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EDITED TRANSCRIPT

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PRESENTATION

Warren Cheng - *Evercore ISI - Analyst*

Hi, good morning everyone, and thanks for joining us. We're very pleased To be joined this morning by Bath and Body Works, CFO, Eva Boratto, bath and Body works as a market leader in home fragrance, body care and stuff and sanitizers businesses. They're one of the only vertically integrated retailers we cover, which gives them some key advantages with speed and also cost control, which we'll dive into shortly.

Quick note, if anyone has any questions. You see, you should. See a chat box at the bottom of your screen. We'll get to some audience questions at the end of the session here.

QUESTIONS AND ANSWERS

Warren Cheng - *Evercore ISI - Analyst*

So Eva just wanted to first start with your top line outlook. You're expecting a return to sales growth in the second-half. Two of the big drivers there being a pretty big step up in marketing, which started in December as well as some major new product launches. Can you give us an update on the impact you're seeing from those thus far and how those initiatives and other drivers later on to that sales outlook as we get into the second-half?

Eva Boratto - *Bath & Body Works Inc - Chief Financial Officer*

Sure. Thanks, Warren. And before I jump in, hi, everyone out there in virtual land. And Warren, thanks for hosting us today. So, I'm excited to talk about our top line, right? As we came out of earnings, we're pleased that we were able to narrow the range of our sales by increasing the midpoint and maintaining the high end of our guidance range. And the four key elements of our return to growth strategy remain intact.

So, just to get into those and our return to growth strategy, first, I'll speak to candles and sanitizers. We expect those to continue to normalize, but at a moderating rate. Second, growth from our core categories, supported by newness and seasonal storytelling. If you think about it, our outperformance in the first quarter was driven by that newness. So, our new product strategies have proven successful.

I'll start with everyday luxuries. It was a limited launch in about a third of our stores. Our fine fragrance Mist category outperformed the shop during that period. And we gained a new customer, a slightly younger and more diverse customer. Bridgerton, our first collab in a long time in recent history.

Over the launch period, that represent 4% of the shop. It exceeded our expectations and really resonated with our core customer. And Warren, in your intro remarks, you spoke to our integrated model. Bridgerton's a great example of that, as well as everyday luxuries. Given the performance, we have the ability to chase and drive further sales as we look throughout the year.

Now, let's go to our adjacencies, our third core element. We continue to roll out our adjacencies. And they're all in different stages of the rollout, our men's hair, lip, laundry. So, I'll start with laundry. At the end of the quarter, we were in about 300 stores. We've been testing different assortments, how to display in the store, what's the right size of the assortment in the store. And we're pleased that we will roll laundry out to the full fleet in the fall.

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Lip, we've had great success with lip. Our new lip fixture, it was in about 1,000 stores at the end of first quarter. And we've seen consistent performance that we're able to double our lip sales with that fixture. And we expect, again, the rollout to nearly all North American stores by July.

Men's continues to be one of our fastest-growing categories, benefiting from the new forms that we introduced last year, as well as newness into the core, i.e., fragrances and what have you. Continues to perform really well. And I would say awareness amongst men continues to be low, so an area we're going after with our marketing investment.

And finally, hair. We were in the full fleet early in the year. We put hair in our best-selling fragrances, and it resonates with our customer. We've brought -- of the hair customers, about 14% are new to brand. And we recently launched travel size that we think is a great way for new customers to try the product.

And finally, more loyal and engaged customers driven by our marketing, our full-funnel marketing investment, enhancing our loyalty capabilities and personalized digital experiences. So that's some of the things that we're working on, Warren, a lot going on, but we're super excited.

Thanks. That's really good color. I just wanted to double-click on one element there. So one of the things that struck me about your business recently is the newness. So everyone likes to talk about newness, but it really seems like you've achieved something here. It's really been an effective sales driver for you the last several quarters. Can you just talk about how the processes around newness have changed to enable this higher frequency you're seeing? And is there any way to contextualize how much more newness is in the assortment today?

Yeah. I'd say innovation has always been a core tenant of the company, and that has not changed. We have been increasing our innovation over the years, and I think it shows up in the adjacencies that I just spoke to, men's lip, laundry, hair care. And what's unique to us is our vertically integrated model with Beauty Park enables us to test and learn and expand our assortment quickly.

And I'll point back to everyday luxuries, right? A third of our store is able to roll it out to the full fleet based on the strong performance that we saw. So the team, we win with our newness. It was an outperformance for the quarter. So that innovation is core to what we do and focus on each and every day.

Warren Cheng - *Evercore ISI - Analyst*

Got it. And you just talked about how Beauty Park allows you to test and learn. I think one of the things that sets Bath & Body Works apart is it also allows you to read and react at a speed that other retailers can't. So how quickly can you react if something isn't working? And can you maybe just walk us through an example of a time recently that, if a product or collection wasn't working, how that read and react capability kicked in?

Eva Boratto - *Bath & Body Works Inc - Chief Financial Officer*

Yeah, sure, Warren. I'll focus on the positive areas first where we've been able to read and react and respond quickly. It's Bridgerton and everyday luxuries. So we were able to what I'll refer to as chase additional units given the customer response we were driving and seeing. At everyday luxuries, we did our limited launch and able to get ourselves by fall into a position that we can be confident in launching in the full fleet of stores.

And I will say an underpinning tenet of this company is not to disappoint customers, to making sure based on the demand that we have the confidence that we will be able to provide the product in a consistent manner for our customers.

On products where the take up isn't as quick, given our capability, we're able to, I'll say, not build toward our full sales expectation because we can chase and we can pivot and look at a low end of the range and a high end of the range. Thus, if you have something that doesn't perform as expected and every company has that, you don't have as much inventory there because of our ability to pivot.

Warren Cheng - *Evercore ISI - Analyst*

Thanks. That's a really useful color. And then if we just pivot to promotions and some of the new tools you've gained since you've launched your loyalty program, it's ramped up to 80% sales penetration in less than 2 years. Can you just talk about how that's changed your approach and capabilities with promotions? What's changed? What's still to come? And what are your expectations around promotional pressure for the year?

Eva Boratto - *Bath & Body Works Inc - Chief Financial Officer*

Yeah, I think -- so there's a few pieces to that question, right? I'd say personalization is a key element and part of our return to growth in the back half of the year. And we're on track with our personalized marketing, which enables us to capture data from the loyalty program.

I would say a couple of examples I would give is, one, we've used machine learning algorithms to predict when a one-tripper, one-trip customer is about to make their second purchase or about to drop off, and using this personalized data to engage them in a very targeted way to drive another trip.

I'd say we're in the early innings, but the results are promising. Another example is use of clickstream data, customer value filters. And, again, we were able to test these areas, learn as we go, and then scale with effective tactics.

In regards to promotional pressures this year, I'd say we expect promotion as we look forward in the year to be pretty comparable. We've spoken to AURs as flat in the Q2 with modest expansion for the year. And we'll use our promotional tools to drive traffic to engage the customer and drive ultimate performance.

Warren Cheng - *Evercore ISI - Analyst*

Great. And maybe if we switch to AUR for a second. In 1Q, it was just a touch lighter than you guided the quarter before. It was a couple points better. I know it's hard to be too precise here because there's just a lot of factors that feed into AUR. I think your latest thinking is for some improvement in the second half.

How should we think about the biggest headwinds and tailwinds to AUR as we think about the second half of the year playing out?

Eva Boratto - *Bath & Body Works Inc - Chief Financial Officer*

Yeah. Warren, I'm going to go back and speak to Q1 in the context to talk about our confidence in the back half of the year. As you look at Q1, I would break the quarter into 2 halves, right? As a reminder, we were pressured at the start of the quarter. We spoke to a floor set and our marketing didn't resonate, didn't drive the call to action as we expected. We pivoted quickly.

But we did continue to use our agile promotion model into the early part of March. As you think about how March progressed with our new floor set and the newness that came in, right, between that time and the end of the quarter, we were able to achieve flat AURs in the back half of the quarter. So that gives us confidence around our customer engagement when we bring the product, the newness that they're expecting.

I would also say we continue to see customers carefully manage their basket and that their spending, which pressures our basket, that's been no better, no worse, but that's what we're seeing. In the back half, we do expect modest increases. And I'd say it's a function of our good, better, best pricing strategy.

The new products, the newness that you heard Julie and Gina talk about on our earnings call enables us to take price. We continue to test for opportunities where we can do better. And I would just provide one other broader context data point. Relative to pre-pandemic levels, AURs remain elevated double digits.

Warren Cheng - *Evercore ISI - Analyst*

Got it. Okay, so AUR is going to be one component of the merge margin algorithm in the second half. So if I just zoom out, you're lapping some pretty tough merge margin compares starting in the third quarter.

Your guidance implies still some expansion in the second half, something along the lines of 30 basis points, 50 basis points. Can you just parse out for us, other than AURs, some of the other moving pieces that are driving that merge margin outlook as we get into the second half of the year?

Eva Boratto - *Bath & Body Works Inc - Chief Financial Officer*

Yeah, so overall as you look at margin, I'll level it up to gross margin. I know you specifically spoke to merge margin. We continue for the full year and Q2 to expect about 50 basis points of margin expansion. We in Q2, we start to wrap the improvements we drove last year.

And additionally, we expect international sales to improve throughout the back half of the year Q2 forward. So relative to Q1 expansion, that is an offset there. We're also lapping our reformulations we did last year in our body care and soaps and sanitizers products.

I would think about body care, we're annualizing in the back part of Q3, as well as soaps and sanitizers in Q4. So that investment we made, we have the impact this year. I'd say they're the key drivers. I'll wrap it up with B&O. We do expect B&O deleverage given our real estate investments.

Warren Cheng - *Evercore ISI - Analyst*

Got it. And your latest guidance, or I think the latest long-term guidance you've given implies there's still some margin opportunity relative to, I think the latest goal is 45% gross, 20% EBIT. Is that still your latest thinking in terms of the margin structure that the business can maintain here? And can you walk us through the multi-year path from here to there?

Eva Boratto - *Bath & Body Works Inc - Chief Financial Officer*

Yeah. Warren, it continues to be our north star. We think we're confident in our ability to achieve it over time, gross margins of 45%, SG&A rate of 25%. I'd say as you think about leveraging your costs to leverage B&O, you need 2% to 3% sales growth, SG&A 2.5% to 3.5%. So growing the top line is a critical component of those.

But we'll always look to drive efficiencies, cost improvements, as we've done over the long history of the company, but I'll speak to our $250 million program over the past two years, last year and this year, to drive savings to also enable us to deliver on those goals.

Warren Cheng - *Evercore ISI - Analyst*

Okay. So that was actually the next question I had was just on that cost savings plan. So it was originally $250 million last year. I think that came in a little bit faster than expected. You added on another $100 million. You're almost halfway through that in the first quarter. How should we think about cost efficiencies as a driver of margin going forward? Could this be a normalized component of the algorithm as we look ahead?

Eva Boratto - *Bath & Body Works Inc - Chief Financial Officer*

Yeah. I think, Warren, if we go all the way back to last year, the initial program targeted $200 million of cost improvements, expecting to deliver $100million last year and $100 million this year. We exceeded that goal, delivered $150 million last year, and increased the goal by $50 million to deliver an incremental $100 million this year.

That's 60/40 gross margin. It's things like value engineering, transportation costs, efficiencies in our fulfillment centers. We were able to exit a fulfillment center on the SG&A side, managing, better managing our store labor with traffic, optimizing that without sacrificing customer experience, improving our indirect procurement capabilities are a couple of the areas that I would highlight.

And I think as you think about cost, you can never say you're done. You have to think about it as ongoing opportunities to improve the overall underpinnings of the business. So I don't have more to announce here today, but we will always continue to look for opportunities and are focused on delivering on our commitments for this year.

Warren Cheng - *Evercore ISI - Analyst*

Got it. And maybe we could just shift to the store opportunity. One thing that stands out about your story, there's a very healthy new store component of the algorithm the last couple of years. Can you just give an update there? Where are you building these new stores that are still driving such solid returns? And how much runway do you see from here?

Eva Boratto - *Bath & Body Works Inc - Chief Financial Officer*

Yes. So overall, we're really pleased with the performance of our store fleet, right, with their profitability with their positive cash flow. And we do still see opportunity. We view the stores as a critical element of our omnichannel experience. Sitting here today our fleet is more skewed to off-mall than on-mall locations regarding -- if you think about our long term, we think the right algorithm is two thirds off-mall, one-third mall.

So we'll continue to migrate more of our stores to off-mall location. As I think about square footage growth this year, I would think about is pretty comparable to last year in that 4%-ish, 3.5% SIC code.

And in terms of locations -- follow the people, follow -- if you think about our customers. We want to target Hispanic customers. You think about certain geographies there where we're penetrated. Our real estate team just does a tremendous job evaluating and what are the right areas regions and locations to enter into.

Warren Cheng - *Evercore ISI - Analyst*

Got it. And then as you approach that two-thirds off-mall goal over time, can you talk about how much of that is going to be a shift from existing mall location? How much is going to be greenfields? I think today it's about half and half. So as I think about progression is there a big net opportunity? How much closure is closures are embedded in that algorithm?

Eva Boratto - *Bath & Body Works Inc - Chief Financial Officer*

Yes, I think more to come longer term. Certainly as we as we think about the closures, think about them as RDNS small locations and they're still there still are a number of those to close. I would think about it over the coming years. I'm focused around the square footage growth, but I think as you look here in the near term, that 3.5% to 4% is the right natural [tears].

Warren Cheng - *Evercore ISI - Analyst*

Got it. And then maybe we'll shift to higher level question what's your assessment of the overall health of your core consumer? And maybe you could just add a category lens to that, which categories do you think are most discretionary, which are more stable -- not value-seeking environment -- consumer environment here?

Eva Boratto - *Bath & Body Works Inc - Chief Financial Officer*

Yes, on the consumer, we've talked about for a number of quarters now around -- we see our consumer seeking value, right? I would say that hasn't changed materially to one end or another from a positive or a negative and that's what we expect is as you look at our outlook. In terms of our categories, I wouldn't say we're seeing discerning pressure in one category versus another based on consumer behaviors. Within our shop, we are seeing a trade down.

We've used this example a lot. We don't see a customer putting a three wick candle back to get a single wick candle. But we do see them managing their basket size. So putting a product back. Which is where we're focused on how do we drive more trips? How do we drive engagement through our loyalty program, right? We've 37 million active loyalty users and engaging them to bring them in for more tricks, redeem their rewards that they've earned are opportunities for us to continue to drive the customer.

Warren Cheng - *Evercore ISI - Analyst*

So maybe we can just double click on loyalty. And you say you're at 37 million new members. You've talked about before, 80% penetration, even though it's only launched less than two years ago. Can you talk about what's you're most excited about in terms of the loyalty program looking forward? I think you've kind of -- a really good job at, step one, increasing their penetration and usage of the loyalty program. But as you roll out the capabilities and look to drive engagement, change the processes, what are you most excited about?

Eva Boratto - *Bath & Body Works Inc - Chief Financial Officer*

Yes. So Warren, I would put it into two buckets of where we're focused and are super excited. As we grow our customer share, bring new customers to the brand, there's opportunities to convert those to loyalty members. I think this is evidenced by -- we cited a stat that 40% of our new loyalty members were new-to-brand in the first quarter.

So we have a proven track record, then you want to deepen your engagement, right, quantity and quality. So we [decile] out our active loyalty members. We know active members spend materially more in the shop then those fit -- are in your in your lower deciles. So we'll look for opportunities to keep moving our members up on that activation and engagement. And I think we'll do that you'll see more loyalty exclusive opportunities. Julie likes to say are -- they want to be in the know, they want to have early access. They get the right product, they get the candle that they wanted on Candle Day.

So more loyal, exclusive early access event along with point accelerators. It's a way to drive engagement, a way to bring them back to the store. We introduced that in Q4, and we think it's a critical aspect to engaging those customers.

Warren Cheng - *Evercore ISI - Analyst*

Thank you. And then we'll just shift to international. For the international consumer, how different is the brand positioning? And if we look at the last results, obviously the conflict in the Middle East had a huge impact. Is there a way to parse out the impact there? Is there a way to look at kind of what the ad retail sales trends look like, excluding the Middle East?

Eva Boratto - *Bath & Body Works Inc - Chief Financial Officer*

Sure. So a few pieces that -- I'm going to take your second set of questions first, and then we'll come back to the consumer, Warren. As you look at our international retail -- system-wide retail sales, i.e., end market sales, for the quarter, our total portfolio was flat in Q1. And that was a slight improvement from the decline that we experienced in Q4, when you piece parts the regions, those areas not affected by the war in the Middle East, they continue to grow a very healthy, mid teens in those regions.

So as we look at the health of our brands outside of the US, that's a key data point that says our brand resonates. People want our products and there's tremendous opportunity and we opened our first stand-alone store in London in the first quarter. In Q2, we opened our first store in South Korea in [Shenjigen] Mall and we're super excited to expand markets and continue to penetrate our markets. And we see ourselves opening at least 35 net new stores internationally this year.

And we're only in six of the top 10 markets today. So there's tremendous opportunity. Going back to the consumer, I'll speak -- I'd say customers are pressured. You see outside of the US inflationary pressures as well. So I wouldn't really call out any discernible differences of our international customers versus our US.

Warren Cheng - *Evercore ISI - Analyst*

Got it. That's very, very helpful. And can we just talk a little bit about the new categories? First, how did you kind of calibrate these were the correct categories or these were the right categories to pilot? And you've now a few months in stores for some new categories like laundry and hair. Can you talk a little bit about what you're learning about the purchase behavior there? How would you score customers extending the basket versus new customers?

Eva Boratto - *Bath & Body Works Inc - Chief Financial Officer*

Yes. How we how we determine these categories -- we have an unbelievable merchandising team that is out scanning what is going on in the marketplace worldwide, right? What are trends with consumers? What fits with our brand? What is a natural expansion to our brand? What are customers asking us for, right? They're all factors that play in.

And also as we bring categories, new categories and we test. Like you saw us do with laundry using that as an example. So just to highlight a few key areas that that as background, [men's] continues to be one of our fastest growing categories introduced. We expanded the portfolio last year with grooming and antiperspirant deodorant as well as expanding the fragrances in our core collection.

We're super excited about this category. Women continue to be the larger shoppers. Women shopping for men. So we see a real opportunity of gaining awareness amongst men, and that's where we're investing marketing dollars. You saw some of our influencers back during the NFL season during the NBA. But driving that awareness, we believe there's considerable opportunity remaining.

Hair. Hair, we rolled out to the fleet and in our best-selling core fragrances. This was an opportunity to enable our customers continue to use their favorite fragrance in just another part of their daily routine. Performance to date we brought in about 14% new customers. I think I said that earlier and now we have trial size. So it's going to enable new customers to -- it's a great way for new customers to enter the brand.

And finally, I'll say on laundry, we're pleased with all of the testing we've done with the optimization of the portfolio, what's right. Fragrances put into the stores. And our inventory position that gave us the confidence to accelerate our rollout to the full US fleet in late fall of this year. So there are some of the highlights, Warren, that I would bring.

Warren Cheng - *Evercore ISI - Analyst*

Great. And just as a reminder, if anyone has any questions, feel free to put them in the chat box. So we'll go to a couple of audience questions here. The first one, just to follow up on your earlier comments that the second half outlook embeds some normalization, candles and sanitizers. How much further normalization might we see from here? And can you talk about the plan for managing the floorspace as some of these new categories come online? So I guess the floor space for candles and sanitizers.

Eva Boratto - *Bath & Body Works Inc - Chief Financial Officer*

Yes, sure. So as we look at candles and sanitizers, as I said before, we don't expect it to return to growth. We do expect the declines to moderate. As you look at the last three quarters of performance, Q3 to Q4, we did see modernization -- moderation, excuse me. In Q1 was comparable with that we experienced in Q4.

As you look at the floor space, we highlighted on the earnings call that we did right size our single wick portfolio. We had two versions of our single wick. A more recently introduced tumbler as well as an older, I'll say, more dated mason jar.

What we did was we rightsize that, removing the mason jar from the portfolio, while still maintaining the all [factive] breadth that our customers expect from us. And what that really enables us to do is to free up that shelf space to higher more productive categories. Think about the new adjacencies that we're bringing in. So while it may cause a little more pressure in the near term, we believe it's the right decision for driving growth over the long term.

Warren Cheng - *Evercore ISI - Analyst*

Another question that came in is on a couple of components of the cost structure here, freight and labor. There were some big investments in labor early last year. What are you seeing in terms of wage pressures? What's embedded in the guidance? So the question there is on both freight and labor pressures in the second half.

Eva Boratto - *Bath & Body Works Inc - Chief Financial Officer*

Yes, I would say on both of those, I would consider this year, our expectations is -- it's a more normal year. From a wage rate pressure, think about it more in line with normal merit type of cycle. Certainly in different pockets through regulation, you could have some hourly rate pressures. We watch those where we manage this.

But overall, I would think about it as a more normal year for us. And then on transportation, again, you saw us outperform in terms of transportation costs throughout the back part of last year. We also over-delivered on our transportation benefits in the first quarter, and I'd say it's embedded in our run rate.

Warren Cheng - *Evercore ISI - Analyst*

Got it. And I think we just have time for one more question. This question is on the technology investments. So you made some heavy technology investments in the last year. What are the capabilities gained? How should we think about the technology investments this year versus last year? And how do you measure the returns on this investment?

Eva Boratto - *Bath & Body Works Inc - Chief Financial Officer*

Yes, thanks for that question. Overall, as you think about total technology investment, I would think about 2024 pretty comparable to the 2023 levels, which was a step up given we were investing in separation. We've now pivoted from investing in separation to investing in -- I'll bucket them into two key areas. Value creating capabilities to improve our omnichannel experience, whether that's data and analytics, whether that's personalization, whether that point of sale to create better integration of our data to service that customer in a meaningful omnichannel way, as well as foundational back-office systems that we need to invest in to modernize that technology.

So they're the two key areas. We always look to measure [returns]. Some of these are fundamental capabilities that you need in this decade and going forward. But where there is the opportunity to measure we are and we look to really prioritize to drive the highest returning items first to help us fund the journey, if you will.

Warren Cheng - *Evercore ISI - Analyst*

Perfect. That's all the time we have. This sounds like a perfect starting point. Thanks, Eva, for all the great insights. Have a nice day, everyone.

Eva Boratto - *Bath & Body Works Inc - Chief Financial Officer*

Thank you. Thanks, everyone. Have a great day.