Corrected Transcript

09-Sep-2020

G-III Apparel Group Ltd. (GIII)

Q2 2021 Earnings Call

CORPORATE PARTICIPANTS

Neal S. Nackman
Chief Financial Officer & Treasurer, G-III Apparel Group Ltd.

Morris Goldfarb
Chairman & Chief Executive Officer, G-III Apparel Group Ltd.

OTHER PARTICIPANTS

Edward Yruma
Analyst, KeyBanc Capital Markets, Inc.

Erinn E. Murphy
Analyst, Piper Sandler Companies

Rick B. Patel
Analyst, Needham & Co. LLC

Jim Duffy
Analyst, Stifel, Nicolaus & Co., Inc.

Susan Anderson
Analyst, B. Riley FBR, Inc.

John Kernan
Analyst, Cowen & Co. LLC

Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC

MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by, and welcome to the G-III Apparel Group's Second Quarter Fiscal 2021 Earnings Call. 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] Please be advised today's conference is being recorded [Operator Instructions] I would now like to hand the conference over to your speaker for today Mr. Neal Nackman, CFO, you may begin sir.

Neal S. Nackman

Chief Financial Officer & Treasurer, G-III Apparel Group Ltd.

Thank you, and good morning, thanks for joining us. Before we begin, I would like to remind participants that certain statements made on today's call and the Q&A session may constitute forward-looking statements within the meaning of the federal securities laws. Forward-looking statements are not guarantees, and actual results may differ materially from those expressed or implied in forward-looking statements.

Important factors that could cause actual results of operations or the financial condition of the company to differ are discussed in the documents filed by the company with the SEC. The company undertakes no duty to update any forward-looking statements.

I will now turn the call over to our Chairman and Chief Executive Officer, Morris Goldfarb.

Morris Goldfarb

Chairman & Chief Executive Officer, G-III Apparel Group Ltd.

Good morning, and thank you for joining us. Also joining me today are Sammy Aaron, our Vice Chairman and President; Neal Nackman, our Chief Financial Officer; Jeff Goldfarb, Executive Vice President; and Priya Trivedi, Vice President of Investor Relations.

G-III is a merchant led company with an entrepreneurial culture that can identify and swiftly execute on opportunities and situations. This has always been our competitive advantage, and even more so in this pandemic world. We have evolved into a well-diversified apparel company. It is impressive to see the expertise and the dominance we've developed especially over the last 15 years. We've fueled our growth and captured market share in almost all major classifications including sportswear, coats, dresses, athleisure, suits separates, jeans, swimwear, handbags and footwear. These categories enable our brands to be displayed at multiple locations and multiple floors of our retailer stores, with some brands in over 10 locations per door. Importantly, our merchants have proven to be nimble, shifting talent and resources to product categories based on rapidly changing consumer demand.

Our strong portfolio of globally recognized brands sold across a broad array of diverse distribution channels has also set us up well to successfully manage through these unprecedented times. Our management teams, structured by brand and by category, are responsible for driving sales and profitability of their individual businesses. This enables us to continue to operate efficiently and at high levels of productivity. I am incredibly proud of our people for meeting the challenges posed by the pandemic to adjust quickly as we navigate through this complex environment.

Let us review some of our key developments and accomplishments for this quarter. We worked with our retailers to reassert and reallocate our order book for the balance of the year. Although our product categories have been evolving towards more casual dressing over the last several years, our teams were able to move rapidly to further change our fall and holiday seasons' product assortments to address the clear shift in consumer needs.

We feel comfortable with our inventory positions as our vendors have worked collaboratively with us to shift our production to align with our redeveloped order book. As a matter of fact, inventory levels were down 32% this past quarter as compared to last year's second quarter.

Let's walk through some of our bigger categories and provide you with some additional color on the product mix. The demand for [ph] outperformance to our (00:04:36) athleisure wear category is really accelerating. We've built the strong essentials program, which enables us to replenish quickly to facilitate demand both in stores as well as digital. Our recently added jeans lines for three of our power brands lend themselves perfectly to today's casual and active lifestyle. From their initial launches, we designed these lines to have a ratio of multiple tops to one bottom. Our focus is on casual and comfortable tees, woven tops, sweaters and sweatshirts. We have also added an assortment of relaxed bottoms, leggings and casual pants in a variety of fabrics.

Overall, with three of the most globally recognized power brands, DKNY, Calvin Klein and Tommy Hilfiger, we've become the dominant resource in athleisure wear. We expect the athleisure wear and jeans category to be a big growth area for us going forward.

Coats are another classification that we're the best positioned to capitalize on. We're seeing a greater demand for coats based on the population's growing interest in an active lifestyle and in indoor activity, outdoor activities including walking, running, biking, hiking and dining. To meet this demand, we've expanded our offerings of traditional mid-weight styles, packable jackets and layered pieces, all designed for comfort and functionality.

As for sportswear, for the fall and holiday season, we're emphasizing the casual components of these collections, featuring knit and woven tops and sweaters, as well as casual comfortable dresses and bottoms. We're also seeing good traction in casual handbags and footwear. On the flip side, we have deemphasized categories like suit separates, the career components of our sportswear lines and social dresses.

Our full assortment of products come together to offer a great selection of casual, comfortable clothing and accessories that can be mixed, matched and layered for spending time at home and outdoors. In early June, we also announced the restructuring of our retail segment, which includes the closing of all our G.H. Bass and Wilsons Leather store locations. The store liquidations are underway and progressing according to plan. Last year, our annual operating losses for these stores were approximately $50 million. We expect the restructuring to eliminate almost all of these losses. We are optimistic about our ongoing DKNY and Karl Lagerfeld Paris stores and digital sites.

In addition to restructuring our retail operations, we also made the difficult decision to reduce our global wholesale head count by approximately 20% to better match our business needs. This staff reduction is expected to result in annual savings of roughly $22 million. We further solidified our capital structure and enhanced our financial flexibility and liquidity by refinancing our balance sheet and extending the maturity of our revolving credit facility on term debt to 2025. We issued $400 million of senior secured notes, which repaid the previously outstanding $300 million term loan and increased our cash balance by approximately $90 million. We also simultaneously amended and extended the $650 million revolving credit line.

Now, turning to some more of the specifics of our business in the second quarter, many of our brick-and-mortar locations of our partners as well as our own were closed for about half of our second fiscal quarter. The majority of the stores have reopened. Encouragingly, in the months of June and July, we saw positive week-over-week trends as a result of pent-up demand. This resulted in sequential improvement in our wholesale shipping for each month of the quarter.

Let's review the financial results for our second fiscal quarter ended July 31. Net sales for the second quarter were $297 million compared to last year's $644 million. GAAP loss per share was $0.31 compared to a gain of $0.23 per diluted share last year. The GAAP loss per share for this quarter includes a $0.53 loss per share related to the operations of the G.H. Bass and Wilsons Leather stores which will be closed after the liquidation sales.

The pandemic's ripple effect on the retail industry has been evident with the unprecedented disruption causing bankruptcy filings and announced store closures. In our view, the reduction in bottom tier unprofitable retail store locations will be a long-term net positive for our retailers as they deploy resources to their digital business, and top tier locations, which will ultimately improve their overall financial health. Our consistent track record for execution and strong financial results position us well to capture market share, and grow our business in what will clearly be a narrower field of competition.

Let's take a moment and talk about our digital businesses. In the second quarter of this year, we saw significant demand in our retailer sites through all categories. On our own DKNY and Karl Lagerfeld Paris sites, we had comparable sales increases in excess of 50%. We approximate last year's digital retail revenue on our partner sites as well as ours to be in excess of $1 billion. We are increasing our investments on both the front and back end. We've dedicated teams in the US, Europe and Asia working to capture a growing share of the digital business. These teams focus on our brand sites as well as our retailer sites which amongst others include Macy's, Nordstrom, Amazon, Fanatics, Zalando, ASOS and Taobao.

In addition to our dominant position in North America, we're just getting started and to grow internationally with our DKNY brands. We've seen improving trends through the second half of the quarter across China with some comps up about 20% over the last two months. We operate China through a joint venture and will be increasing our ownership from 49% to 75%. We're thrilled to accelerate growth and awareness of the DKNY brand with consumers in this key international market.

We're also expanding our sales in Europe and elsewhere through our distribution partners. Now, with our own brand DKNY, we're finally developing and expanding these overseas markets and believe they present the potential for growth.

Our wholesale businesses will continue to be the primary sales and profit engine to G-III. We remain focused on leveraging our wholesale expertise to drive long-term growth. As we navigate through this pandemic, I am confident that our strong financial position, dedicated management team and adaptive and agile organizational culture will strengthen our leadership position as a supplier of choice, and will enable us to grow our market share.

I will now pass it to Neal for a detailed discussion of our second quarter results.

Neal S. Nackman

Chief Financial Officer & Treasurer, G-III Apparel Group Ltd.

Thank you, Morris. The results for our second quarter ended July 31, 2020 were significantly impacted by the ongoing effects of the pandemic. We began the quarter with many of our partners and our own retail stores closed. Stores began to open midway through the quarter and the majority of the stores are now reopened.

As we announced in June, we're restructuring our retail operations. We will be closing all of the 110 Wilsons Leather, and 89 G.H. Bass locations, and have reached early lease termination agreements with our landlords. In connection with this restructuring, we expect to incur an aggregate charge of approximately $100 million. Of which, cash charges will approximate $65 million.

Accordingly in the quarter, we recorded significant charges for our retail operations, the landlord termination fees, severance costs, store liquidation and closing costs, write offs related to right of use assets, and legal and professional fees. On a year-to-date basis, we have incurred approximately $56 million in charges. We have included some relevant break-out data for the four wall retail operations of Wilsons Leather and G.H. Bass in our earnings release issued this morning.

For our second quarter results, net sales for the second quarter ended July 31, 2020 decreased approximately 54% to $297 million from $644 million in the same period last year. Net sales of our wholesale operations segment decreased approximately 55% to $267 million from $589 million. Net sales of our retail operations segment for the quarter were $35 million approximately 59% lower compared to last year's sales of $84 million. Retail sales included $20 million and $54 million of sales for the Wilsons Leather and G. H. Bass stores in the quarter ended July 31, 2020 and 2019 respectively.

Our gross margin percentage was 45.3% in the second quarter of fiscal 2021 as compared to 36% in the prior-year's period. The increase in gross margin was primarily driven by the gross margin percentage in our wholesale operations segment, which was 46.3% compared to 32.8% in last year's quarter. Wholesale gross margins were positively impacted by the reversal of previously anticipated markdown approvals that are no longer necessary due to the reduced wholesale shipping.

Also impacting the positive gross margin improvement was a reversal of a portion of the higher royalties accrued in last quarter as a result of favorable negotiations with our licensors, which yielded reductions in our royalty commitments. The gross margin percentage in our retail operations segment was 32.5% compared to 46.5% in the prior year's quarter, and was primarily impacted by store liquidations for Wilsons Leather and G.H. Bass stores.

We maintained our vigilance over cost controls. SG&A expenses were down 40% to $118 million in this quarter compared to $196 million in the same period last year. We have brought back a portion of our furloughed staff as needed in conjunction with the retail store reopenings. We made the difficult decision to permanently reduce our global wholesale head count, resulting in approximately $22 million of annualized savings. We still have portion of our wholesale employees on furlough. We continue with significant salary reductions for management and other employees and have been tight with other discretionary spending items as well, like capital expenditures and marketing.

Net loss for the second quarter was $15 million or $0.31 per share compared to net income of $11 million or $0.23 per diluted share in last year's second quarter. Net loss per share in the current quarter included a four-wall loss of $0.53 for the Wilsons Leather and G.H. Bass stores. The comparable quarter in the previous year included a $0.13 loss for the Wilsons Leather and G.H. Bass stores operations.

Looking at our balance sheet, accounts receivable were $277 million as compared to $465 million at the end of the prior year's quarter. Inventory decreased approximately 32% to $575 million from $842 million, as we did a good job working with our vendors to cancel and re-work orders in anticipation of a challenged fall and holiday season. This reduction is despite approximately $50 million of spring and summer products that we are carrying over from this year into next year. This is the inventory that did not make it onto the selling floor, and we feel will flow naturally into next year's spring and summer season shipping.

Our net debt position at July 31 this year is $156 million as compared to $514 million in the prior year. We extended the term of our revolver, which now expires in December 2025, subject to certain availability requirements. In addition, in August, we issued $400 million of 7.875% senior secured notes, which we used to pay off the previously outstanding $300 million term loan and added approximately $90 million of cash to the balance sheet. We ended the second quarter with cash and availability in excess of $650 million. Our current strong liquidity and financial position will enable us to navigate through the current environment.

Now, to our guidance. We continue to expect the COVID-19 pandemic to negatively impact our results in the second half of the year. Accordingly, we anticipate a decline in net sales in the range of 28% to 33% in the second half of this fiscal year compared to the same period last year. The impact of the pandemic continues to be fluid, making it difficult for us to provide additional guidance at this time for fiscal 2021.

That concludes my comments. I will now turn the call back to Morris for closing remarks.

Morris Goldfarb

Chairman & Chief Executive Officer, G-III Apparel Group Ltd.

Thank you, Neal. Thank you, all, for joining us today. G-III has a long history of successfully managing through turbulent uncertain times. In prior economic cycles, our diversified portfolio with strong brand equity has proved to be resilient. Our highly skilled and experienced management team is essential to our future success. Our teams across the globe have performed with unwavering dedication and tremendous innovation to position G-III to successfully meet the challenges we are facing through this unprecedented time in our history.

On behalf of the entire G-III organization, I'd like to thank all of our shareholders and stakeholders for their continued support. Operator, we are now ready to take some questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And our first question comes from Edward Yruma with KeyBanc Capital Markets. You may proceed.

Edward Yruma
Analyst, KeyBanc Capital Markets, Inc.

Q

Hey. Good morning, guys. Couple of quick ones from me. I guess, Neal, first, just a quick housekeeping question, if you could maybe give a little bit more color on what the reversal markdown accruals entails, kind of quantify that maybe and just try to help us understand exactly where that came from.

And then, Morris, a bigger picture question, obviously, you've highlighted the success you've had in athleisure, in the casualization trend, I guess, as you look to kind of re-ramp the business, is that an area we should expect you to continue to invest in? And then conversely, are there other areas in the wholesale business that you think are maybe more structurally challenged over the medium term? Thank you.

Neal S. Nackman
Chief Financial Officer & Treasurer, G-III Apparel Group Ltd.

A

Yes, so just taking in order, Ed. The – look, on the gross margin percentage in our wholesale segment was unusually high, that was a function of the two things that I mentioned, the reversal of markdowns that were previously provided, and then in addition, we had increased the first quarter's royalty charge as a result of the reduced wholesale forecast for the entire year, and we subsequently negotiated some relief to that royalty. The main piece of the markdown reversal is really a function of the fact that our wholesale business really did not operate in the normal course of events during this pandemic. And so, therefore, we were able to take back a significant amount of dollars that were previously accrued for.

Without specifically quantifying those amounts, what I would tell you is that if you think about our wholesale business, we see nothing that will prevent us from continuing to perform really in the low 30% gross margin percentage going forward, once we get past what I would characterize as some very unusual times at the moment.

Morris Goldfarb
Chairman & Chief Executive Officer, G-III Apparel Group Ltd.

A

So, Ed, thank you for your question. The athleisure area clearly has become a way of life. It's a way of dressing today. People are – I don't know the last time I really saw a tie, but nobody's wearing ties, nobody's wearing nested suits to work or to go out for dinner, or to sit around the house and do what they do, do their business or work out. So, there's a new – I am not sure it's new, but it's certainly much more powerful than it's ever been. So, the athleisure size of our business is growing very rapidly, and fortunately for us, we have three of the world's best brands that are represented in athleisure in department stores, digital sites that we serve, and it's grown amazingly well.

We were prepared for growth, but not at this level, and not with an interruption of production that we had when this pandemic started. So, it was a stop and then a major restart. And as you know, you don't switch an off button and an on button and you're back to normal. So it's taken a little while to service the demand that's out there.

Alongside of that, we newly licensed CK Jeans from PVH on the women's side. And it has done incredibly well. Our formula for success is a multiple of tops compared to bottoms, so there are cut and sew tops, there are knit tops, there's a ton of amazing T-shirts that coordinate with pretty much everything a woman wears. That's worked very, very well in CK. And again, we simultaneously launched DKNY and Tommy Hilfiger also in the denim side of the business. Although small, they've got a lot of power in them and we believe there's great future growth. There's great demand. We are going to service this demand. We'll be creative on our designs and it's a way of life. It's a long distance away from where we started, which was the bomber jacket, but it's a testament to who we are, we'll address whatever the consumer is asking for and we'll do it best in class.

You asked about challenged areas. There are; certainly, there are challenged areas during this pandemic side. We have a challenging nested suit business, although the tops in the suit area are doing well. The nested suits, the more career suits and go-to-church suits are not selling nearly as well as they had historically. And social dresses, in as much as we're not going to very many parties, weddings, there's no demand for bridesmaid dresses. So, that side of our business is challenged.

We responded immediately. We knew we were going to be faced with a slowdown in specifically those two areas and we addressed it. We had a little bit of inventory that we needed to deal with, and the bulk of what was in work we were able to negotiate out of our vendors [ph] that – (00:26:38) either not produced it or found other solutions in other parts of the world for it.

So, we're fine. We're a malleable company that can do virtually anything. And if it's not a high heeled stiletto, it can be a canvas sneaker. If it's not an evening bag that you wear to a wedding, it's a canvas bag that you put your workout clothing in. So, we pretty much covered it all, and we allocate our resources to whatever the consumers are asking for.

Edward Yruma
Analyst, KeyBanc Capital Markets, Inc.

Q

Great. Thanks so much, guys.

Morris Goldfarb
Chairman & Chief Executive Officer, G-III Apparel Group Ltd.

A

Little wordy, but hopefully that helps you.

Edward Yruma
Analyst, KeyBanc Capital Markets, Inc.

Q

Yeah, absolutely. Thanks, guys.

Morris Goldfarb
Chairman & Chief Executive Officer, G-III Apparel Group Ltd.

A

Thank you.

Operator: And our next question comes from Erinn Murphy with Piper Sandler. You may proceed.

Erinn E. Murphy
Analyst, Piper Sandler Companies

Q

Good morning. Couple of questions from me as well. I'd say, first, Neal, I was hoping you could speak a bit more about the retail losses. It sounds like, in the prepared remarks, you're planning to eliminate all of the losses. And I believe previously I thought there was like $15 million to $20 million of maybe stranded costs in the business. So, just curious of what changed and do you see kind of on a go-forward basis, DKNY and Karl Lagerfeld retail businesses actually making money on a standalone basis? Thank you.

Neal S. Nackman
Chief Financial Officer & Treasurer, G-III Apparel Group Ltd.

A

Yes, Erinn, the losses are from the Wilsons and Bass we approximated $50 million. If you looked at the end of last year, the DKNY and Karl business lost about $50 million. So we will continue to have some [ph] trapped (00:28:17) overhead that we will have to deal with, and those businesses that we will continue with are obviously going to have to have improvement from where they were at the end of last year, the calendar 2019. And we expect that that will happen, but we will have to continue to deal with some [ph] trapped (00:28:36) overhead in the business. The disclosures that we got in the earnings release are actually before any of the shared overhead expenses, so we've identified only the four-wall losses in our disclosures in the earnings release.

Erinn E. Murphy
Analyst, Piper Sandler Companies

Q

Okay, that's helpful. And I guess my second question, Morris, is for you, just on the kind of broader expectations of holiday 2020. I mean some retailers are talking about setting holiday early. I know Amazon Prime Day has shifted into October, so just curious how you see the holiday season unfolding. Anything that you're changing strategically as you think about product flows this fall?

Morris Goldfarb
Chairman & Chief Executive Officer, G-III Apparel Group Ltd.

A

Yeah, we're little bit at the mercy of our sourcing structure on product flow. As we stopped production for a period of time and restarted, as I explained to Ed, that doesn't give us free mobility as to how we flow product. And there are some issues on container space as well, coming out of several countries, so we're eager to get our products in. We believe that holiday will come early and we will have the opportunity to ship earlier than ever for the holiday product. I believe there is a shortage of inventory in our industry. Contrary to what most people believe the adjustments that were made early are impacting the availability of inventory. And as you shop stores, you can clearly see that. So, the early demand should help us somewhat as we can service it if we can get our product here earlier. I believe we will be able to ship it earlier.

And as we've stated, our inventory levels are down about 32% comp to last year. Our residual dated inventory has been dealt with, so there is not a lot of inventory that is from past seasons. So all that said, we don't have the luxury of being perfect on what the retailer is going to demand, but we're going to service it to the best of our ability. And we're looking forward to having an acceptable year. It's not going to be a banner year, but I believe it'll be an acceptable year. Many factors fall into place beyond just the pandemic, it's sourcing, it's the global initiatives of bringing product in through container space that's somewhat limited at this point, which we believe will lighten up, but there is a whole world of issues that have affected us. And when I look at what we're likely look like at the end of the year I think this company has done an amazing job and I'm grateful for everybody's participation and maybe the patience of our investors as well. This is a great company. We're unchallenged in many of the categories that we represent, and will come out a stronger company at the end of this year.

Erinn E. Murphy
Analyst, Piper Sandler Companies

Q

Great. Thank you. All the best.

Morris Goldfarb
Chairman & Chief Executive Officer, G-III Apparel Group Ltd.

A

Thank you. Thanks for your question, Erinn.

Operator: And our next question comes from Rick Patel with Needham & Company. You may proceed.

Rick B. Patel
Analyst, Needham & Co. LLC

Q

Thank you. Good morning. I hope everyone is well. Nice progress on the growth through digital. Can you talk about the outlook here and to what extent do you believe this strength is sustainable? And just given the investments you're making, does this change your thinking about what the right channel mix for the business could be as you think beyond the pandemic?

Morris Goldfarb
Chairman & Chief Executive Officer, G-III Apparel Group Ltd.

A

So, the channel mix for us is a little bit unique. We do not own all the brands that we produce. We license, quite honestly, the majority of our volume and, therefore, we can't build sites for Calvin Klein or Tommy Hilfiger or Guess? or Cole Haan. We sell the product we produce to the licensor who then puts it on their site, or we can sell through pure play digital businesses. We sell directly to Amazon to Zalando, all the sites that are accepted by our licensors.

The pieces that we can build and we're working at aggressively are DKNY, Karl Lagerfeld. We're keeping the Bass site alive. It's a very good site. The product mix will change. Retail price points will change. The marketing will change. And we're spending a good deal of – we've accelerated our budget on digital marketing, which certainly will enhance our business there.

The other piece that's becoming important, as I stated in a statement earlier, was that we are now distributing in Europe. And alongside of that comes the ability of distributing on pure play and digital businesses as well as our own site, and that's coming along nicely. Same goes for China. So, over time, it won't be an overpowering percentage of our overall sales, but hopefully, we can get to as much as 20% digital over time.

Rick B. Patel
Analyst, Needham & Co. LLC

Q

And a question on the guidance for the back half to be down 28% to 33%, can you help us understand how much of that plan represents what you would consider demand from department stores versus how much G-III maybe intentionally pulling back in order to avoid future mark down pressure? I was just curious how much of that pullback is by design.

Morris Goldfarb
Chairman & Chief Executive Officer, G-III Apparel Group Ltd.

A

Good deal of it is pullback by design. The uncertainty of where we might end up forced us to tamper the level of inventory we were willing to risk. Our department stores are not operating at their optimum. So, we were conservative. We were still concerned about additional periods of time where the stores might be closed. So, rather than bet the entire ranch, we took it conservatively. As I said, we're likely to come out with a reasonable year. This will not be a stellar year.

It would've been a major risk to shoot for a great year this year. And that's not the profile of this company. We're fairly conservative in our approach. We've got sufficient inventory to service the needs of our – some of the needs of our retailers. And as we all know, if you try to fill every order, you are likely to be left with far more inventory than you'd like without an outlet for it or an outlet that would be very costly to market choice. So, we are quite happy with what the visibility of the next two quarters look like for us. And it's not all about top line. We're looking at a period of time where improving on our margins. We're likely to have better earnings than one might expect with lower top line.

Rick B. Patel
Analyst, Needham & Co. LLC

Q

Thank you. All the best this fall.

Morris Goldfarb
Chairman & Chief Executive Officer, G-III Apparel Group Ltd.

A

Thank you. Thanks, Rick.

Operator: And our next question comes from Jim Duffy with Stifel. You may proceed.

Jim Duffy
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Neal or Morris, can you explain the favorable changes to license terms with partners? Was that temporary forgiveness on guaranteed minimums or something more permanent?

Morris Goldfarb
Chairman & Chief Executive Officer, G-III Apparel Group Ltd.

A

Jim, thank you, thanks for the question. The solutions that we've gotten from our licensors are all pretty much temporary. These are forgiveness for the time period that we've both struggled toward. It was a fair solution. And the future is pretty much contractual subject to renegotiations, if possible. But the solutions that you are seeing, the royalty reductions are temporary.

Jim Duffy
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. And then, Morris, the two key organizations again and again has demonstrated how to be nimble with the pivot to athleisure. Can you speak about how you have managed through supply chain challenges and some of the challenges that you're facing? Do you have vendors with expertise in these areas that have sufficient capacity available to meet demand and have there been any challenges with the availability of raw materials?

Morris Goldfarb
Chairman & Chief Executive Officer, G-III Apparel Group Ltd.

A

Let me hit the last one first. The raw materials are not a problem at all. The vendors – we've done a great job of moving a good deal of our production from China to other countries. Vietnam has become incredibly important, Indonesia is important. Jordan is very important for our athleisure and our denim areas of business. So, we've done a masterful job of finding sources through either experienced talent that we hired who had experience in factories or just our network of vendors who manufacture in many different countries, and our focus became the countries that were most competitive and most appropriate for producing these products.

Jordan is duty-free. That helped us a good deal. We became a dominant player in Jordan literally overnight. We deployed about 10 managers from our Chinese office to live and oversee our production in Jordan. And it's worked out quite seamlessly. And that's a primary source for, as I said, athleisure and our denim areas.

The business that we've developed overseas in Vietnam is incredibly important to us. Again, we're one of the larger importers from Vietnam. We moved our handbag production from China to Vietnam. We produced an incredible amount of coats in Vietnam. And that was a key solution for Chinese production. We were – as you know, Jim, we were, one time, predominantly, a coat company. And the best place in the world to produce coats became China. Over time, either some of the Chinese vendors, Korean vendors or the local Vietnamese picked up a proficiency that enables us to produce our coats there.

So, we've got different countries for different areas of business and no concern for, really, a crisis on quality. And the – as I explained to Erinn, the lack of immediate inventory is really a product of how we responded to the pandemic and how the retailers responded to the pandemic. Pretty much all the lights were shut for a little while and it hurt a lot of the vendors. And now they're pretty much back, but it takes a little while.

Jim Duffy
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Thank you for that.

Morris Goldfarb
Chairman & Chief Executive Officer, G-III Apparel Group Ltd.

A

Thanks, Jim. Thank you for your question.

Operator: And our next question comes from Susan Anderson with B. Riley. You may proceed.

Susan Anderson
Analyst, B. Riley FBR, Inc.

Q

Good morning. Thanks for taking my question. I was wondering, Neal, if maybe you could talk about just your expectation for SG&A for the third and fourth quarter versus second quarter, I guess, how much of the cost cuts will continue into the back half. And then, I was curious just – are there any significant differences in gross margin in the denim and athleisure segments versus the more fashion products. Thanks.

Neal S. Nackman
Chief Financial Officer & Treasurer, G-III Apparel Group Ltd.

A

Yes, so, Susan, as far as gross margins, we don't anticipate anything significant in terms of a difference between those categories. With respect to the SG&A for the back half of the year, we'll continue to keep a very watchful eye on it. We'll certainly be down compared to the prior year. That's a function of both what you might call fixed cost reductions as well as certainly variable reductions related to shipping. So, we do continue to see a tight trend on SG&A the balance of the year.

Susan Anderson
Analyst, B. Riley FBR, Inc.

Q

Great. And then, just on the outerwear category, looking into the fall, I think you had mentioned that it was one of the categories that actually did relatively well maybe as people are dining outdoors more. I guess how are retailers thinking about the orders there? I think we are supposed to have a warmer start to this fall/winter. I mean is that impacting their decision at all or, because the category is in greater demand, are you are seeing some greater demand from the retailers there? Thanks.

Morris Goldfarb
Chairman & Chief Executive Officer, G-III Apparel Group Ltd.

A

We're seeing greater demand from retailers. There was some serious demand that we still had an opportunity of servicing. It came through in mid-August. The anticipation of the world living a little bit more outdoors and either exercising or dining, brought a new reality to our retailers. And we had an opportunity to produce more product which we're in the process of doing. And again, we believe we'll be short of supply for the coat side of our business. Our inventories have never been leaner, so to depend on residual inventory to service reorders is going to be a problem as well.

Susan Anderson
Analyst, B. Riley FBR, Inc.

Q

Great. That's very helpful. Thanks so much. Good luck in the back half.

Morris Goldfarb
Chairman & Chief Executive Officer, G-III Apparel Group Ltd.

A

Thank you, Susan.

Operator: And our next question comes from John Kernan with Cowen and Company you may proceed.

John Kernan
Analyst, Cowen & Co. LLC

Q

Hi. Good morning, Neal and Morris. Thanks for taking my question. Morris, how should we think about – not being able to issue specific guidance for fiscal 2022 yet, but how do we think about how your wholesale partners are going to think about their businesses then versus fiscal 2020? I mean you finished fiscal 2020 really with your most robust wholesale performance ever as a company from a sales and margin perspective. Just wondering how we think about the wholesale partners and how they think about their – might think about their business in fiscal 2022 and how your vision for that business is going to unfold?

Morris Goldfarb
Chairman & Chief Executive Officer, G-III Apparel Group Ltd.

A

So, our vision, talk about like-for-like accounts, we are working hard at layering on other distribution channel, which will alter our plans, if that comes into place. But if we're talking like-for-like accounts, I would tell you that we would plan our business not to fully recover, but possibly be down 10% for fiscal 2022 with the ability of chasing. I think it will be easier period of time to chase. Our sourcing would be much better and in much better place. The confidence level of our business partners overseas that produce for us would be in better check. And there is greater opportunity when everybody is moving at a logical convinced state of mind. This is not a year where anything was logical. So, to recover fully would be a big bet, so we would plan our business down mildly in 2022.

Added to that, there is a fair amount of bankruptcies that we have been part of. The Lord & Taylor bankruptcy certainly didn't help us. Some of the store closures may not help top line. They may help bottom line. And the store closures might be of Macy's and Neiman Marcus, the stores that we do service, if they are not there, we're going to give up some of the top line for it. But as I said, we're known to be, in a sense, minors for new business and we do that well, whether it's private label, whether it's going after the mass channel that we're not well populated in or the international side of our business. So, it's all opportunity, and yet to be scoped out.

John Kernan
Analyst, Cowen & Co. LLC

Q

Got it. Thank you.

Morris Goldfarb
Chairman & Chief Executive Officer, G-III Apparel Group Ltd.

A

Short answer, 2022 is probably about 10% down.

John Kernan
Analyst, Cowen & Co. LLC

Q

That's helpful. Thank you.

Morris Goldfarb
Chairman & Chief Executive Officer, G-III Apparel Group Ltd.

A

I'm not sure Neal – and Neal is not kicking me yet, but I think we're aligned in our thinking. We delayed putting a firm plan down, as you would understand. We're working on that now. Greater visibility gives us a better plan.

John Kernan
Analyst, Cowen & Co. LLC

Q

Neal, may be just one follow-up, just how do you feel about markdown reserves as you go into the back half of the year? Obviously, some accruals moved gross margin around in the first and second quarter. How do you feel from where you are from reserve standpoint right now?

Neal S. Nackman
Chief Financial Officer & Treasurer, G-III Apparel Group Ltd.

A

Yeah, look, we certainly feel that our reserves are adequate. Probably, we'll have a little more of a positive impact in the second half. I don't think there'll be anything of the magnitude that you saw in the second quarter. And like I said earlier, I think that ultimately the wholesale gross margins again land in those low-30s, in that 31% to 33% zone prospectively.

John Kernan
Analyst, Cowen & Co. LLC

Q

Excellent. Thanks.

Morris Goldfarb
Chairman & Chief Executive Officer, G-III Apparel Group Ltd.

A

Thank you.

Operator: And our last question comes from Dana Telsey with Telsey Advisory Group. You may proceed.

Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC

Q

Good morning, everyone. As you think about the denim category which is certainly a highlight, given in terms of new introductions, where do see that going as a percent of sales? How do you see that impact on the margins?

And then, just following up on outerwear, I believe the order book last time we spoke for coats was down around 30%. Any update to that? Thank you.

Neal S. Nackman
Chief Financial Officer & Treasurer, G-III Apparel Group Ltd.

A

Yeah, no real change on the order book, Dana.

Morris Goldfarb
Chairman & Chief Executive Officer, G-III Apparel Group Ltd.

A

So, the percentage of sales on the denim side of it is not huge. We are new entry, as I described. The growth percentage-wise is off the charts. As pure dollars, not going to have the impact that you would like to see or I would like to see. But over time, and time is – a year down the road, it's a different story. I would say we launched three denim lines simultaneously, and launching is learning. As you have your first season, you learn from your mistakes, and you prosper for the future on things that you done right.

So, we seem to be on prosper mode. It doesn't seem like we made very many mistakes. Our strategy of doing multiple tops to bottoms has worked very, very well for us. The problems that we had, we come out of the coat industry. And the average unit retail per unit is much higher on the coat side. The distribution costs per unit are much more as a percentage of cost for T-shirts than they are for coats. So we're adjusting our business accordingly. Our warehousing is changing. Our packaging is changing. And our ability to distribute direct-to-consumer on some of the low cost items is also changing and becoming much more efficient.

So, at the end of the day, we believe that there will be better margin that's garnered out of the denim side of the business than the coat side of the business. We will have greater gross margin dollars on a coat, but pure margin gross margin will be better on the denim side.

Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC

Q

Great. And then any update on DKNY and Donna Karan, what you're seeing there and how you're thinking about that for the upcoming year?

Morris Goldfarb
Chairman & Chief Executive Officer, G-III Apparel Group Ltd.

A

Yeah, we're quite aggressive on it. And the digital business has grown quite strong, somewhere around 50% over last year. The retail business is much better. We like our inventories. The consumers are liking our inventory. We have better – different management teams that is operating more efficiently. We are liking the business a lot. We have a global initiative, working very, very well in Europe. And as I said, the Chinese part of our business, we own 49% of the joint venture. We brought a partner in that was quite knowledgeable on the Chinese retail market. And we took back an interest or we bought back an interest, 25% interest, therefore we're left owning 75%, and our business in China is comping up for the last few months north of 20%. We're expanding door count. We're adding franchisees and that market should provide a great benefit for us. And Taobao as well is doing much better than they had historically.

So, DKNY turns out to be a great acquisition for us. It gives us flexibility. It's ours to do as we need. We don't have to follow the guidelines of a licensor, particularly in a pandemic area. The flexibility is ours to choose. And we've done a really good job of protecting the brand and prospering through its merits as well.

Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC Q

Thank you.

Morris Goldfarb
Chairman & Chief Executive Officer, G-III Apparel Group Ltd. A

Thank you, Dana.

Morris Goldfarb
Chairman & Chief Executive Officer, G-III Apparel Group Ltd.

And with that...

Operator: And this does conclude the...

Morris Goldfarb
Chairman & Chief Executive Officer, G-III Apparel Group Ltd.

I'm sorry. With that, we will end the call and thank you very much for being patient with us and being great stakeholders and shareholders. Thank you very much and stay safe.

Operator: Ladies and gentlemen, today's conference has now concluded. Thank you for participating, and you may now disconnect. Everyone have a wonderful day.