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L Brands (LB) on Q3 2019 Results - Earnings Call Transcript

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FQ3: 11-20-19 Earnings Summary

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EPS of \$0.02 misses by \$-0.01 | Revenue of \$2.68B (-3.54% Y/Y) misses by \$-13.96M

Earning Call Audio



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L Brands Inc. (NYSE:LB) Q3 2019 Earnings Conference Call November 21, 2019 9:00 AM ET

Company Participants

Amie Preston - Chief Investor Relations Officer

Stuart Burgdoerfer - Executive Vice President, Chief Financial Officer

Conference Call Participants

Sue Anderson - B. Riley FBR

Mark Altschwager - Baird

Alex Walvis - Goldman Sachs

Lorraine Hutchinson - Bank of America

Ike Boruchow - Wells Fargo

Kate Fitzsimons - RBC Capital Markets

Jamie Merriman - Bernstein

Oliver Chen - Cowen & Company

Kimberly Greenberger - Morgan Stanley

Carla Casella - JP Morgan

Marni Shapiro - Retail Tracker

Paul Lejuez - Citi

Tiffany Kanaga - Deutsche Bank

Operator

Good morning, my name is Zutania and I will be your conference operator today. At this time, I would like to welcome everyone to the L Brands third quarter 2019 earnings conference call. At this time, all participants are in a listen-only mode. After the speaker presentation, there will be a question and answer session. To ask a question during the session, you will need to press star, one on your telephone. Please be advised that today's conference is being recorded. If you require any further assistance, please press star, zero.

Thank you. I will now turn the call over to Ms. Amie Preston, Chief Investor Relations Officer of L Brands. You may begin.

Amie Preston

Thank you. Good morning everyone and welcome to L Brands third quarter earnings conference call for the period ending Saturday, November 2, 2019.

As a matter of formality, I need to remind you that any forward-looking statements we may make today are subject to our Safe Harbor statement found in our SEC filings and in our press releases. Our third quarter earnings release, additional commentary and earnings presentation are available on our website, lb.com.

All of the results discussed in today's call are adjusted results and exclude the significant items described in our press release.

Stuart Burgdoerfer, EVP and CFO and I will handle the call today.

Thanks, and now I'll turn the call over to Stuart.

Stuart Burgdoerfer

Thanks Amie, and good morning everyone. Our third quarter earnings per share results of \$0.02 was within our forecasted range of between a loss of \$0.05 and earnings of \$0.05. Bath & Body Works exceeded our expectations for the quarter and continues to deliver strong results with a 9% comp increase and a 10% increase in operating income. Outperformance at Bath & Body Works was offset by a Victoria's Secret result that was at the low end of our expectations. Looking to the fourth quarter, we are forecasting earnings per share of about \$2.

New CEOs, John Mehas and Amy Hauk are very focused on getting close to our customers and making improvements to our merchandise assortments, marketing and customer experiences in stores and online. We have more work to do, and we recognize that it will take some time to see improvement in the business.

Also, as mentioned earlier, we are up against aggressive promotions from last year and the time period between Thanksgiving and Christmas is six days shorter than last year. Therefore, our fourth quarter guidance assumes a Victoria's Secret merchandise margin dollar decline in the high-single-digit range, which is consistent with our third quarter result. We expect continued strong performance from Bath & Body Works.

We're very focused on executing a successful holiday. We will continue to rely on the strength of our agility, and we will continue to test pricing and promotion strategies, react to customer preferences, and chase into proven product winners to drive results.

Thanks, and over to you, Amie.

Amie Preston

Thanks Stuart. That concludes our prepared comments, and at this time we'd be happy to take any questions you might have. In the interest of time and consideration to others, please limit yourself to one question.

Thanks, and I'll turn it back over to the Operator.

Question-and-Answer Session

Operator

Your first question comes from the line of Sue Anderson with B. Riley FBR.

Sue Anderson

Hi, good morning. Thanks for the question. I wanted to follow up on PINK. It's nice to see the sequential improvement in the comp there. I was wondering if you could talk about the strong performance in intimates and how it outperformed so well versus VS intimates. On the lounge side, it does sound like you're seeing some improvement in some products. How should we think about that for holiday? Do you expect more of the newness to flow in for holiday or should we think about spring as maybe increasing that better mix? Thanks.

Stuart Burgdoerfer

Thanks Susan. In terms of the PINK results in intimates, Amy and her team have made product improvements and have also developed an assortment architecture that has very sharp price points that make the intimate offerings very accessible to the PINK consumer, so very strong unit growth results, a strong sales result, again a rebalancing of the mix there to really distort to sharp price points, and highly accessible from a retail price positioning for intimates in PINK, and the consumer has reacted well to that, and it's driving a strong overall result.

With respect to improvements that the team is making in apparel, and particularly in the tops business, obviously there are adjustments happening on an ongoing basis. There is some strength in the apparel assortment as was called out in our pre-circulated remarks.

The business will continue to advance the assortment in the fourth quarter, but as you recognized in your question, more to come in 2020 in terms of change in the assortment, the apparel assortment to drive the results we're looking for there. Thanks.

Amie Preston

Thanks Susan. Next question?

Operator

Your next question comes from the line of Mark Altschwager with Baird.

Mark Altschwager

Good morning. Thanks for taking my question. I also wanted to dig into VS for a moment. There are some cross currents on the merchandise margin line with AUR being planned up with lingerie, but down at PINK given the different strategies there. To the extent that you hit your plans for each division, how should we think about the net impact to merchandise margin in the near term? Then separately, you cautioned that VS lingerie is up against a heavier promotional period from last year. Overall, how are you thinking about the balance of capturing your fair share of traffic during the competitive holiday period versus holding firm on the product and AUR elevation strategy? Thank you.

Stuart Burgdoerfer

Sure. In terms of the AUR positioning for lingerie and for PINK, it starts with a point of view that John and Amy communicated back at the analyst day in September, which is the businesses are going after different target customers that are in different stages of their life and otherwise just have some distinction, and so as a result of that, as you know, John is developing, pursuing, offering a more elevated product, more glamor, more fashion, a lot of emotional content, and over time we expect that we'll get paid for that work through AUR and margin rates. Amy and team have also done customer work, consumer work, and one of the things that they have assessed is that they really want to make sure that our offerings to that customer, again a younger customer, that the offerings are highly accessible from a pricing standpoint, so there's a natural delineation in average unit retails.

As it relates to margin rate with the context I just provided, and over time or as a target, we would expect that both the businesses, including in the bra business, should earn healthy margin rates consistent with those strategies, so again over time I don't start with a point of view that the margin rates would necessarily be different between the two. Again, the price levels are different, but I'm not sure that the margin rates would be different.

Second part of your question was about promotion, and how will we manage through the holiday period given the significant promotions from a year ago. Obviously, we're trying to get paid for our work to have an appropriate amount of promotion, but there are a couple things that I would just reinforce. One is we need to, and we will, end inventories with a clean position so that we start 2020 in a healthy inventory standpoint, both financially and numerically, and also in terms of the freshness and the quality of the assortment that we carry over into the spring season. So, ensuring that that happens, depending upon how things go, obviously will be an important input to the degree or level of promotion through the holiday period.

The other is, as you recognize in your question, it's a key time for our consumers. We have a lot of traffic in our stores and online, and we'll be balancing promotional levels to drive volume engagement with customers, profit, again the management of inventory flow and sell downs, so we're not overly principled about it. We certainly are pursuing a strategy to get paid for our work and to reduce the level of promotion, but it is dynamic. We do a lot of testing as you're familiar with, and we'll try to strike the right balance considering the factors that I've mentioned. Thanks.

Amie Preston

Thanks Mark. Next question, please.

Operator

Your next question comes from the line of Alex Walvis with Goldman Sachs.

Alex Walvis

Thanks so much for taking the question. I wanted to go back into VS lingerie and talk about the pricing strategy there. So, I think you've pulled back on promotions in the bras business and raised prices there. What's going on with panties, apparel, and other categories within that business?

Then maybe one quick follow-up on that inventory point - you know, inventory is up on a per-foot basis at both VS and BBW. I mean is that what was planned? It seems like a high-growth rate given the shorter holiday season.

Stuart Burgdoerfer

I'll start with the second part of your question first. Inventory is in line with our expectations, so to be clear we are making important investments particularly in the sleep and lounge category in the Victoria's Secret Lingerie business, and also there's some timing and investment related to the Bath & Body Works business that we believe is appropriate, so inventory is in line with our expectations and we're making deliberate investments, given the factors that I described.

With respect to pricing in panties and apparel for lingerie, John is also in those categories, given the quality of the brand and what we believe is our opportunity in offering differentiated merchandise that has significantly more emotional content. He's shifting the panty business to include a lot more single ticket panties that are matched back panties, that come at higher average unit retails, and separately in the sleep and lounge business, a significant investment in the product in terms of quality of fabrics, hand feel, quality of fashion, and design esthetic, and going in we believe we'll get paid for that work. Certainly a view, a strong view that there's an opportunity to elevate the product quality, the emotional content across all categories in Victoria's Secret lingerie, and again over time I believe, we believe we'll get paid for that work. Thanks.

Amie Preston

I'll just add too that in the third quarter, we did see strong growth in that single ticket panty category including things like the Brazilian panty, which is more of a higher fashion item.

Thanks Alex. Next question?

Operator

Your next question comes from the line of Lorraine Hutchinson with Bank of America.

Lorraine Hutchinson

Thank you, good morning. Looking at the full year guidance, I think you had been expecting comps to be up low-single digits and now expecting flat to down slightly. Can you just talk about really what changed throughout the course of the third quarter to cause that adjustment in the guide?

Stuart Burgdoerfer

Well, Victoria's was at the low end of our expectations fundamentally, so we've got good results and strength and entered the fourth quarter with momentum in the Victoria's Secret Beauty business, but both in lingerie and PINK at the lower end of a range of outcomes or expectations, and as a result an adjustment to the fourth quarter and thus the full year.

Lorraine Hutchinson

Thank you.

Stuart Burgdoerfer

Sure.

Amie Preston

Thanks Lorraine. Next question please?

Operator

Your next question comes from the line of Ike Boruchow with Wells Fargo.

Ike Boruchow

Hey, good morning Amie and Stuart. Two questions for you, Stuart. Number one, on the dividend, could you just comment on your confidence in your ability to sustain the dividend payment given the trajectory of the business? Just curious on your thoughts there. Then

second, and I hate to bring this up, but I know you've said and been very clear that you are looking at all options in regard to the business and optionality that may exist with both concepts, but I guess my question is the more BBW outperforms and VS either underperforms or comes in at the low end of your expectations, does that basically compel you to look at this potential optionality deeper? I'm just kind of curious how the thought process evolves given what's going on in the business. Thank you.

Stuart Burgdoerfer

Sure. So two different subjects, Ike, but one important aspect of both, and that is that those subjects are evaluated by the Board. On the dividend, the Board regularly reviews our policy, and on a quarterly basis approves the payment of our dividends. That would be my comment there.

With respect to given the persistence of difference in performance between Bath & Body Works and Victoria's, does it give rise to questions like yours or the curiosity that you're expressing in your question, it does. You know that we have a long history of managing the portfolio of our businesses to drive value for shareholders. That history includes splits and spins and sales. The board periodically evaluates those opportunities to increase shareholder value over time, and the Board does receive input from outside financial advisors with respect to those subjects. Thanks Ike.

Amie Preston

Next question, please? Thanks Ike.

Operator

Your next question comes from the line of Kate Fitzsimons with RBC Capital Markets.

Kate Fitzsimons

Yes, hi. Good morning. Thanks for taking my question. My question is on BBW. I'm curious about that 5% store comp. There was a call out in the prepared commentary around strong response during some key days. Curious what the traffic was behind that 5% number, and also if you can just speak to maybe monthly cadence or at least the

constituency in traffic in the quarter, it just feels like across the industry, the highs get higher around some of these key days and the lows get lower. Just curious what you keep meeting around some of these bigger events to comp the comp.

Then secondly, Stuart, if you can just speak to the nature of the impairment that you took in the China business overall in the quarter, that would be helpful.

Stuart Burgdoerfer

Okay, so in terms of--as I sift through your question, if I miss something, come back at me. With respect to traffic levels and comp at Bath & Body, what I would call their retail math, which is traffic, conversion, average unit retail growth, it's all healthy, it's relatively stable. Their traffic is up low single and the retail metrics are healthy across all meaningful periods of time. That would be my response to your first question around retail metrics for Bath & Body. Does that address your question?

Kate Fitzsimons

Yes, it does.

Stuart Burgdoerfer

Okay. Then with respect to the impairment that we took in China, the results have been challenged there, as we've talked about, and we believe that based on historic results, our forecast for the passage of time as required by the accounting standards, that it was appropriate based on a complicated set of analyses and judgment, that it was appropriate to take--and necessary, I should say, to take an impairment charge related to many of our stores, full assortment stores in China.

Kate Fitzsimons

Okay, great. Thank you very much.

Stuart Burgdoerfer

Sure.

Amie Preston

Thanks Kate. Next question, please?

Operator

Your next question comes from the line of Jamie Merriman with Bernstein.

Jamie Merriman

Thanks very much. Stuart, can you just talk a little bit more on the inventory? Specifically, I'm wondering as the Victoria's Secret lingerie business works to take AUR up and comp has come in lower and getting lower, and maybe not surprisingly given the decision to take AUR up and pull back on promotion, can you just talk about where inventory within that business is? I understand that it's up for Victoria's Secret overall, but are you planning for those comps to be worse as AUR comes up or how are you thinking about that?

Stuart Burgdoerfer

We're not planning for comparable store sales to be down as AUR goes up. Obviously we're highly motivated to grow the top line in our business at healthy margin rates to stabilize and then get the business back to where it has been and should be. The strategy of finding the right pricing structure for the assortment - good, better, best, getting paid for our work in the case of lingerie, as expressed to earlier Q&A, AUR increases based on quality of product, that's all intended to have a healthy balance between units and pricing over time. But we certainly don't have a strategy to raise prices to drive sales declines - I'm exaggerating a little bit - and profit declines. It's intended to drive healthy top line growth over time and get paid for our work.

Jamie Merriman

Sure. I guess maybe a better question is are you expecting units to be down as AUR comes up, and are you planning--

Stuart Burgdoerfer

Yes, potentially in the short term, but not on a long term basis. But in the short term, will there be some volatility in units, and conversely in the PINK business units are up dramatically with AURs down, so there are some significant shifts in the unit AUR

architecture, one going lower AUR with substantial unit growth at PINK, and the other with AUR increases, and it's why you're asking your question what's our expectation on units. There will be some pressure on units, but again our intent in total would be to drive revenue growth as a result of these strategies. Thanks.

Amie Preston

Thanks Jamie. Next question, please?

Operator

Your next question comes from the line of Oliver Chen with Cowen & Company.

Oliver Chen

Hi, thank you. Hi Stuart. Regarding VS, would love your thoughts on the holiday season as we approach it this year versus last year, and any thoughts on segmentation and using your customer list in a more segmented manner just to drive traffic and balance healthy promotions. Also, there has been more talk about lower productivity malls and also underperformance in C and D locations at different retailers. What are your latest thoughts on the healthier store base and how you're evaluating that question you get so often? Thank you.

Stuart Burgdoerfer

In terms of promotional approach, Oliver, segmentation, customer file, we engage with our customers in lots of ways through email, through direct--through traditional mail communication, through social media, etc. We certainly employ different views of segmentation in each of those and other contact strategies. We have done that historically. We obviously work to get better at that over time.

In terms of our general views about promotion and promotion in key periods, I would say apart from not anniversarying some very significant intimate apparel promotions or at least going in not expecting to anniversary some of those, otherwise I would say our promotional strategy is largely consistent with the prior year, with some evolution to fewer,

simpler, more impactful offers. That would be, I guess, the main point that I would want to register on promotion, and obviously we utilize various segmentation approaches in our contact strategies.

With respect to the store base part of our business, it's a critical part of our business obviously as we've registered very consistently now for many years, and as I think as remarked on in our pre-circulated commentary, we open a lot of stores every year and we close stores every year, and on a net basis we have opened more stores than we've closed. That is just the natural proactive, healthy management of a multi-unit store base. We believe strongly in the relevance and the opportunities associated with the store based business and at the same time, as you also know, this isn't either-or. We have a very significant online business at both Bath & Body Works and Victoria's Secret, so we're pursuing appropriate growth and customer experiences in both channels. We actively manage our real estate. The real estate outcomes are a function of overall business performance, so obviously we've pulled back on investment in the Victoria's business over the last two or three years given its overall performance, and conversely we've increased our investment in Bath & Body over the last five or six years given the quality of overall result and the specific results that we get from remodeling stores or opening new stores that include the White Barn shop-in-shop treatment or overt White Barn store design, as we refer to it.

It's dynamic, but overall we're a strong believer in the store-based part of our business. We're making important investments in it where there's results, and we proactively manage it. Thank you.

Oliver Chen

Okay, and lastly, if you could just help us understand what's next with digital, or things we should focus on, whether that be the inventory management between channels or BOPUS. Would love your thoughts. Thanks, best regards.

Stuart Burgdoerfer

Sure, thank you, Oliver. As we've outlined, we completed in the spring season a multi-year technology project to re-platform the VictoriasSecret.com website. It's up and running and supporting the business. That work continues to support international online business outside the United States, so work underway there that will go live in the first half of 2020. As we've mentioned, a foundational capability that we're investing in to do things like Buy Online Pick Up In-Store is inventory accuracy, and we're getting after that through a project to have RFID information from our stores to ensure that we have appropriate visibility to inventory so that we don't disappoint customers with a misunderstanding of the specifics. We have broad assortments, and so we want to make sure that we have very accurate information such that we have the right foundation to do Buy Online Pick Up In-Store. I would expect that, Oliver, sometime over the next couple years, depending on timing and priority. We recognize the opportunity that comes with it. I'm not sure we'll be evaluating as we close the year, start the next year, as to whether we get after some of that in this next 12 months or whether it moves into 2021. Thank you.

Oliver Chen

Thank you, best regards.

Amie Preston

Thanks Oliver. Next question, please?

Operator

Your next question comes from the line of Kimberly Greenberger with Morgan Stanley.

Kimberly Greenberger

Great, thank you so much. My question is on Victoria's Secret. It looks like there was sequential improvement in PINK with comps getting better relative to the second quarter. It seems like merchandise margin also got better relative to the second quarter, and the last piece is the tops business. It seems like that needs to turn, so I'm wondering if you can talk about Amy's strategy in tops.

With regard to the core lingerie business, it seems at least like the initial reception to the new strategic direction that John has laid out has not been received well, so I'm wondering if he is course correcting. Understanding that he hasn't affected the full assortment at this point, just the initial flows that came in the third quarter, it doesn't seem like the reception to that has been favorable, so I'm wondering what sort of course correcting measures he might be taking. Thanks.

Stuart Burgdoerfer

On PINK, Kimberly, you recognized in the question the progress made in the intimate apparel side of the business, bras and panties, and the overall sequential trend improvement is still not where we want it to be. Margin dollars in the third quarter for PINK overall were down, but up in bras and panties and down in the apparel categories, driven by tops as mentioned. In terms of what is Amy doing about that, she and her team are leveraging our testing and speed and agility capabilities to provide more new offerings to the consumer in that space and also doing more work in sport and seamless and outfitting with respect to sport and seamless in that part of the apparel part of the business. It's not just how do we go back and try to do what we've done historically better, but rather really mining for, including a real emphasis on sport and seamless, what is the new positioning for apparel, and particularly apparel tops in PINK, again leveraging our design and fast supply chain capabilities that the business has. So a work in process, some signs of success, but the overall result not what we want it to be in apparel, and it's a big part of the business, as you appreciate, so the team is very focused on it but it's right to be curious about it. The team is very, very focused on continued improvement in that part of the business.

With respect to an assessment of Victoria's Secret lingerie and the initial offerings that John has introduced into the assortment, I really believe it's substantially too early to come to any conclusion on it, and I'll elaborate on that. There certainly are offerings that have been introduced into the assortment that have had strong positive customer response, meaning new stuff, customer bought a lot of it, indication that glamour and elevation in product at higher price points, when executed well, gets a strong customer response.

Examples of that more specifically would include the match back panty categories that come at substantially higher AURs and that have real fashion content to them, along with sexy sleep and lounge offerings that have gotten a strong customer response.

All that said, Kimberly, the progress, and this is why you're asking your question, the progress made, those examples being provided, has not been sufficient to overcome the year-on-year declines in other very significant categories within the intimate apparel and sleep and loungewear businesses, so we're very clear minded about where we are on an overall basis with a lot more work to do. John is working smart and very hard building a new team, focused on improving execution in stores and online along with some evolution on the marketing of the business, and there are signs of progress for sure, but as again commented on in our pre-released information, lapping a lot of promotion and some weakness in legacy core frames that are big books of business, and what's happening there, as you would expect us to be doing, is a lot of development work where we think we will have significant re-launch activity in 2020 in some of those--early 2002 in some of those core frames that are big books of business, that have meaningful year-on-year declines that we're not able to overcome with the progress we're seeing in some of the new items introduced.

That would be my overview of it. This is a business that's had challenges, lingerie, now for three or four years, and it's going to take some time to stabilize it and get it back to where it should be. I absolutely believe John and his team are working on the right stuff, signs of progress, but it's going to take some time. All that said shouldn't be interpreted as any sense of complacency or we'll get to it when we get to it. The team couldn't be working harder and with more energy to get the results that we're all looking for.

Thanks.

Kimberly Greenberger

Thank you Stuart.

Amie Preston

Thanks Kimberly. Next question, please?

Operator

Your next question comes from the line of Carla Casella with JP Morgan.

Carla Casella

Hi. My question is on two things. The La Senza charge or payment for this quarter on the guarantees, is there any residual guarantee on La Senza or future cash flows out for that? Then just your comfort level with leverage, target leverage, and if the rating agencies are looking at it anywhere different, and does that double-B rating matter to you?

Stuart Burgdoerfer

Sure, thanks Carla. On the La Senza charge, it's a non-cash charge related to potential - and I emphasize potential - liability that we may have with respect to leases and some credit support that we provided in connection with the transition of sourcing to a third party. It's a booking of a non-cash reserve for potential cash exposure that we may have in future periods related to, again, leases and credit support associated with sourcing, so that's what that is about.

With respect to, Carla, our leverage and credit ratings, as we announced a year ago, the company is taking steps to reduce its leverage. We made a bit of progress in terms of debt reduction this year, and those steps include reductions of capital expenditures. We made a change in the dividend announced a year ago, taking effect in January, that freed up a bit more than \$300 million, so management with the board will continue to evaluate those things.

The most important aspect of any of that is improving the cash flow of the business, which is associated with, as you appreciate, the operating improvements that we're pursuing in lingerie and PINK particularly, but at the end of the day we expect to end the year with about \$1.4 billion of cash. We generate significant free cash flow, our debt maturity profile is healthy and well spaced out, and so those are all aspects of our capital structure that certainly we consider and any outside party would naturally consider.

Thanks.

Carla Casella

Great, thanks.

Amie Preston

Thanks Carla. Next question, please?

Operator

Your next question comes from the line of Marni Shapiro with Retail Tracker.

Marni Shapiro

Hey guys. I'm curious on Victoria's Secret, just on the marketing side, as you enter the holiday season we haven't really talked about the fact that over the last many years, you've had a fashion show driving a lot of impressions -and yes, sometimes some controversy, but a lot of impressions, a lot of marketing on television through the holiday season. Have you contemplated how that would impact just the brand itself? You've been very quiet, Victoria's Secret, over the last--you know, as you're transitioning, but over the last couple months, and as you come into the holiday season it's still been kind of quiet. But in the holiday season, you're going up against years of fashion shows, so can you talk a little bit about your thoughts there?

Stuart Burgdoerfer

Well, we have certainly thought about it. As communicated previously, we think it's important to evolve the marketing of Victoria's Secret. That is happening in certain respects now and I think there will be more to come as that continues to get evaluated. Again, we believe the most important thing is the quality of the merchandise itself, the quality of our execution and selling in stores and online. But Marni, we recognize and appreciate that the communication of the brand, the offerings, the emotional content of Victoria's Secret is obviously an important thing, and I expect that we'll have evolution of those things certainly as we move through the next six, 12 months, and John focused on those things.

In terms of in a granular way, specifically as timing over the years shifted in terms of the airing of the fashion show, did we see specific material impact on short term sales response to the airing of the fashion show, as a general matter the answer to that question is no. So if you're like, oh my God, Stuart, are you freaked out about the day after the fashion show result and what's going to happen, it did air at different times over the years and we didn't see a material impact on the next few days' results.

With that said, it was a very important part of the brand building of this business and was an important aspect of the brand and a remarkable marketing achievement, and with that said, we're figuring out how to advance the positioning of the brand and best communicate that to customers, and that's among the things that John is focused on.

Marni Shapiro

But nothing for this holiday season, is that right?

Stuart Burgdoerfer

We'll be communicating to customers, but nothing that I would say is similar in magnitude to the fashion show. You can be sure we'll be communicating with customers through lots of vehicles, including social media and various more current platforms, if you will.

Marni Shapiro

Are your mailings up this year to last year? Last thing.

Stuart Burgdoerfer

Generally consistent.

Marni Shapiro

Okay, thank you.

Amie Preston

Thanks Marni. We'll take two more questions. Next question, please?

Operator

Your next question comes from the line of Paul Lejuez with Citi.

Paul Lejuez

Hey, thanks guys. Curious on Bath & Body Works, can you give a sense of the magnitude of the merch margin and overall gross margin decline this quarter versus the SG&A leverage, just in terms of basis points, and how should we think about the leverage point for occupancy and SG&A in that business in the fourth quarter and into F20?

Then just one clarification, Stuart, were the charges this quarter all related to China? I just wanted to understand which assets did you take the impairment charge on and if that impacts your depreciation going forward. Thanks.

Stuart Burgdoerfer

Okay. Paul, your first question is again about margins. There's a lot there and we'll get to all of it. Your first question was about merchandise margin rates for Bath & Body in the third quarter, is that what your question was?

Paul Lejuez

Yes, just merch margin versus SG&A in terms of basis points, what were the drivers to the overall change in BBW's EBIT margin.

Stuart Burgdoerfer

The first thing I would say, Paul, and again it may seem like pabulum but I think it's important because it's really important, is an operating income rate for Bath & Body Works in the lows 20s, we believe, Nick believes, the business believes is appropriate and the business has consistently delivered very healthy top line growth and very healthy bottom line growth with a little bit of deleverage in the rate over the last few years, largely reflecting the impact on depreciation and occupancy of the White Barn remodel program that we believe is a very positive thing for the business. That's the overarching point.

With respect to movement in the merchandise margin rate, three or four things to know. There is some inflation in the supply chain. There is some impact of tariffs. There is some impact of channel shift given the outpacing growth is very dramatic and healthy, frankly remarkable growth in the direct side of that business where the merchandise margin rate profile is a little different than the store profile. Again, that channel is very profitable at the bottom line but the geography of rate different, so that puts a little pressure on things. Promotion is up slightly and largely due to consumers responding in a very significant way when the business does offer promotion versus the business offering a lot more promotion in terms of days or depth.

That really is, Paul, the big picture on the margin architecture for Bath & Body, and that's how we think about it and that's certainly what we would hope investors would appreciate and understand.

Then separately on the management of expenses, the team, Nick, Andrew Meslow, the management team at Bath & Body is, frankly, extraordinary at balancing expense management in the business, so investing in things where it makes sense and being tough minded and disciplined where it doesn't, so not just cutting hours and having bad customer experiences, that the business offer terrific experiences for consumers, the business invests in product quality, etc. So the expense management in the business, the inventory discipline in the business is very, very strong, and those capabilities, that mindset, that stability and that management team is really what drives the overall result.

With respect to the impairment and what geographies were included in the impairment, China was the greatest amount of impairment but there was also, Paul, impairment--we impaired stores and there was charge associated with the U.S. and Ireland, and some in the United States as well. But China was the biggest component followed by the U.K. and Ireland, and then a little bit more in the United States beyond the impairments we took a year ago. Thanks.

Oh sorry, in answer to your question, does it save depreciation, yes it does, and that's not--some people think that's why you take impairments. It's actually a required accounting evaluation, so it's not to save deprecation but in fact does have the result of reducing

depreciation in forward periods. Obviously, Paul, part of the China evaluation relates to our business in Hong Kong, so unique circumstances there, as you would appreciate. Thanks.

Amie Preston

Thanks Paul. One last question, please.

Operator

Your final question comes from the line of Paul Trussell with Deutsche Bank.

Tiffany Kanaga

Hi, this is Tiffany Kanaga on for Paul. Thanks for fitting us in. You've touched on it, but would you discuss the pricing architecture rebalancing at PINK in more detail in terms of who specifically that customer is that the lower price point is attracting, where you believe she might have been shopping previously for that product, as well as how you're thinking longer term about potential for moving her up to higher price points and building our her basket?

Stuart Burgdoerfer

Yes, we spend a lot of time with our target consumers, Amy and team, including in her environments on campus. We leverage the campus representative program which is significant, and frankly - and I don't mean to give you a vague or general answer to a question, it's the fundamental answer to the question, like any good retailer would do, we think about it as good, better and best, a pricing pyramid, an assortment architecture that includes a range of price points in the assortment in major categories, good, better and best, and the business will continue to balance its offerings, its results, its communication using that foundational aspect of any good retailer.

I don't mean to suggest in saying it that way that we always get it exactly right. Obviously there are times where we execute against that better than others, but it really comes back to a strong engagement with the consumer, good thinking from a merchandising standpoint around good, better and best, and then leveraging a speed mindset and a

supply chain capability in terms of sourcing relationships and transportation and flow that allows us to make adjustments pretty quickly along those lines. That's how we think about it. Thank you.

Amie Preston

Thanks everyone. Thank you for your continuing interest in L Brands and we hope you all have a happy Thanksgiving.

Operator

This concludes today's conference call. You may now disconnect.