Ralph Lauren Corporation (RL) CEO Patrice Louvet on Q2 2020 Results - Earnings Call Transcript

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FQ2: 11-07-19 Earnings Summary

Press Release

EPS of $2.55 beats by $0.16 | Revenue of $1.71B (0.90% Y/Y) beats by $14.49M

Earning Call Audio

Ralph Lauren Corporation (NYSE:RL) Q2 2020 Results Earnings Conference Call
November 7, 2019 9:00 AM ET

Company Participants

Corinna Van der Ghinst - Vice President of Investor Relations

Patrice Louvet - President, Chief Executive Officer

Jane Nielsen - Chief Operating Officer, Chief Financial Officer

Conference Call Participants

Paul Trussell - Deutsche Bank

Michael Binetti - Credit Suisse

Matthew Boss - JPMorgan

Ike Boruchow - Wells Fargo

Kate Fitzsimons - RBC Capital Markets

Dana Telsey - Telsey Advisory Group

Rick Patel - Needham & Co.

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Ralph Lauren second quarter fiscal 2020 earnings call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. Instructions on how to ask a question will be given at that time. [Operator Instructions]. As a reminder, this conference is being recorded.

I would now like to turn over the conference to our host, Ms. Corinna Van der Ghinst. Please go ahead.

Corinna Van der Ghinst

Good morning and thank you for joining Ralph Lauren's second quarter fiscal 2020 conference call. With me today are Patrice Louvet, the company's President and Chief Executive Officer and Jane Nielsen, Chief Operating Officer and Chief Financial Officer. After prepared remarks, we will open up the call for your questions, which we ask that you limit to one per caller.

During today's call, we will be making some forward-looking statements within the meaning of the federal securities laws, including our financial outlook. Forward-looking statements are not guarantees and our actual results may differ materially from those expressed or implied in the forward-looking statements. Our expectations contain many risks and uncertainties. Principal risks and uncertainties that could cause our results to differ materially from our current expectations are detailed in our SEC filings.

To find disclosures and reconciliations of non-GAAP measures that we use when discussing our financial results, you should refer to this morning's earnings release and to our SEC filings that can be found on our Investor Relations website.

And now, I will turn the call over to Patrice.

Patrice Louvet

Thank you Corey. Good morning everyone and thank you for joining today's call. We delivered second quarter results slightly ahead of our overall expectations including better than expected revenue, expanded operating margin and double-digit EPS growth. Our performance this quarter was driven by ongoing momentum in our international markets both Europe and Asia and balanced gross margin expansion and expense management. Meanwhile, we continue to invest in brand elevation and execute key initiatives to stabilize our North America business against a more volatile backdrop.

As we indicated at the start of this fiscal year, we are monitoring the global retail environment closely, particularly around trade and macro conditions. Our teams remain intensely focused on managing through volatile industry dynamics and executing on our strategic plan to deliver long term sustainable growth and value creation. As I have shared before, the three principles underlying this work include putting the consumer at the center of everything we do, elevating the brand and balancing growth and productivity.

During the second quarter, we continued to drive our performance across the five strategic priorities that we laid out as part of our five-year plan. These include first, win over new generation of consumers, second, energize core products and accelerate high potential underdeveloped categories, third, drive targeted expansion in our regions and channels, fourth, lead with digital across all activities and fifth, operate with discipline to fuel growth.

Starting with win over a new generation of consumers. We continue to invest in media channels that matter most to consumers today, namely digital and social and are on track toward our long term marketing investment target of 5% of sales. In the second quarter, marketing declined 10% to last year due to timing of investments as we anniversaried our landmark 50th anniversary celebrations last fall. Our key marketing initiatives this quarter centered around our September fashion show experience, Wimbledon and U.S. Open Tennis partnerships as well as the Ralph Lauren and Friends collaboration.

This September, we presented an exciting Fall 2019 collection through a one-of-a-kind immersive experience of fashion, hospitality and live entertainment we called Ralph's Club. Our jazz age inspired nightclub seamlessly integrated guests into the show itself as the multitalented Janelle Monae inspired us with a performance for the ages. Influencers and celebrities from around the world from Taylor Hill to Cate Blanchett, Mandy Moore to A$AP Ferg, Henry Golding, JJ Lin and Luodan Wang joined in the evening. It was our most viewed live stream to-date. As we continue to leverage our global digital reach, we have more than 10 billion total media impressions around the event. In Asia alone, we generated over 32 million live and video views of the show.

Moving on to our sports engagements. We closed out our summer sports program with our official sponsorship of the U.S. Open Tennis Championships here in New York. The U.S. Open, combined with our high visibility Wimbledon partnership earlier in the summer, drove over 17 billion media impressions globally. Building on the April release of our Earth Polo shirt made entirely from recycled plastic bottles, the official ballpeople were outfitted in uniforms using the same innovation. The tennis ball cans collected from the tournament this year will be used to produce mix-use uniforms. This is a great example of our Design the Change sustainability strategy coming to life across our products.

To further amplify our sponsorship, we partnered with TikTok, the social media platform beloved by GenZ becoming the first luxury brand to drive a digital commerce campaign on the platform. Our campaign leveraged influencers and custom content to drive more than 0.5 million views and significant click-through to ralphlauren.com.

And lastly, we finished up quarter with our Ralph Lauren and Friends 25th Anniversary capsule collection in September, a playful ode to lead character Jennifer Aniston's fictional work experience at Ralph Lauren. Featured exclusively at Bloomingdale's and on ralphlauren.com, the campaign generated over one billion media impressions alone.

Finally, as you may have seen, we recently celebrated the upcoming HBO release of Very Ralph directed by the award-winning Susan Lacy. The documentary follows Ralph's journey from his childhood in the Bronx to building an iconic lifestyle business and becoming an emblem of American style around the world. I hope you will all watch it live on HBO on November 12.

Moving on to our second key initiative, energize core products and accelerate high potential underdeveloped categories. In the second quarter, Ralph and our design team continued to drive excitement in core product categories while also leveraging the halo of limited edition releases and expanding into high potential underdeveloped categories. Top-selling categories for Fall 2019 to-date have included lightweight down jackets, windbreakers, fleece and casual woven shirts, including Oxford shirts.

We continue to work to consistently get the balance of core, seasonal core and fashion right across each brand and distinct channels. This quarter, we released a limited-edition draw, Indigo Stadium, in September inspired by our original 1992 Polo Stadium collection. Pieces included signature silhouettes such as our popover jacket, windbreaker, tearaway track pants and fleece updated with indigo dye treatments. The release was available exclusively on our Polo app, influential specialty accounts like Opening Ceremony, Fred Segal, HBX and Bodega as well as select Ralph Lauren stores and retailers internationally.

Other exciting projects this quarter included an exclusive youth oriented capsule collaboration with ASOS available globally online and the special collections celebrating our 35th Anniversary of Polo Ralph Lauren in Korea. We continued to make solid progress this quarter on our five underdeveloped categories as well. These include denim, outerwear, Wear To Work, footwear and accessories. Denim sell-out outperformed our total topline trends in the second quarter. And as we approach the upcoming winter season, outerwear sell-in are strongly outpacing our overall sales trends. Meanwhile, our Ralph Lauren and Friends collection leverage our expanding Wear To Work initiative with modern pieces for both men and women rooted in the Ralph Lauren aesthetic.

In fragrance, we launched the latest iterations of Romance for women and Polo Red for men. Focused on reaching a new generation of consumers, the campaign featured our Ralph Lauren ambassadors, Taylor Hill for Beyond Romance and Ansel Elgort, Polo Red Remix.

Moving on to our third key initiative, drive targeted expansion in our regions and channels. Our long term expansion strategy remains focused on building a cohesive brand elevating Ralph Lauren experience across our retail, wholesale and digital commerce presence in key cities around the world. During the second quarter, we opened 20 new stores and concessions globally and closed 21 locations. This included 15 openings in Asia. We also completed door refreshes in key markets around the world, including our Place de la Madeleine flagship store in Paris and factory door renovation in North America and China, where we continue to elevate our fleet across every touch point.

Our consumer centric ecosystem approach drove strong results in the quarter with China Mainland sales up more than 20% in constant currency, driven by comp growth and new stores. Total China sales were up modestly to last year in constant currency including Hong Kong headwinds, which Jane will discuss in her remarks. In Europe, we opened four owned and partnered full price stores. While we are making good progress, we still have significant expansion opportunities with only 40 full price stores across Europe with all of this complemented by our successful digital commerce expansion.

Which brings me to our fourth key initiative, lead with digital. Our global digital ecosystem, including our directly operated flagship sites, departmentstore.com, pure players and social commerce increased low teens in the second quarter in constant currency. The strong performance was driven by more than 30% growth in international. While this was tempered by more modest growth in North America, our North America digital sales were positive and ahead of expectations improving sequentially from first quarter trends.

Starting with Europe. Digital sales were up double digits in the quarter with strong performance across each channel. We added 17 new wholesale digital partners including La Redoute, one of the largest digital pure players in France. Our directly operated digital sites in Europe also saw continued momentum delivering 13% comp growth this quarter. Recent enhancements included optimizations to our mobile site and checkout process and a new digital commerce flagship for Ireland as we continue to drive our localization efforts by market. We also recently launched Instagram in Europe.

In Asia, digital ecosystem sales were also solid led by China. We added five exciting new digital partners in the second quarter, including Secoo, a luxury e-commerce platform in China, GS Shop, the number one multimedia retailer in Korea and Marui, a leading omnichannel retailer targeting younger consumers in Japan. We also continue to elevate our presence with key digital pure players like Tmall during the quarter.

Turning to North America. Second quarter comps on ralphlauren.com were up 2% and better-than-expected. Similar to the first quarter, we continued to experience declines from international consumers on our U.S. site due to FX headwinds and increased import regulations in key Asian markets. However, sales to domestic shoppers were up single digits and slightly better than first quarter trends as we started to improve our mobile user experience and drive more targeted email marketing.

Under our new global merchandising effort, we are also rebalancing our buys to emphasize stronger selling core and seasonal core products going forward. Our digital performance should start to reflect these initiatives, along with further improvements in mobile and personalization to drive conversion more in the back half of fiscal 2020.

Lastly, we continued to build partnerships with new digital platforms in North America, which are extending our reach to new and younger consumers. In the second quarter, we launched men's polo sportswear on revolve.com and its sister site, FWRD. We also launched Lauren ready-to-wear and dresses on Nuuly, the new subscription service from Urban Outfitters, targeting our next-generation consumer.

Touching on our fifth key initiative, operate with discipline to fuel growth. In the second quarter, we continued to challenge every cost and improve our efficiencies. Adjusted operating margin expansion of 100 basis points exceeded our expectations, driven by gross margin expansion, disciplined expense management and lower marketing spend in the quarter. This cost discipline enabled continued expansion of our global retail presence while increasing operating profit and operating margin.

Looking at our supply chain. Year to date, we have continued to increase its flexibility and efficiency. With the enactment of this List 4 tariffs from China in the quarter, we have continued our multipronged effort to mitigate the cost impact. This includes, first, working with our existing partners within China to drive increased productivity. Second, further diversifying our supply chain outside of China. Over the past two years, we have reduced our U.S. exposure to China from over 40% to about 22% by the end of this fiscal year and moving to approximately mid-teens for fiscal 2021. And third, while we are focused on driving the first two strategies to mitigate as much of the tariff headwind as possible and minimize the direct impact to the consumer, we are also planning targeted global price increases.

As previously discussed, the central part of our next great chapter strategy is raising AUR to elevate the brand globally and create value. We began phasing in strategic ticket price increases in our North American outlet channel in late September. Our North America full price wholesale and direct to consumer doors will reflect targeted price increases, starting with our Spring 2020 assortments. Leveraging the success we have had implementing this strategy in Asia and Europe, these ticket increases reflect our competitive benchmarking analysis and are focused on the value proposition for our consumers. Jane will provide further detail on AUR and the expected financial impact of tariffs in her prepared remarks.

In closing, in the context of a more volatile environment, we continue to deliver solid progress on our next great chapter plan. Ralph and I are proud of our teams' execution this quarter as they delivered across each of our strategic pillars with passion and excellence. Together, we remain focused on driving each of these areas to deliver long term sustainable growth and value creation for all of our stakeholders.

With that, I will turn it over to Jane and I will join her at the end to answer your questions.

Jane Nielsen

Thank you Patrice and good morning everyone. Our teams delivered solid top and bottomline results in the second quarter with expansion in both gross and operating margin driving operating profit growth and double digit EPS growth. Globally, we also continue to make progress against our key strategic initiatives in the quarter with encouraging early signs of progress in our direct to consumer business in North America, our largest market. These included positive brick-and-mortar and digital comps in North America as well as Europe and Asia, sequential AURs improvement on top of difficult compares and inventory more closely aligned to our topline growth.

Second quarter revenues increased 1% on a reported basis and 2% in constant currency. Our international business, which represents about 45% of our sales, delivered 7% topline growth in constant currency while North America was down 1%. Total company retail comps grew 2% in the quarter. Adjusted gross margin was up 60 basis points in the second quarter on a reported basis and up 80 basis points in constant currency. Gross margins benefited from AUR growth of 2% with favorable channel and geographic mix, coupled with pricing, promotion management and product assortment. All three regions delivered positive AUR growth.

Looking ahead, we expect second half AUR to be incrementally stronger than the first half of the year, driving our full year expectation of low single digit AUR growth for fiscal 2020. This will be driven by, one, targeted price increases in select channels and categories based on competitive benchmarking and where we have a proven opportunity to play, two, accelerated product mix shifts such as an increased penetration of fleece and outerwear for fall holiday which are already resonating well with consumers and three, our ongoing strategy of pulling back promotions to improve quality of sales and elevate the brand globally across each of our distribution channels. While we are closely watching the broader competitive environment and in-season trends, we are pleased with our inventory position and remain focused on managing our inventory with discipline in order to mitigate promotional risk.

Adjusted operating margin in the second quarter was 14.9%, up 100 basis points on a reported basis and up 130 basis points in constant currency. Adjusted operating profit dollars grew 8% to last year. SG&A expense declined to 46.6% of sales, down 30 basis points to last year, driven by cost reduction initiatives and lower marketing expense. Marketing decreased 10% in the quarter as we anniversaried last year's higher investments around our 50th Anniversary show and related events. However, we continue to expect marketing spend to grow ahead of our sales for full year fiscal 2020.

Our teams remain focused on generating operating efficiencies across our business. Some key highlights from our second quarter include, first, we realized continued efficiencies across our supply chain including incremental productivity with our existing strategic sourcing partners, reduced freight cost contracts and lower air freight cost, all contributing to mitigating the cost of List 4 tariffs.

On the product side, we reduced product cost in outerwear while also improving our on-time delivery rate by over 30% in order to drive sales and margin in this high potential underpenetrated category. At the same time, we also improved our overall value proposition by significantly increasing the use of sustainable materials in our outerwear production. Our continued work on corporate expenses delivered a 10% reduction in corporate overhead. This includes our ongoing vendor renegotiations process where we are addressing over 100 global indirect spend contracts this year, driving savings of about 15% from our previous contracts and we continue to digitize the way we work to drive both productivity and a better consumer experience.

We recently completed the successful transition of our order management system for ralphlauren.com in North America, which will enable the implementation of new omnichannel functionality and improved mobile experience, personalization and more, all at a significant saving to our previous provider.

Moving on to our segment performance, starting with North America. Revenue decreased 1% in the second quarter, as growth in our retail business was more than offset by our wholesale revenue declines. Adjusted operating margin was 22.7%, a 100 basis point decrease to last year with operating margin expansion in our retail businesses more than offset by gross margin contraction and SG&A deleverage in our wholesale business on lower sales. In the retail channel in North America, comps were up 2% as both brick-and-mortar comps and sales on our own digital commerce site, each grew 2%. Brick-and-mortar comps were driven by a 2% increase in AUR.

In the second quarter, we tested targeted email offers, improved outlet window signage and leveraged page search optimization to mitigate traffic challenges. At factory, AUR and comp conversion both improved in the quarter and we continue to focus on driving better traffic trends through increased marketing, refreshed store experiences and product improvement, including expansion in underdeveloped categories like outerwear. Comps in our North America directly operated digital commerce business were up 2% above our expectations.

Positive growth from domestic consumers was partially offset by lower sales to international shoppers on our U.S. site, as Patrice discussed. We expect to reduce sales to international shoppers to continue to pressure our North America digital comps through the rest of fiscal 2020. Through the second half, digital sales to our domestic online shoppers are expected to improve. Our teams are focused on driving higher conversion among domestic consumers through, one, favorable product mix towards categories like outerwear or fleece and two, investing in improved mobile functionality, site architecture and personalization to drive more relevant content.

Moving on to North America wholesale. Second quarter revenue declined 6%. Excluding off-price, our underlying North America wholesale business was down high single digits in the second quarter, as expected. While our market share increased slightly in our men's polo business, we continue to see modest share declines in women's as Lauren underperformed the market. We continue to work on improving our product mix while also driving a return to core categories in Lauren's women's.

Additionally, we continue to improve the consumer experience in the wholesale channel through in-store refreshes, expansion into underpenetrated categories and increased marketing. With North America now mobilized under new leadership at both wholesale and regional level, it will take some time for our wholesale business to start reflecting these improvements.

Moving on to Europe. Second quarter revenue was up 3% on a reported basis and 8% in constant currency. Adjusted operating margins expanded 170 basis points on a reported basis and 220 basis points in constant currency. Operating margin expansion was driven by strong gross margins and SG&A leverage. In the retail channel in Europe, comps were up 3%, driven by a 13% increase in our own digital commerce sites and a 2% increase in our brick-and-mortar stores.

The increase in our directly operated European digital commerce business was above our expectation, driven by solid merchandising execution and traffic increases. Our sites continue to benefit from platform enhancements, more targeted performance marketing and further localization of regional sites. Across our Europe direct to consumer channels, our ongoing effort to elevate the brand and improve product mix continued in the second quarter, with AUR up 6% on top of a strong 8% increase last year.

Wholesale revenue in Europe was up 7% in constant currency in the second quarter and also ahead of our expectations. The strong performance reflected solid sell-out trends driving stronger reorders particularly with our digital pure play partners, modest distribution growth with both digital and wholesale partners similar to the last few quarters and a shift in timing of shipments to a key digital pure play account from the back half of fiscal 2020 into Q2.

Turning to Asia. Revenue was up 4% on a reported basis and 5% in constant currency in the second quarter. We saw solid performance across nearly every market in Asia including China Mainland sales growth of over 20% in constant currency. Our product and marketing initiatives are resonating well in this region and we continue to increase our digital efforts, expand and elevate our store fleet and engage with local influencers and celebrities.

Comps in Asia increased 1% with positive AUR growth and a strong contribution from our newer doors. In Hong Kong, where we have several important retail doors, heavy protest disruption drove the equivalent of 48 full days of store closures during the quarter. These closures, along with significantly lower tourism, drove declines in our Hong Kong business and negatively impacted our total Asia comp by about three points. While we expect Hong Kong to remain a near term headwind, we are encouraged by continued momentum in the rest of Asia and we still expect positive fiscal 2020 comp growth for this segment as we invest in our distribution network and drive marketing to amplify and elevate the brand. Adjusted operating margin was up 140 basis points to last year driven by strong gross margin expansion.

Moving onto the balance sheet. Our balance sheet remains strong and we continue to return capital to shareholders. We ended the year with about $1.6 billion in cash and investments and $693 million in total debt which compares to $1.9 billion in cash and investments and $684 million in debt at the end of last year's second quarter. We accelerated our share repurchases to $250 million in shares in the second quarter. We will continue to opportunistically buy back stock and remain on track to complete our target of about $600 million in repurchases for fiscal 2020.

Moving on to inventory. At the end of the second quarter, inventory was up 2% to last year, improving significantly from up 11% at the end of the first quarter. Inventory growth was driven by Asia to support our strategic expansion of retail distribution in that market. North America inventory growth was moderately above sales trends, but improved sequentially. And Europe inventories were down significantly as we started to anniversary last year's investments in our factory stores. We continue to expect second half inventories to remain relatively aligned with our sales outlook.

Now I would like to turn to guidance for the full year and third quarter of fiscal 2020. As a reminder, this guidance excludes restructuring and related charges and reflects our best assessment of the global retail landscape in the context of increased volatility from macroeconomic and geopolitical events. For the full year fiscal 2020, we are maintaining guidance of 2% to 3% revenue growth in constant currency introduced at the beginning of this year, but now expect results closer to the low end of this range.

Foreign currency is now expected to have about 130 basis points of negative impact on revenue growth based on currency shifts. We are maintaining our operating margin guidance for fiscal 2020 of 40 to 60 basis points expansion in constant currency, driven primarily by gross margin expansion and slight SG&A leverage. Foreign currency is estimated to have about 20 basis points of negative impact on operating margin in fiscal 2020.

While these topline expectations are still within our original guidance, our outlook now incorporates intensifying headwinds and some continued temporary door closures in Hong Kong, pressuring both Asia comp and retail expense leverage. Nevertheless, we are maintaining our full year operating margin guidance despite the headwinds from Hong Kong along with increased tariff related startup costs as we buildout new regional sourcing operations and our initiatives to prepare for a potential Brexit.

Based on the tariffs enacted to date, our guidance includes about $10 million in negative impact to our fiscal 2020 cost of goods. Meanwhile, we have maintained our commitment to accelerate marketing investments to position the company for sustainable long term growth. We now expect other income of approximately $10 million for the year, down to the prior year, as a result of lower interest rates and accelerated share repurchases, reducing our interest income.

For the third quarter of fiscal 2020, we expect revenues to be flat in constant currency. Foreign currency is expected to negatively impact revenue growth by 70 to 90 basis points in the quarter. We expect disruptions in Hong Kong to negatively impact revenue by about $10 million in the quarter. Operating margin for the third quarter is expected to be flat to down 20 basis points in constant currency. This is primarily due to the timing of SG&A investments with our highest dollar marketing in the third quarter this year and temporary duplicate rent as we consolidate our New York headquarters, more than offsetting gross margin expansion in the quarter. Foreign currency is expected to have a minimal impact on the operating margin in the third quarter. Third quarter tax rate is estimated at 21%.

In closing, we continue to be vigilant regarding the geopolitical and macroeconomic environment and we are committed to maintaining discipline on costs and inventory as we elevate the brand and return the company to sustainable growth and value creation. We are proud of the work our teams around the world are doing to execute on our next great chapter plan. Guided by Ralph's creative vision, our teams are executing with agility and a passion for the brand.

With that, let's open up the call for your questions.

Question-and-Answer Session

Operator

[Operator Instructions]. The first question comes from Paul Trussell with Deutsche Bank. Your line is open.

Paul Trussell

Good morning and congrats on quite solid results.

Patrice Louvet

Good morning Paul.

Jane Nielsen

Thank you Paul.

Paul Trussell

There are a number of notable headwinds in the marketplace, some of which have led your peers to reduce their go-forward expectations. In your view, what drove your performance in Q2? And what are you seeing in the business that enables you to maintain your earnings guidance for the full year? And on North America specifically, could you speak to your surprising positive comps and the outlook for the region? Thank you.

Patrice Louvet

Hi. Good morning Paul. Thanks for your question. The first thing I really want to say is, I am really proud of the way our teams executed this quarter because, as you mentioned, we were able to exceeded expectations while dealing with a wide range of challenges from tariffs, the Hong Kong situation, the Brexit uncertainty and the further acceleration of our supply chain moves. This coupled with the organizational changes that we talked about over the past few months really gives us confidence that we should just continue to running the play through our next great chapter plan, obviously with a higher degree of agility that's required in today's context.

On the specific drivers of this quarter's performance that we believe are sustainable, there is probably four I would call out. The first one is the fact that we are seeing brand momentum both with new consumers and with current consumers and we have had, I think as you have heard during our prepared remarks, a number of high impact marketing activities during the quarter. One I would highlight is the application we did on Wimbledon globally through celebrities and influencers around the world. Second driver is product, right. I think we have seen this quarter is the beginning of a better balance between core, seasonal core and fashion product, coupled with exciting growth in outerwear as we go into the holiday season.

Third area is distribution. And one of our big priorities is to continue to elevate the brand presence, the shopping experience for consumers wherever they shop, be that in brick-and-mortar or in digital. And we are also continuing to expand both in Europe and Asia and have significant growth opportunities moving forward in those two regions. And the final point is, while we are investing behind all these initiatives, we are continuing to drive operating efficiencies and cost discipline.

Now specifically to your question on North America. We were very pleased with the comp performance this quarter of 2%. The key thing I would highlight here is the during progress we made in our full price stores were the result of marketing and really bringing consumers into the store, the result of engagements with our VIPs and the change we made in our compensation structure to really drive a total team push in our respective stores has really played out very nicely. We are also encouraged by the progress we are making on our website, particularly with domestic consumers and also continued to see good progress in our factory outlets.

Jane Nielsen

Yes. I would say, Paul, that we were really pleased with Q2 and our ability to maintain our fiscal 2020 guidance. As we look at some of the headwinds that we named, from Hong Kong to tariffs to Brexit, it's about $0.25 to $0.30 to EPS. And what we have really been able to do is to have our teams react in a very agile fashion and what we are seeing is that continued momentum on AUR, plus our brick-and-mortar conversion improvements that we are seeing in our stores, notably in North America and continued strong performance across Europe and Asia are what's enabling us to hold our overall operating margin guidance and our revenue guidance through the year. So really proud of the teams. And we see those drivers as durable throughout the rest of this year.

Corinna Van der Ghinst

Next question.

Operator

Our next question comes from Michael Binetti with Credit Suisse. Your line is open.

Michael Binetti

Hi guys. Good morning. Thanks for our questions. I add my congrats on a good quarter, specially the North American comp. I know it's the best number you have seen in a while.

Patrice Louvet

Thanks Michael.

Jane Nielsen

Thank you.

Michael Binetti

Any initial response to those U.S. price increases would be helpful. But I did want to talk about the outlook for second half for a minute, Jane. The guidance you give us implies the operating profit growth rate to slow and even potentially turn negative on a year-over-year basis at the end of the year. The 20118 Analyst Day guidance assumes operating profit growth each year. Can you give us some high level thoughts on how to think about the lower, even negative, growth rate at the end of this year? And how you see that starting to improve into next year, in particular North America where your operating margins have been negative on year-over-year basis? I think it's really a sentiment of the ongoing declines in wholesale and you guys make very good money in that channel. So those losses are profitable. Can you speak to how you look at North America margins in the second half? Thanks.

Jane Nielsen

Sure. In terms of the first part of your questions, which is U.S. price increases, we are still in early days. As you will recall, Michael, we set first tranche of prices in late September, early October. While it's too soon to call, we are encouraged by what we saw through back to school and through the early days of the work that. So that is sort of guiding our own guidance for AUR growth in the low single digit range for the full year and an increase in AUR as we move through the back half.

While we anticipate some headwinds in third quarter from an OI margin perspective, we still are guiding and maintaining our guidance for OI expansion for the fiscal year, which puts us in line for continued operating margin expansion through the course of our next great chapter plan. As we laid out the guidance, we knew that some things would respond better than others. With their puts and takes we are certainly encouraged right now by our gross margin progress that we are making.

And then other things would take longer to turn like North America wholesale. We are just really focused on our pressure areas, the Lauren brand, the Polo brand is performing in wholesale. Were back to investing in marketing with our wholesale partners and are really focused on sell-out in that channel. That will be the ultimate metric pf performance in that channel. And so we still feel good as we look to our five-year guidance with that mid-teens operating margin target that we laid out over a year-and-a-half ago.

Corinna Van der Ghinst

Next question.

Operator

Thank you. Our next question comes from Matthew Boss with JPMorgan. Your line is open.

Matthew Boss

Thanks and congrats on a nice quarter.

Patrice Louvet

Thanks Matt.

Jane Nielsen

Thanks Matt.

Matthew Boss

So on the gross margin, maybe Jane, what was the break down of the 80 basis points constant currency expansion in the second quarter? How best to think about puts and takes for the back half of the year? And then as we think multiyear, I guess maybe Jane again, how would you rank the buckets of continued gross margin expansion opportunity versus any headwinds to consider as we are thinking beyond this year?

Jane Nielsen

Sure. So let me lay out what happened in this quarter first because I think it provides good context to the back half of the year. As I look at pricing, promotion management and assorting in to higher AUR and gross margin overall product, that is a little over half of the benefit that we saw from gross margin expansion. We also got some benefits from channel and geographic mix.

As you know, we expect those to be durable through the course of the plan with greater and lesser puts and takes. And obviously, we called out the pressure points from FX and some ongoing tariff benefits, which is small today based on the tariffs that were enacted in Q2, but we expect to be the biggest point of increasing pressure as we move through the back half of the year.

Now counterbalancing that as we move into the back half, we expect that some of our pricing actions will start to kick in. And we go in with tighter inventory positions and edited but improving assortments that should improve our excess positions as we move through the back half of the year. So an encouraging start, a little ahead of where we thought we would be but a driver through the remainder of FY 2020.

Corinna Van der Ghinst

Next question.

Operator

Thank you. The next question comes from Ike Boruchow with Wells Fargo. Your line is open.

Ike Boruchow

Hi. Good morning everyone. Let me add my congrats. Two quick ones for Jane, I think. Could you just help us understand what's embedded in the North America wholesale plan for the back half and if there is any variability between Q3 and Q4? And then any color around off-price versus the traditional U.S. wholesale within that? And then just really quickly, you had commented I think that the Q2 digital comp had some benefit from timing from a very big partner. Should we be expecting the digital European comp to be much less robust in the back half or any specific quarter? Just trying to understand what's going on there. Thank you.

Jane Nielsen

Sure. A multi-part question. All right. Let me start with the first part which is what's embedded in our back half outlook for North America wholesale. We don't guide regions and certainly not channels but I can tell you, Ike, that what we see today with our sell-out trends down mid to high single digits, we are expecting that to continue through the back half of this year.

We are focused on our sell-out trends. We believe that we will be making some edits into the spring that will be better. But until we have better sell-out trends, that's our expectations for the revenue that we will report which is sell-in and so that's our expectation and that's embedded in the back half of the year. Always working to improve and we think that you will start to see that as we maintain a new leadership set but that will be closer to the start of our next fiscal.

If you think about the color on overall North America off-price, this quarter off-price, especially in North America, was essentially about flattish. We had a pullback in some of our cut it business that we, in order to keep our inventories clean, had some flow of overall excess. I expect that that trend, as we use it as an excess channel, it will be a little choppy as we move through the back half of the year.

And then on Q2 and back half European digital trends, we did in preparation for holiday accelerate a little bit of shipments into Q2 to one of our larger customers and that we expect that for fiscal 2020 digital comps will be at a more normalized level following last year's replatforming in the second half. But the total ecosystem will be a low double digit comp for the year.

Corinna Van der Ghinst

Next question, please.

Operator

Thank you. The next question comes from Kate Fitzsimons with RBC Capital Markets. Your line is open.

Kate Fitzsimons

Yes. Hi. Good morning, I will add my congratulations. I wanted to dig a bit more into the North American digital comp plus 2%. Can you just speak to what drove that sequential gain? It sounds like you saw some resonance with some mobile investments domestically. So just wanted to hear more about what changes were made in the quarter and what gives you confidence that business can continue to improve go forward? And I guess when you benchmark your digital and mobile experience relative to peers, where do you really see as the opportunity go forward on as we look to 2020? Thank you.

Patrice Louvet

Sure. So we had a number of things that kicked in, in the quarter and we continue to see it raise the bar, right. So for me, it's a continued journey. First intervention is the mobile dimension which you touched on. So optimizing the mobile experience through both better site navigation and better search functionality. The second piece is, we launched Apple Pay, right. And we want make sure that we have all the payment approaches that our target consumers want to use.

The third area is, as we looked at our email segmentation, we were more precise in our email targeting and so we are seeing some benefits from that and I expect that to actually strengthen over time. And then the last one, which is important because we want to make sure we provide great customer service, we moved to actually 24/4 customer service call support during this quarter and obviously we are going to continue to do that.

And then as you look at the next phases of capability that we are building on the site, continuing to build out the mobile functionality, personalization, big focus areas for us. And then the whole connected retail piece, whether it's buy online, find in store and buy online store, pickup in store. So those have been drivers that have helped our business this past quarter.

The progress was, remember last time we talked about how there is a bifurcation between our domestic consumers and our international business. So our domestic consumer progress was solid this quarter. Our international business continues to be pressured because of the foreign exchange dynamics and because of the import restrictions, particularly in China and in Korea.

Jane Nielsen

Yes. I would just add that we expect that some of that international pressure will continue through the balance of this year.

Patrice Louvet

Will continue, yes, right.

Corinna Van der Ghinst

Next question.

Operator

Thank you. The next question comes from Dana Telsey with Telsey Advisory Group. Your line is open.

Dana Telsey

Hi. Good morning everyone. And I also want to say congratulation on the nice progress. As you think about Hong Kong and obviously the uncertainty there, how you are planning that going forward? The down 27% that you had this quarter, how do you see that progressing? And then on new channels of distribution that you mentioned, Patrice, how do you balance out new channels with wholesale? Where do you see the endgame winding up with wholesale as a percent of sales and perhaps some of these new channels? And is there a margin differential? Thank you.

Jane Nielsen

Yes. Dana, why don't I start on Hong Kong and then I will turn it over to Patrice. So as we look at Hong Kong this quarter, it was about a three point pressure to overall Asia comp. As we look forward to Q3, we are expecting that pressure to accelerate and it will be about four to five points of negative impact on Asia comp as we move forward. We have seen like many others, the tourist falloff has accelerated and door closures due to protest, we don't expect to improve. And it's embedded in our guidance for Q3.

Patrice Louvet

And then on the channel play. So listen, we have a very simple principle. We want to be where the consumer wants to shop us. And it's clear that there is new model that consumers are excited about where we want to play. So rental, subscription, retail, all right.

So on rental, I think we have actually been on rental runway for several months. We just started on Nuuly. We are excited about that. And there are other platforms that we are looking at. Initial results are quite encouraging. So very early days, but encouraged by the progress.

Subscription, whether that's Stitch Fix or Trunk Club, are also performing well for us and we want make sure we are there and we play to win there.

And then we are starting on retail. We had an activity with Depop in the U.K. where results were quite encouraging. And obviously given the nature of our brand, timelessness, basically more style driven than seasonal fashion driven, more focus on quality, we think we are actually very well-positioned to play to win in that segment.

Listen, your crystal ball is going to be as good as mine, Dana, on this one in terms of what share of the business it will be down the road. The consumer, I think, will tell us that based on their behaviors and the services that we can offer. But our mindset is, we want to build on their behaviors and the services that we can offer. But our mindset is, we want to build an ecosystem that's consumer centric and within that ecosystem wholesale still has a very important to play, both brick-and-mortar and.com. And so we want make sure we are where the consumer expects us to be. We are well set up for success in those channels where the brand can show up in the right way as well as in the developing new channels.

I think the key thing from me here and I am very proud of the work that the teams are doing here, is the agility that the organization is demonstrating because typically we wouldn't necessarily be as nimble on some of these new opportunities. And I think there has been a lot of wonderful work done internally to take advantage of these opportunities and to have a bit of a first-mover advantage on some of them.

Corinna Van der Ghinst

Last question, please.

Operator

Thank you. Our final question comes from Rick Patel with Needham & Co. Your line is open.

Rick Patel

Good morning and well done managing the tough environment. I had a question on marketing. So it sounds like some of the efforts to leverage the targeted performance channels are working very well. Should we expect more of this in the back half? And does that mean that you will move away from some of the brand-building investment you have made in the past? Or should marketing grow across all channels? Thank you.

Patrice Louvet

Thank you Rick. Well, listen, first of all, our end goal is one-to-one marketing, right. I mean that's where we want to go. Now that's probably a few years away still. But that's certainly the personalization journey we are on across all elements of our marketing. So you will see, no, we are not going to get down to quarter-by-quarter specifics on this, but you will see us continue to increase personalization focused both mobile, on our site and in our email activities, so that the page that you get when you sign on to our site is dramatically different than the page that I get when I sign on.

That will not be done at the expense of overall brand-building activities like our shows, like our partnerships with sports, like our limited editions. But it's really about being more efficient in the way we spend our money. And I think what we will find with personalization is actually we will be able to be a lot more effective and efficient with each dollar being spent. We are still on the trajectory to get to 5% of sales expense in marketing by the end of the five-year phase.

We expect marketing to continue to grow ahead of revenue this year as well, just like we had over the past two fiscal years. So think of us playing across the pallet of marketing tools, but indeed with a deliberate focus on ultimately getting to one-to-one marketing.

Jane Nielsen

And expect marketing dollars to grow in the second half, Rick.

Patrice Louvet

All right. Well listen, thanks to all of you for joining us today. We look forward to sharing our third quarter fiscal 2020 results with you in early February. And in the meantime, have a great day.

Operator

Ladies and gentlemen, that does conclude your conference for today. Thank you for your participation. You may now disconnect.