael Kors, we have two issues in the quarter. First, as you know, for the company, inventories were down approximately 11%, Michael Kors brand only. And in Americas, it was down high single digits. So, we probably, Erinn, were a little too lean on inventory across the group. I think we had anticipated that we could really achieve our sales goals with less inventory. And I think that was a probably a little too lean, as I said before.

And the second thing that happened is the logo category has really taken off much greater than we had anticipated. So we are sold out in certain styles in the stores. We're very, very lean on inventory. And that's both in our own retail channels and in the North American wholesale channels as well.

You saw that Wholesale did better in North America than we had anticipated and that's, again, we could have done even better than that, had we had additional inventory. So on the one hand, I wish we performed a little bit better, because I think that would have made everyone a little happier. But on the other hand, the customer's resonating for us. So we see that in our database. We see it on our social media. So all of that hasn't changed.

We need to get in a better inventory position. We believe we're going to be there for Q3, but it will be more towards the tail end of Q3. We are clearly chasing merchandise and that's not only for North America, but that's for some of the other regions in the world. Europe did a little better than we also thought as well. So we feel like all the indicators are there. We've got to get more inventory into the stores to be able to really fill the consumer demand. So that's the first thing.

Second thing, unit sales were actually up slightly during the quarter and that was a function of, again, we continue to sell smaller bags and also smaller [ph] SLGs (37:06) as well as you move down kind of the chain in terms of products. So once again, that's another indicator that the consumer is absolutely responding to the brand.

The one last point I might make, too, in North America, the comp was very minor negative. We were impacted slightly also in Americas by some of our business in Canada and actually in South America, where it's been a little more challenging and there's been some currency issues, et cetera.

So we're not unhappy with our performance, as a company, in North America and, in particular, we were happy with our business in China, where we had double-digit increases in Mainland China.

So, again, we think we're tracking very nicely to our initiatives around Runway 2020. And, of course, I commented to the #MKGO, which I have to say is, I'll call it, a surprise. We thought it would be successful, but nowhere near what we're seeing happening. Some of our best-selling styles over the last few weeks for the company, both in footwear and in handbags, are coming from the #MKGO capsules. And that's both with our Kors logo, which you've seen on some of the products, which is really resonating with consumers. Some of the items with taping on them that say Michael Kors down the sleeve and, of course, our regular MK logo.

So clearly, the customer's voting. We need to get more inventory into their hands. And again, we feel that we're on the right track. And we'll be making some exciting announcements shortly about our new marketing campaigns for next year. They're going to feature some incredibly powerful faces that I think you will see will resonate with millennials as well as our broader base of customers.

So I think we still feel very encouraged. And I might just conclude by saying that, again, we've raised guidance for the year. And I think that's a real positive indicator for how we feel about our company and our business. And we have to have our accessories business driving to be able to do that and we feel like it will be. So, thank you very much, Erinn.

Operator: And our next question comes from Matthew Boss of JPMorgan.

Matthew Robert Boss

Analyst, JPMorgan Securities LLC

Q

Great. Thanks. On gross margin at the Kors brand level, I guess, what factors account for the change in the forecast to flat versus modest expansion, I think was previously? And maybe, John, just any higher level thoughts or changes maybe that you're seeing on the promotional front into holiday at all?

Thomas J. Edwards, Jr.

Executive Vice President, Chief Financial Officer, Chief Operating Officer & Treasurer, Michael Kors Holdings Ltd.

A

Sure. Matt, in terms of gross margin and flat versus modest expansion, I think as we looked in this quarter, and our inventory levels were lower, particularly in logo. We did have some markdown activity in our end of season inventory. So, it's a really a reflection of that quarter.

When we look at the full year, the first half and second half, we expect gross margins to be relatively consistent with prior year and have actually raised our overall operating margin for Michael Kors brand as part of the guidance outlook.

For the first half, net margin is even with prior year and for the second half, we expect similar performance, even with prior year. So, really it's more of a quarterly item related to the second quarter.

John D. Idol

Chairman & Chief Executive Officer, Michael Kors Holdings Ltd.

A

Yes, Matthew, on the promotional front, you know as a company close to two years ago, we changed our cadence in North America. And that's really had a very, very strong impact on our business. In our lifestyle stores, AURs rose again in the quarter, so we're very pleased with that. Conversion is actually up in those stores. So, we're not seeing any more or less promotional activity than we've seen before. And we can't comment on to what will happen during the holiday season. But so far, it's been relatively consistent to where we've been in the past.

Operator: And we'll move next to a question from Oliver Chen of Cowen & Company.

Oliver Chen

Analyst, Cowen & Co. LLC

Q

Hi, thank you. Thank you, John. Versace is a big opportunity. What are your thoughts on sequencing timing in terms of how you're thinking about product and accessories relative to demand creation on the marketing side?

And at the Kors brand, you mentioned the end of season markdowns. We've seen really good product innovation as well as consumer traction, so would love details on what happened with the markdowns in some of the seasonal fashion product.

And just lastly, China is a big topic amongst incoming calls that we're receiving. What are your thoughts about the global Chinese customer in terms of the Chinese purchasing goods abroad? And anything you're seeing regarding China, Mainland Chinese purchasing and geopolitical factors as well, that'd be helpful. Thank you.

John D. Idol

Chairman & Chief Executive Officer, Michael Kors Holdings Ltd.

A

Sure. Let me take the second question first, Oliver. The end of season markdowns that we saw, unfortunately, they end up being a greater percentage and have impacted the retail gross margin because we did not have enough logo product in particular. Logo product for us accounts for 20% to 25% of sales. And we actually think that's going to climb again. You know what's happening in fashion today, so we planned it at a rate. We've sold through much, much faster than that rate. So, therefore, when we took the markdowns on some of our fashion product, it just accentuates the gross margin when you don't have enough of the other product to sell through at full price. So I think that's really what we were trying to explain. And again, we drove the inventories a little too low in the company. You can understand at 11% down, that was probably a little aggressive on our part in terms of going after the full price sell-through.

We believe we'll be in a better shape at the end of Q3. A lot of that inventory is getting here latter part of November into December. So it's not going to have the full effect that we would have liked to have had and hence why you see some of the increase in Q4 because we'll be able to have better positioning, both in our retail and for our wholesale partners.

Secondly, I would like to take the China; we see continued strength in the China marketplace and we see them clearly domestically as being very, very strong. We know there are issues in terms of how the government is looking at domestic consumption. And we've always been of the point of view that we're very comfortable working with our clients, whether in their home markets or whether they're abroad.

That being said, I have to tell you that one of the best businesses in the company, and I've commented on this a few times, is our businesses in airports, in particular, and certain duty-free locations around the world, where we continue to see very, very strong activity. And many of those occasions are led by Chinese consumers and Chinese traveling.

So we have not seen anything yet that would give us indication that that is changing. We're certainly watching it very closely. And I might add we also saw the same type of actually very strong momentum at Jimmy Choo in China as well. So the two brands that we have, they're resonating well, performance is good and we think that that's going to continue through the balance of this fiscal year.

Lastly, I would like to talk to you about Versace. And I am terribly, terribly excited. I've been working with Donatella and Jonathan many, many times over the last few months. We've met with the design teams. We've met with the marketing teams. We have some extraordinary plans for Versace. First off, Donatella is an incredible partner.

We have some very clear visions around how we can quickly accelerate our accessories and footwear business. As you know, by the information that we put out today, the accessories part of the business is considerably underdeveloped for a company with this reputation and this heritage. And so, we have the know-how and Donatella has the innovation. So you'll be seeing that on the runways in February and in the stores in August, September.

So that product, it's already literally been designed over the last few weeks. And so we're super, super excited about where we're going there. And it will be incredibly iconic. And when you have someone like Donatella with the following and the voice, it gives us an opportunity to market in a way that many, many companies do not have the way to do.

So that would be product cadence. And I would look for accessories as being the main driver of that first. I also might add that Versace has a very strong sneaker business today. And, again, if you go on some of the collector websites and some of the new launched websites for sneakers, Versace is one of the most sought after products, in particular, our Chain Reaction Sneaker, which again, we're doing everything we can to stay in stock on that product right now.

And I also might add that the company is having double-digit comp store increases. I want to repeat that, double-digit comp store increases right now. So, as we said, double-digit revenue growth, 50% EBITDA growth, and double-digit comp store growth. So we believe that we have been able to acquire a company that is, quite frankly, running very, very strong right now. And with our five-point initiative, we're going to really help accelerate that.

And, of course, I think you've heard that we're going to have a major, major fashion show here in New York because we think America, in particular, is an underdeveloped market for Versace. And one of the best ways to kick it off is to have Donatella here, and she'll be here on December 2. And we will do an incredible fashion show, which is one of her strengths. And we will amplify that to millions and millions of our followers around the world.

And, again, the power of the Versace brand is really incredible and it's untapped, in our opinion. I would also say if you look at us compared to our competitors in the Milan area, and I think you know who they are, we are from a revenue standpoint, substantially below the two or three major competitors that are in that marketplace.

And so it gives us just amazing hope and more than that, it gives us the confidence to be able to develop this. And having Donatella completely aligned with us and also having Jonathan Akeroyd, who is absolutely an outstanding CEO, and really under his direction, has turned this company around in two years. It gives us the ability to really work closely with that team and make our strategies happen. Thank you very much.

Operator: And our next question comes from Omar Saad of Evercore ISI.

Omar Saad

Analyst, Evercore ISI



Thanks. Good morning. I wanted to ask a follow-up on product strategy, John, and maybe some of the logo comments as well. Maybe you could clarify, is it more classic logo, that incremental demand that you're seeing

where you're kind of chasing on the supply side, or is it more logo with a twist? Help us understand what specifically you're seeing within the logo category of products.

And then, maybe layer that into how you're thinking about the product strategy overall. It sounds like you guys have really nailed, for the Michael Kors brand, digital marketing. The loyalty program, it sounds like product might be that last [ph] leg (50:06) to really amplify the sales growth into next year. But maybe a little bit more details around that would help us clarify. Thank you.

John D. Idol

Chairman & Chief Executive Officer, Michael Kors Holdings Ltd.

A

Sure. I'm going to start with product overall. Again, we're very pleased with the new product launches that we've had and the success that we've seen around those new product launches. We think that our innovation strategy has really positioned the company for future growth.

I also would like to add that our women's ready-to-wear and our footwear business has been growing basically at double digits and high single digits rates. So, again, the customer is resonating with us and, as many of you know also, some of the active footwear is becoming as iconic to some people as accessories is.

Again, I don't think that's going to replace it, by any means, but it is certainly a very, very important part of fashion today. And we're one of the leaders in that area. So, I feel very strongly about how the company has positioned itself.

In terms of logo, it's really, I'd call it, kind of 70%-30%. When I say that, it is our classic logo and it is some of our key shapes in classic logo. And unfortunately, those are the ones that we do not have enough inventory on. But I might also add that the way that we've layered in logo with our Mercer and our Whitney and some of the other core styles that we have in the line, has been equally as strong. And you'll see our holiday campaign, we actually have a Whitney in logo in our advertising.

So we're moving very quickly. And you're going to see a major campaign around it for spring season as well. So not only are we following on consumer demand, but we're actually going to be pushing it much, much stronger than we had previously done in the past. And so we think when we get into better inventory position, we'll be in a better place to meet the consumer demand on that product. Thank you, Omar.

Operator: And we will hear next from Camilo Lyon of Canaccord Genuity.

Camilo Lyon

Analyst, Canaccord Genuity, Inc.

Q

Thanks. Good morning. John, just continuing on the logo theme, if you're able to talk more about how much of the shortfall in your logo mix accounted for what happened in the quarter. So if you say that logo mix is usually about 20% to 25%. If you had the right amount of inventory, what would that have roughly been in [ph] a quarter? And what level are you willing to let that float (53:02) as a part of your mix?

John D. Idol

Chairman & Chief Executive Officer, Michael Kors Holdings Ltd.

A

Yeah. Thank you, Camilo. First off, we don't really break down that level of detail. What I will say is the following. Number one, our view of our accessories business is that we want to be balanced between fashion and logo. And

we had traditionally, as I said, run 20% to 25%. That's been historical for the company. That is accelerating. And, again, the end consumer is really driving that.

And it's not only in the traditional products, like when Omar was discussing that before, but we we're seeing it in other fashion products, talked to you about how Whitney and Mercer. In addition to that, we're seeing it in the new Kors #MKGO logo items as well.

So she's clearly responding to it. It is a fashion trend right now. And it seems that when we have the inventory there, the consumer is responding to it very strongly. So we will plan the inventories up appropriately to try and get in a better position. But I can only tell you that we know we would have done more business because we would have had more product and that would have filled the customer demand. Thank you, Camilo.

Operator: And we will hear from Paul Lejuez of Citi.

Paul Lejuez

Analyst, Citigroup Global Markets, Inc.

Q

Hey, thanks, guys. I think you said third quarter comps are expected to be down low single digits. Any color you can give us on a constant currency basis by region. Also curious, if you can talk about within your North America business, performance in mall stores versus off-mall, maybe outlet, any color you can give on that front. Thanks.

John D. Idol

Chairman & Chief Executive Officer, Michael Kors Holdings Ltd.

A

Sure, Paul. On the comp store, again, remember there's going to be a currency headwind that's going to impact us by at least 100 basis points. So that is the primary driver of our now revised guidance to down during the quarter. I think you would see similar trends globally. I think you'd see Asia being up, Europe being down and Americas in the flat to slightly down type of range.

So I think the complexion is going to look a little bit like it looked for this quarter. And we think fourth quarter will get a little better, given our inventory positions. So hopefully, we'll see some improvement at that point.

In terms of traffic, traffic actually improved for us during the quarter. So we were pleased with that. And we've seen a sequential improvement. It's probably one of the first times we've seen a sequential improvement in traffic in two years. So we're seeing that mitigate/getting better.

As I said before, conversion is up. And in our lifestyle stores, AUR is up. So I think we're feeling pretty good about the metrics of the business from a KPI standpoint. We've got some work to do on balancing our inventories to get the right product in the right place. And I feel confident that we'll do that. It's going to take us a little bit of time, given that we've got to work around Chinese New Year. So this is a little issue.

So we've got to bring some stuff in a little earlier than maybe we wanted to and maybe we won't get it all here before the Chinese New Year. So we're working diligently around those issues. But I think in general, we feel good.

I might also comment that Jimmy Choo had an outstanding quarter. And again, we're seeing real benefits from our initiatives in terms of higher levels of fashion in the footwear business, which has shown double-digit growth. And our initiative on our accessories re-launch is moving along very, very smoothly. And you're going to see the introduction of logo from Jimmy Choo, which will come in the back half of next year.

So there's some very exciting product that's going to be coming there. The company has never really had that before. And so there is a significant launch that will be coming from the company around that. So we feel very good that Michael Kors continues on its Runway 2020 trajectory. And that Jimmy Choo, we've absolutely shown that we're integrating that pretty seamlessly. And now, we're delivering exciting new product launches, in particular, in the footwear, are resonating and soon to be in the accessories business as well. So I think you're going to see the benefits of that starting to flow through, in particular in 2020.

Operator: And at this time, we'll hear from Kimberly Greenberger of Morgan Stanley.

Kimberly Conroy Greenberger

Analyst, Morgan Stanley & Co. LLC

Q

Great. Thank you so much. Good morning, John. I have a quick follow-up question on inventory and Asia, two separate questions. Inventory, it looks to us like there was more of an inventory composition issue, rather than an inventory quantity issue, just given the fact that the Retail gross margin was down 150 basis points in the quarter. Is that a fair conclusion? And are there any strategies in place that would maybe give the merchants a little more guidance to get that inventory composition a bit more right?

And then, in Asia, the 4% growth in Asia revenue this quarter is a deceleration from what's been a double-digit growth rate here for the last three or four quarters. I'm wondering. It sounds like Mainland China is still very strong. Are there other areas of Asia that have softened a little bit, or is it all currency? Maybe if you could just unpack that a little bit, that would be helpful. Thanks.

John D. Idol

Chairman & Chief Executive Officer, Michael Kors Holdings Ltd.

A

Sure. I'll take the inventory piece and I'll let Tom take the Asia and currency piece. So number one, the same buying team that's been here at the company for the past 10 or 11 years has been the same team that's been doing this. And so they've seen the business as it goes up and down, et cetera. So we have a very competent team here. Remember, we had a strategy to reduce inventories to improve sell-throughs. And as I said earlier, we probably pulled those inventories back a little too hard versus what we should have. So that's an overall statement. And that wouldn't have been in just handbags, but that would have been in ready-to-wear and active footwear, et cetera.

So that was an across the board situation, that we probably should have had more inventory going into the quarter. And obviously, ending the quarter means we don't have the kind of inventory levels that we need to head into third quarter. So we're a little light.

That being said, the logo piece of it, I don't think we anticipated the strength of what happened during the quarter. And, again, you head into it thinking you have the right inventory mix and balance. We probably pushed on the fashion a little higher than we did on the logo, because we thought that was what was right for the consumer and for our image. And that balance just has to be readjusted slightly. So I feel good about the team that are here. They have the latitude to buy the merchandise by region, as they see fit. And we think that we've got a really good team to do that and a good strategy. Tom?

Thomas J. Edwards, Jr.

Executive Vice President, Chief Financial Officer, Chief Operating Officer & Treasurer, Michael Kors Holdings Ltd.

A

On the Asia decline sequentially, Kimberly, it was really an FX-driven event. As we looked at FX and, in particular, the renminbi versus prior year, the dollar strengthened high single digits versus our expectations and certainly versus prior year. So when we look at the total company FX impact of over 100 basis points, as we noted before, it's actually a little larger in Asia, impacting the overall revenue and the comps there.

John D. Idol

Chairman & Chief Executive Officer, Michael Kors Holdings Ltd.

Okay.

A

Operator: And we do have one other question. We'll hear from Jay Sole of UBS.

Jay Sole

Analyst, UBS Securities LLC

Great. Thank you. John, I wanted to ask about your comment you made that you're still seeing a trend towards smaller bags and that's impacting ASPs. Are you seeing the same rate of decline in the bag size and ASPs, or is that trend sort of showing that maybe it's slowing down and you can see visibility into when the bag size stabilizes? And then, secondly, Tom, to your point on the RMB, given that that currency has declined, is there any opportunity from a costing standpoint as you look into next fiscal year where your costs might go down just because that's a favorable impact on your ability to buy product?

Q

John D. Idol

Chairman & Chief Executive Officer, Michael Kors Holdings Ltd.

Thank you and good morning, Jay. Jay, bag size continues to accelerate. And I think we would have thought by this time that that would have mitigated somewhat and we actually haven't 100% seen that. Clearly, backpacks have come in and made a very, very strong play in the accessories business.

I think that's been to the extent of totes, where we've seen a decline in overall totes sales, but a significant increase in backpack sales. But clearly, smaller crossbody bags are, by far, what is driving the consumer, in particular the fashion consumer. And, as I said before, unit sales were actually up in the company during the quarter.

So I'm not saying that that's going to go on forever, but it certainly is a trend that doesn't seem to be changing. I don't think we're any different than any of the other luxury good players in the world. We can see it our Jimmy Choo business. Our best-selling bags are smaller bags. And now seeing and understanding Versace, it's the same structure. So it's something we have to live with and we'll continue to go on and grow.

On the other hand, we did comment in my prepared remarks that the Michael Kors Collection handbags were doing very well during the quarter. So that is encouraging for us also. It's Michael's vision in terms of runway. And those bags are \$1,200 up to \$5,000. So we're very pleased that we're seeing traction in that category of merchandise inside of our stores as well.

I'm going to take the production piece of it. We're working with our manufacturers on a regular basis. We produce less than 5% of our product today in China and we've been sourcing elsewhere, mainly from a cost standpoint. So we will work continuously to lower our cost of goods. And we're not prepared right now to talk about how that may or may not impact next year, but we work at it every single day of the week. And whether that's in accessories or ready-to-wear or footwear, it's an ongoing priority for the company.

A

Thank you, Jay.

John D. Idol

Chairman & Chief Executive Officer, Michael Kors Holdings Ltd.

I would now like to conclude the call. I would like to now conclude the call.

Operator: Thank you, Mr. Idol.

John D. Idol

Chairman & Chief Executive Officer, Michael Kors Holdings Ltd.

And say, thank you, everyone, for joining us today and look forward to updating you on our future results and the exciting integration of Versace into our company. Thank you.

Operator: And so, ladies and gentlemen, that does conclude the call. We would like to thank everyone for your participation. You may now disconnect.

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