

# Call Participants

## EXECUTIVES

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*CEO, President & Director*

**James Francis McCann**

*Founder & Executive Chairman*

**Joseph D. Pititto**

*Senior Vice President of  
Investor Relations & Corporate  
Communications*

**William E. Shea**

*Senior VP, Treasurer & CFO*

## ANALYSTS

**Anthony Chester Lebie dzinski**

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**David Kanen**

**Eric Martin Beder**

*Brean Capital, LLC, Research  
Division*

**Jeffrey Stephen Stein**

*Northcoast Research Partners, LLC*

# Presentation

## Operator

Good day, everyone, and welcome to the 1-800-FLOWERS.COM Inc. Fiscal 2012 Quarter Results Conference Call. This call is being recorded. At this time, for opening remarks and introductions, I would like to turn the call over to the company's Vice President of Investor Relations, Joseph Pititto. Mr. Pititto, Please go ahead, sir.

## Joseph D. Pititto

*Senior Vice President of Investor Relations & Corporate Communications*

Thank you, John. Good morning and thank you all for joining us today to discuss 1-800-FLOWERS.COM's financial results for our fiscal 2012 first quarter. For those of you who have not received a copy of our press release issued earlier this morning, the release can be accessed at the Investor Relations section of our website at [1800flowers.com](http://1800flowers.com), or you can call Patty Altadonna at (516) 237-6113 to receive a copy of the release by e-mail or fax.

In terms of structure, our call today will begin with brief formal remarks and then we'll open the call to your questions. Presenting today will be Jim McCann, CEO; Chris McCann, President; and Bill Shea, CFO.

Before we begin, I need to remind everyone that a number of the statements that we will make today may be forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995. These statements involve risks and uncertainties that could cause actual results to differ materially from those expressed or implied in the applicable statements. For a detailed description of these risks and uncertainties, please refer to our press release issued this morning, as well as our SEC filings, including the company's annual report on Form 10-K and quarterly reports on Form 10-Q.

In addition, this morning, we will discuss certain supplemental financial measures that are not prepared in accordance with Generally Accepted Accounting Principles. Reconciliations of these non-GAAP financial measures to the most directly comparable GAAP measures can be found in the tables accompanying the company's press release issued earlier this morning.

The company expressly disclaims any intent or obligation to update any of the forward-looking statements made in today's call, any recordings of today's call, the press release issued earlier today or in any of its SEC filings, except as maybe otherwise stated by the company.

I'll now turn the call over to Jim McCann.

## James Francis McCann

*Founder & Executive Chairman*

Good morning, everyone. During the fiscal first quarter, we achieved solid double-digit revenue growth across all of our businesses. This reflected a continuation of the positive trends that we have been seeing since the second half of last year. This growth resulted from a positive response from our customers to our initiatives rather than from any significant improvement in the overall consumer economy.

Our Consumer Floral business continues to benefit from our merchandising initiatives that focus on our truly original products such as our tremendously successful a-DOG-ables line. These floral puppy arrangements have been tremendous hit for everyday gifting occasions, and we've recently expanded the line with a Halloween and Christmas collection.

We continue to embrace our floristness as demonstrated by our new store-within-a-store boutiques on our website featuring exclusive bonsai plants, orchids and sunflower collections. Customers are also responding to our enhanced marketing programs and messaging, both online and off. Here, our messaging encourages our customers to wow the recipients by sending only the best gifts with an emphasis on arrangements crafted and delivered by our florist, both BloomNet and 1-800-FLOWERS franchisees. These efforts are helping drive further increases in average order value, customer counts and conversion rates.

BloomNet achieved strong revenue growth for this first quarter. This was fueled by the significant increase they had in shop-to-shop order volume that we discussed with you on our last 2 calls and more than 20% growth in our expanded suite of products and services.

Gourmet Food and Gift Baskets also achieved strong revenue growth. This was driven by several factors including: e-commerce growth in our 1-800-BASKETS and Cheryl's brands; significant wholesale business growth, including chocolates and popcorn for the department store channel; and some early shipments of wholesale gift baskets for the [indiscernible] channel. And it was driven by increased store traffic and same-store sales growth in Fannie May, which recently launched its exciting, new, super premium Fannie May Artisan chocolates line.

Also during the quarter, we completed the sale of our winery services business, a nonstrategic asset. This further strengthened our balance sheet and allows us to focus our efforts on growing our winetasting.com direct to the consumer wine business.

Throughout the fiscal first quarter, we continued to execute on our programs to manage our total operating expenses, which improved 370 basis points as a percentage of total revenue. We accomplished this while we're continuing to innovate and invest for the future across a number of initiatives that we believe will drive growth going forward, including our efforts to build local presence through BloomNet and our franchising programs; our efforts in social marketing and commerce, where we are a recognized leader in the space; our programs to enhance the floral industry's supply chain, where we are deepening our relationships with growers and wholesalers alike to leverage our combined assets; at celebrations.com, where our unique party planning, content and customer engagement efforts have made the online destination this month -- made it the online destination this month for Halloween party ideas and inspiration; and in mobile commerce, where we recently launched our brand new 1-800-FLOWERS.COM mobile website, which I'll ask Chris to tell you more about later in the call.

As we've noted in the past, we believe our focus on investing in innovation for the future, even in challenging times, is essential to building future value.

I'll now turn the call over to Bill for him to review with you the financial and operating metrics for the quarter.

**William E. Shea**

*Senior VP, Treasurer & CFO*

Thank you, Jim. As indicated in the press release issued this morning, fiscal 2012 first quarter was characterized by strong revenue growth across all 3 of our business segments. While gross profit margin was impacted by product mix, including some early shipments of wholesale orders on our Gourmet Food and Gift Basket category as well as commodity and other cost increases, we continue to focus on managing cost across our business platform, which resulted in lower operating expenses as a percent of total revenue.

Regarding specific financial results and key metrics for continuing operations for the first quarter. Total net revenues for continuing operations increased 15.2% to \$117.2 million compared with \$101.7 million in the prior year period.

During the quarter, our e-commerce orders totaled \$1,212,000 compared with \$1,152,000 in the year-ago period. Average order size during the quarter increased 5.1% to \$64.99 compared with \$61.84 in the prior year period.

During the quarter we added 384,000 new customers. This was achieved while concurrently stimulating repeat orders from existing customers who represented 62% of total revenues compared with 64% in the prior year period.

Gross margin for the quarter was 39.7%, down 260 basis points compared with 42.3% in the prior period. This reflected a combination of factors including: product mix, with an increase in wholesale business in The Popcorn Factory in Fannie May as well as some early shipments of wholesale basket orders; lower

gross margins in BloomNet, reflecting the significant increase in shop-to-shop order volume growth; and higher commodity costs and shipping fuel charges.

Operating expenses before depreciation and amortization improved 300 basis points as a percent of total revenues to 42.1% compared with 45.1% in the prior year period. Total operating expenses improved 370 basis points. This improvement reflected the revenue growth in the quarter as well as our continued focus on leveraging our business platform. Importantly, our operating expense ratio improved despite the increase of approximately \$3.5 million in operating expense dollars to \$49.4 million compared with \$45.9 million in the prior year period. This increase reflected several factors including operating costs associated with the 3 small businesses we acquired over the past year, including Mrs. Beasley's and finestationery.com in the second half of fiscal 2011 and Flowerama early in the first quarter this year; increased compensation expense related to accruing for incentive compensation at a higher rate early in this year compared with lower accruals in the same period last year; and continued investments in strategic initiatives we have described to you in the past, including franchising, BloomNet and the mobile and social commerce areas.

For the quarter, depreciation and amortization was \$4.9 million compared with \$5 million in the prior year period. And as a result of these factors, EBITDA loss from continuing operations for the quarter was \$2.8 million compared with a loss of \$2.9 million in the prior year period.

Excluding the impact of stock-based compensation, EBITDA loss for the quarter improved by approximately \$500,000 to a loss of \$1.7 million compared with a loss of \$2.2 million in the prior year period.

Net loss from continuing operations was \$5.1 million or \$0.08 per share, essentially unchanged compared with the prior year period. And as announced -- as previously announced in our September 6, 2011 press release, during the fiscal first quarter, we made the strategic decision to sell our WTN winery services business for \$12 million in cash. This resulted in an after-tax gain of approximately \$4.5 million or \$0.07 per share. As a result, consolidated net loss for the quarter was \$0.01 per share compared with a net loss per share of \$0.08 in the prior year period.

In terms of category results. In our 1-800-FLOWERS.COM Consumer Floral business, during the first quarter, revenues in the category increased 12% to \$70.1 million compared with \$62.6 million in the prior year period. Excluding contributions from the acquisitions, revenues increased 8% compared with the prior year period. Gross margin for the quarter was unchanged compared with the prior year period at 38.1%, and category contribution margin increased approximately \$600,000 to \$6 million compared with \$5.4 million in the prior year period. This reflected the strong revenue growth in the quarter as well as effective management of the operating expenses. Company defines category contribution margin as earnings before interest, taxes, depreciation and amortization and before the allocation of corporate overhead expenses.

In BloomNet, revenues increased 23.7% to \$18.5 million, compared with \$15 million in the prior year period. This growth reflected significant increase in shop-to-shop order volume, as well as increased sales of wholesale products and services to florists. Gross margin was 46.1% compared with 56.6% in the prior year period. As we discussed in our past 2 quarterly calls, the decline in gross margin percent primarily reflect BloomNet's significant increase in shop-to-shop order volume as well as the wholesale product mix.

Although the shop-to-shop orders carry a lower gross margin percent, the significant increase in order volume helps drive revenues and gross margin dollar growth. The added orders also provides increased leverage for sales of our expanded suite of products -- of wholesale products and services, which grew more than 20% during the quarter.

Going forward, we anticipate BloomNet's gross margin percent will remain in the current range of 45% to 50% as we continue to grow both revenues and category contribution.

For the quarter, category contribution margin increased to \$4.6 million compared with \$4.3 million in the prior year period.

In our Gourmet Food and Gift Basket segment. Revenue increased 18.6% to \$28.6 million compared with \$24.1 million in the prior year period. This growth reflected several factors including: Fannie May retail same-store sales growth of more than 4%; solid e-commerce growth in our 1-800-BASKETS.COM and Cheryl brands; and a significant increase in wholesale business in several brands, including Fannie May, The Popcorn Factory and wholesale gift basket orders. Gross margin was 39.2% compared with 44.1%, primarily reflecting product mix due to the increase in wholesale orders and the early wholesale basket shipments, as well as commodity and fuel price increases.

Category contribution margin was a loss of \$1.9 million, essentially unchanged compared with the prior year period. In terms of corporate expenses, as I stated earlier, our category contribution margin results exclude costs associated with the company's enterprise shared services platform, which includes, among other services, IT, Human Resources, Finance, Legal and Executive. These functions operate under a centralized management platform providing support services to the entire organization.

For the fiscal first quarter, corporate expense from continuing operations, including stock-based compensation, was \$11.5 million compared with \$10.6 million in the prior year period.

Turning to our balance sheet. At the end of the first quarter, cash and investments position was approximately \$5.7 million. Our borrowings under our credit facility were approximately \$41 million in term loan debt and \$38 million outstanding under our revolving credit line. The borrowings under the credit line reflect the seasonality of our business, specifically increased investments and inventory for the upcoming holiday period.

Inventory of approximately \$82 million was in line with management's expectations and reflects the aforementioned buildup for the year-end holiday season. We anticipate that we will finish the current fiscal second quarter with significantly reduced inventories, 0 borrowings under our revolving credit line and a strong cash position.

Regarding guidance. Based on the continued uncertainty in the overall economy, we do not anticipate significant improvements in consumer demand for discretionary purchases. As such, we are reiterating the revenue guidance we provided at the start of fiscal 2011, which closed the consolidated revenue growth for the full year in the low- to mid-single-digit range. In terms of bottom-line results, we expect to grow EBITDA, EPS and free cash flow at rates in excess of our revenue growth.

In summary, as we enter our fiscal second quarter, we plan to build on the positive trends that we have seen in recent quarters, and we remain focused on seeking cost-efficient ways to stimulate consumer demand across all of our brands and businesses, improving gross profit margins and managing our operating cost by leveraging our business platform.

I will now turn the call over to our President, Chris McCann.

**Christopher G. McCann**  
*CEO, President & Director*

Thanks, Bill. So what we've seen is that the positive trends we've seen in our business since last year and the strong revenue growth we achieved this quarter illustrates the success of our initiatives to enhance our marketing and merchandising programs, particularly in our core 1-800-FLOWERS brand.

In merchandising, our product design teams are working more closely than ever with our BloomNet and 1-800-FLOWERS.COM franchise florists through our Florist Design Council and our Floriology Institute learning center. We've also invited our customers behind the curtain, so to say, through Facebook, Twitter and customer panels to help us create truly original designs that help them express themselves perfectly. This collaborative effort has resulted in hit designs such as our a-DOG-able line of irresistible arrangements in the shape of puppies in a basket dressed to fit any occasion, including our new Halloween Witchy-Pootch and Cupcake in Bloom; our new Happy Hour collection and Halloween-specific designs like the Shocktail and Witchy Sour bouquets; and our expanded collection of beautiful centerpieces designed to put you at the center of the table and family traditions for the holidays.

Our customers have responded enthusiastically to this focus, resulting in continued growth in average order value as well as improving trends in customer counts, conversion and transactions.

In terms of providing an easy way to deliver a smile, we have continued to invest and innovate in our award-winning website design and our industry-leading mobile commerce efforts. Continuing the evolution of our websites, we recently expanded our cross-brand, marketing and merchandising capabilities via our newly launched multi-branded website, which extends for our Fannie May, Cheryl's and Popcorn Factory brands.

Just in time for the holiday season, this effort builds on the success of our 1-800-BASKETS brand by further leveraging the significant web traffic and multimillion customer base of our core 1-800-FLOWERS.

In mobile commerce, we recently followed up the 2 best of the web awards that we picked up last year by launching a completely redesigned mobile site in early September. As a result, we received the best mobile site of 2011 at the E-tailing Mobile Shopping Summit just last week, beating out a number of heavyweight retailers and extending our industry leadership in this fast growing channel.

Most important, our mobile customers are voting with their gifting wallets, illustrated by the more than doubling of conversion rate on our new mobile site, with sales growing at a rate reminiscent of our early days on the web. In marketing, we further expanded our successful radio program where we recently added a nationally syndicated radio personality, Sean Hannity, joining [indiscernible] stars including Dennis Miller, Charles Osgood, and ESPN Radio's local and national personalities.

Most important, all of these efforts are backed by our caring team that is obsessed with service. This emphasis on exceptional service key permeates our entire organization, as illustrated by the overwhelmingly positive feedback we receive from our customers, our consistently rising service metrics and the growing list of industry accolades, including the recent elite ranking by STELLAService for customer satisfaction.

Overall, we believe this focus positions us well to build on the positive trends we see in our business for the remainder of fiscal '12. Jim?

**James Francis McCann**

*Founder & Executive Chairman*

Well, to wrap up, we are really pleased with our first quarter results and the positive trends in all of our businesses. At the same time, we remain cognizant of the challenges in the current environment. We plan to continue our focus on managing those aspects of our business that we can control: our operating costs, our relationship with our customers and our financial posture. While we continue to invest in the future in things like celebrations.com, 1-800-BASKETS.COM, Agile, which is our collection of technology platforms, FruitBaskets.com and our local presence through BloomNet and franchising.

We believe this focus, combined with the initiatives that we've outlined today, will enable us to create additional leverage within our business and provide long-term growth opportunities.

That concludes our formal remarks, and I'll now ask John if he would reinstruct everybody in the Q&A -- how we get to the Q&A, John?

# Question and Answer

## Operator

[Operator Instructions] And we'll take our first question coming from Eric Beder from Brean Murray.

### **Eric Martin Beder**

*Brean Capital, LLC, Research Division*

Could you talk a little bit about the franchising effort and where you're trying to take that? And in addition, what is your -- now that you've expanded the services to florists, what is kind of the main kind of product categories that they're looking for to you to add on?

### **James Francis McCann**

*Founder & Executive Chairman*

Taking the 2 pieces to that, Eric. First is franchising -- we've been a franchisor in the flower space for 15-plus years. Over the last 6 years, we haven't allowed any new franchisees into our system. But frankly, as we finish building out BloomNet, there was a suggestion from many people in our BloomNet organization that they'd like to deepen their relationship with us and move to a branded or co-branded status. Frankly, that was ignited quite a bit by the airing of the show Undercover Boss where Chris was featured, and it showed to many people in the florist community how we embrace our relationship with our florists, how we tied our success to theirs and how well the florists in that show were depicted as caring, thoughtful members of their community who are real artists and craftsmen and had a real sense of caring. So many people were impressed with how florists were depicted in that, particularly in our BloomNet ranks, but not just. Many of them petitioned us to reopen the opportunity for them to become franchisees. We view franchising as the top of our pyramid of our BloomNet relationship. So it's just another part of BloomNet, and so right now we have 3 aspects of BloomNet: we have our franchising, which is the top of pyramid; we have our premier members; and we have our general BloomNet members. So we decided on a very select basis to allow a few more shops who we knew and have good long relationships with to convert to a co-branded status benefiting from the best local brands married to the best national and international brand at 1-800-FLOWERS. So we're going at it slowly. We've just begun to let some new people in. We're very pleased with the early results and we hope in the quarters ahead to be able to give you some more color on how that's going, but again very early in that effort. The other side of franchising is in terms of our personalities on the Fannie May side. And I expect that after the Christmas holiday, we'll shine the light on how things are going. Early stages there as well, but we think that in this economic environment, the local is extremely important to us. We achieved that on the floral side with BloomNet and 1-800-FLOWERS franchise stores, and we achieved it in Fannie May with our company-owned stores and our franchising efforts. And we think it's a good opportunity for individual families and businesspeople and successful franchise organizations that already exist to partner with us to bring to their customers the best products and the best brands, and it's a good way to leverage our capabilities with theirs. So we'll put more color on the franchising in the course ahead. On the product side, what we're seeing is we're leveraging our buying power on the fresh flower side and on the product and market side. So we're introducing these terrific products that consumers are warmly embracing, like the Happy Hour collection, birthday flower cake, the a-DOG-ables collection. And then we're leveraging our buying power, Eric, to secure the supplies hard good supplies and the other supplies that they need to make those products, so that we give them the opportunity to deliver good value to the consumer at the same time leveraging our buying power to improve their margins. So most of the product sales are products related to the items that we're selling, and we're leveraging our sourcing and buying power to achieve and enhance markets for them and create a small margin opportunity for us as well.

### **Eric Martin Beder**

*Brean Capital, LLC, Research Division*

Okay. And in terms of the website, now that has got the multiple tabs on it, what are you seeing in terms of consumer behavior now that they can do Fannie May and Popcorn Factory and 1-800-FLOWERS all on the same card? How is that changing the behavior there?

**James Francis McCann**

*Founder & Executive Chairman*

Yes, well, what we're seeing, Eric, it's been a little bit of time now that we've had 1-800-BASKETS and 1-800-FLOWERS up there in that kind of co-branded fashion. And what we've spoken about previously is that we see customers buying either flowers or baskets. It's not necessarily a lot of combined product in one shopping cart. It's usually mostly in the gifting [indiscernible], single item to a single recipient. But what we have seen is a steady increase in traffic direct to the 1-800-BASKETS.COM URL, which gives us validation that it's a good way to build the brand and build brand recognition. So the same thing now. We're very early. Lots of sell outs since we've added the other tabs onto the site now, and we expect the same kind of things to happen as our customers become aware of those products, aware of the brands, aware of the recognition, and in the future, for their gifting needs, in addition to their floral gifting needs, they'll be coming back to those other brands.

**Operator**

And we'll take our next question from Jeff Stein from Northcoast Research.

**Jeffrey Stephen Stein**

*Northcoast Research Partners, LLC*

Just a question on marketing because you really don't face a great deal of competition in the September quarter, which really is kind of a non-gifting quarter in your business. But as you move in the holiday, obviously, you're going to face a lot more clutter from a marketing standpoint. And I'm wondering what some of your strategies might be to kind of cut through the clutter and to get your marketing message across to customers.

**James Francis McCann**

*Founder & Executive Chairman*

Well, thanks, Jeff, and we view this first quarter the same way. We view it as a good start to a year. It doesn't make the year, but certainly, it's a good start, so we're pleased with the trend lines we're seeing. In terms of the quarter, you're absolutely right. The second quarter is a very noisy, crowded quarter. We're competing with everybody this quarter. And I think what you'll see is that our marketing strategies that we've embraced in terms of really connecting with our customers, using all the new tools available to bring our customers outside the curtain will serve us well, particularly in the product categories that we think are best positioned to compete this quarter. That will be our 1-800-BASKETS product and, frankly, all of the products that we have in our Gourmet Food and Gift Basket category, including Cheryl's, our Fannie May product and our Popcorn Factory product. So we think we have distinct strategies for each of those brands and clearly, as they come in to our shop at 1-800-FLOWERS, being able to merchandise our store with the products that are more competitive, like our basket products, I think positions us well to shine, particularly in the category where, if you were only a florist, with only floral products, I think you'd be more challenged as these holiday periods become more competitive. I think that we have introduced over the last half a dozen years now this broader range of gift products, in particular the 1-800-BASKETS line for the holiday period positions us well. We have discreet marketing strategies against each of the brands and collectively for 1-800-FLOWERS that gives us the confidence that we'll have a good and solid quarter this year and, frankly, position us even better for the second half of the year.

**Jeffrey Stephen Stein**

*Northcoast Research Partners, LLC*

Jim, are you willing to spend any more and is your media mix going to be appreciably different this year versus last?

**James Francis McCann**



*Founder & Executive Chairman*

Well, I think that where we find opportunities, where we think we're getting the good yield, we'll be comfortable spending more money on our marketing efforts. And the mix along the trend lines will continue in the way that we've had. We see all of the appropriate channels working for us, but the mix will change as we go into the next 2 quarters. And I think you'll see evidence of that as you see us in the marketplace. But I'd rather not have specifically say where we're going to be spending in the next 2 months.

**Operator**

And we'll take our next question from David Kanen from Williams Financial Group.

**David Kanen**

First question is on the BloomNet side, revenues and -- it looks like revenues have been growing at a faster rate, you're gaining some market share. When do those revenues translate into better gross margins, if at all?

**James Francis McCann**

*Founder & Executive Chairman*

Well, I think what Bill said, and I'd ask him to chime in is we're seeing -- yes, BloomNet is doing well. Its revenues are growing nicely, our market share is growing, our share relationship is growing in what is otherwise a challenged environment. So not only are we pleased with the growth of BloomNet, but we're especially pleased with the growth of BloomNet in considering that the category of retail florists in this part really is a struggle for the broader picture. So our growth is particularly good in that light. But I think what Bill said was the outline where we expect our gross margins to be in that 45% to 50% range, so you see an increase in gross margin dollars in this quarter. And we're very happy with that because we're helping our florists improve their gross margins by leveraging our buying capacity to make more products available for them to put more smiles on the faces of customers. So Bill?

**William E. Shea**

*Senior VP, Treasurer & CFO*

I think just a few more points to what Jim said, and that is the strategy to increase our shop-to-shop orders do have lower gross margin percent, but as you mentioned, they do drive both revenue and gross margin dollars. They also -- from a competitive standpoint, they take those orders away from our competitors, so we feel good about that. But what they really do is position us to really kind of provide us with a little more leverage to sell other products and services to them. So it's kind of like BloomNet has -- we try to get across BloomNet has a new model now with a new marketing structure, still going to be strong in the contribution margins. The gross margin's are going to be down slightly for another quarter, we're going to still see that, that high growth that we've seen the last 3 quarters, but we have a new kind of margin structure. But we think it does provide lot of other baskets for us, providing leverage for incremental opportunities to sell our product and services.

**David Kanen**

So over time, you do expect as you sell more products and services to those new members in the network, in a few quarters, gross margin percentages should creep up a little bit? Is that accurate?

**William E. Shea**

*Senior VP, Treasurer & CFO*

Not really on the gross margin line. But right now, I think we're going to continue to see is some top line growth and contribution margin increases. So we want to drive incremental gross margin dollars and thus, incremental contribution margin dollars. We're not concerned about the gross margin percent. Still going to be a strong gross margin percent, but it's down off of those historical levels.

**James Francis McCann**

*Founder & Executive Chairman*

So our business, David, it's good, it's growing. It's growing in a tough environment. Our gross margin dollars are improving. Our top line is improving and, as a consequence of that, is we're helping our florists to be more successful every day while we still have a very good gross margin business and our gross margin dollar basis improving every quarter.

**David Kanen**

Okay. And what are you seeing now in terms of costs, in particular cocoa materials and fuel surcharges? Is the worst behind you, or do you still see -- should we expect those costs to continue to creep up?

**William E. Shea**

*Senior VP, Treasurer & CFO*

Yes, to be able to predict the future is difficult. But what we've seen is kind of a leveling out on the commodity side, including fuel. What we're still seeing in Q2 is some negative comps. But if things stay at the current level with respect to -- certainly with respect to fuel, we'll start comping even and maybe start getting positive at the second half of the year. From a commodity standpoint, the biggest commodity that we have is cocoa. So we're still feeling a little pain year-over-year on cocoa, but that levels out, and we think we've protected ourselves, especially as we get to the second half of the year.

**James Francis McCann**

*Founder & Executive Chairman*

And we reaffirmed our guidance, David, so that gives you an indication that this is the quarter where we have the biggest food commodity expenses, so we've already absorbed all of that, and we feel comfortable that our margins are still improving despite the fact that we've had to absorb some of those increases, but we actually -- we know what they are for the bulk of our business, our food side, because this is our big food gift quarter.

**David Kanen**

Okay. And then in the press release that you put out, there's sort of a cautionary tone in regards to guidance or the economy. Now is that just based on the macro view, what you're seeing in the U.S. economy, or is it something specific to your own business? Because this is the second time you've done it. And last quarter, I mean, revenues were up 15% year-over-year, but yet there was a very cautionary tone. So I just want to get a little more color on that.

**James Francis McCann**

*Founder & Executive Chairman*

I think it's a direct outgrowth of the Greek debt crisis that we're commenting on. It's funny that here we are, a floral and gift shop, and we're having to view commodity prices across the world and be sensitive to the machinations and the financial climate across Europe and the U.S. So I think you're correct in your first guess there that this is just our take on the consumer environment, particularly in North America where our primary business is. That is, when you still have 9-plus-percent unemployment, and you still have housing underwater and you still have unemployment, construction starts where they are, we're looking at the macro environment, it's like, we're so pleased with how we're doing especially in this kind of environment, but we can't help but be cautious about the macro environment. And as we've said many times, let's work on the things that we can control ourselves: our cost, our balance sheet, our investments for the future, going after margin dollars and incremental customer acquisitions where we can cost-effectively do that. So let's be cautious, let's keep our ears out for any changes in the environment, but let's be deliberate about the things we can control and be creative in how we develop growth in what is otherwise a growthless environment. So yes, it suggests an overall macro concern, and clearly, we're quite bullish on our abilities to both control costs and invest for the future, at the same time we're growing our business and improving our margins.

**David Kanen**

Okay. And last question is I view you guys as a gift-giving company. So if there are creative products and/or services that you could plug in to your distribution network, you can get significant leverage off of that. Is there anything new, any new products and/or services that you can plug in that you're excited about? Anything that you can talk about? I could understand for competitive reasons maybe you wouldn't, but anything out there you can share with us?

**James Francis McCann**

*Founder & Executive Chairman*

I think you're viewing our business in the right way. We're a flower and gift shop, so clearly, it's all about gifting, but not just. I think recently, it's not just, but primarily, it still is a gifting business or a florist and gift shop that we are. We've been delivering over the last 6 or 7 years of introducing into that shop the appropriate brands that our customers tell us that they're interested in, others that we anticipate they'll be interested in like the basket business. So the 1-800-BASKETS is the thing that we're most excited about as a new entrant, less than 24 months in existence now, capitalizing on the track that the 1-800-FLOWERS site generates, the share-a-wallet opportunities that we have with our consumers who told us they we're buying baskets elsewhere before we introduced 1-800-BASKETS as a new enhanced product category. So yes, that's the one we're most excited about. And the only other one I'll put a light on today is in its very early stages, and that's the fruitbouquets.com business that we're just in the process of starting to introduce. It's a big business. It's a business that we've been tangentially involved in for all of the 35 years that we've been in business, something that I literally made myself 35 years ago. But clearly, we see from our customers, over the last year, our customers telling us they'd like us to be in that business. They'd like to have a branded company that they know and trust that they already transact with provide that product. There are lots of issues in terms of getting it rolled out into the marketplace, so we mentioned in the last call for the first time that fruitbouquets will be an important part of our business going forward. We're being slow and deliberate about it and working with our BloomNet florists and our -- in particular, our franchisees to develop that capability on a local basis across the country, and that is one I'd expect in the next several quarters and as we reach next summer, frankly, to be shouting about because I think it's a big -- can become a very good and big business for us. But it does exactly what you said, David. It leverages off of BloomNet network. It leverages off our franchise network, it leverages off our franchise networks. It leverages off our capabilities and our relationship with tens of millions of customers, who, by the way, told us, "Hey, guys, I can't believe you don't already provide this product." So that's one, in addition to 1-800-BASKETS, that we're keenly excited about and, hopefully in the quarters and years ahead, becomes a very big business for us.

**Operator**

We'll take our next question from Anthony Lebie dzinski from Sidoti & Company.

**Anthony Chester Lebie dzinski**

*Sidoti & Company, LLC*

My first question is on BloomNet. You talked about the expanded suite of BloomNet products. I was just wondering if you could further discuss that? And also wondering about the point of sales systems that I know you have -- your florists are using some of your point of sale systems, so just wondering about the potential going forward as I think -- I would imagine a lot of florists use still some older technology. Just wondering about the opportunity for them to upgrade into your point-of-sale systems and any other products that you offer?

**James Francis McCann**

*Founder & Executive Chairman*

Sure. Anthony, I'll let Chris talk about the product changes. I'll just touch quickly on the technology side. On the technology side, what we're doing in BloomNet is what we're trying to do elsewhere. We're leveraging things that we already do to benefit our florists. So if we have technology and capabilities that we can retool and reengineer so that its available to our florists to help them manage their shops better, help them to manage their communications with their florists, help them to have access to the products that we already have available to our customers so it's available to their customers on a local basis, it

behooves us to lever that capability. And so that's what we've been doing. And the technology services that we've introduced over the last year are well received and our florists are really benefiting from that leverage. As concerns the product side of it, I'll ask Chris to pick up that question for you.

**Christopher G. McCann**  
*CEO, President & Director*

Yes, I think, I mean, what we're saying really is -- what we've been saying for a while is that it's a slow-steady increase of penetration of -- and sale our products and services stuff [indiscernible]. We're seeing that come to fruition. We'll continue to continue to increase our penetration of the Napco product line and our glass product line into the florists, Yankee Candle, gift baskets down to the florist line, different print capabilities we've brought to the table. So it's a continuation of just working with our florists, what are the products that they need to run their shop and how can we play a role in providing a better buying opportunity for them, and we're seeing our florists embrace that.

**James Francis McCann**  
*Founder & Executive Chairman*

Chris, I think what the other area is -- and I want to touch on for Anthony is when we say embracing our florists, there are a couple of categories that are essential to florists and have not ever received a big marketing push, and we're starting to put a marketing push on those 2 categories, particularly because they benefit our retail floral partners in BloomNet and then our franchising network, and that's the sympathy category and the wedding category. And the wedding category is one where there are a lot of products that we can put into the pipeline that help them to make better products for their consumers, have better selection to make them much more competitive in their own local markets to be a better wedding vendor for their specific community. So that's the area where we're putting some attention, both on the sympathy product side and on the wedding product side where we're creating great product assortments, leveraging our buying power and our relationship with vendors to bring more and more products to them to help them to be better florists in their own community and get their fair share of the sympathy business, which is extremely important to florists, and the wedding category, which is still a growing category where our florists see competition not just from other florists but from supermarkets and wedding planners and all other kinds of people. So we're helping from a branding point of view and from a product point of view to help them to be more competitive in those 2 important areas to help them and help us embrace our floristness.

**Anthony Chester Lebiedzinski**  
*Sidoti & Company, LLC*

Okay. And also as far as BloomNet, the gross margin decline, I know you talked about the mix shift. Just wondering, when you look at that segment, which one had a bigger impact, the shop-to-shop order volume increasing or was it the increased wholesale business in that segment?

**Christopher G. McCann**  
*CEO, President & Director*

Anthony, really, it comes from both.

**Anthony Chester Lebiedzinski**  
*Sidoti & Company, LLC*

Okay. All right. And as far as the Gourmet Food -- Gift Basket business, you talked about early shipment of some wholesale gift basket orders to your customers. Can you give us an idea how much impact that was?

**James Francis McCann**  
*Founder & Executive Chairman*

Well, adjusting for the -- merging the 2 quarters, our wholesale business in the chocolate area and the popcorn area, in particular, have really had a strong quarter here. So we're excited about that, and we're excited about the trend line. There is a difference, though, on the basket side. So we have 1-800-BASKETS, which is our direct-to-the-consumer business, and we have design package, which our

wholesale business. Design package has been struggling in the wholesale business. So you can have 2 effects here between the first quarter and the second quarter. One is the wholesale sale of baskets to the big box retailers is still going to be down this year over last year. And two, the fact that some of those customers ask for early shipments, so that will have a two-pronged effect on the basket wholesale business between the first and the second quarter. The wholesale business from our other food gift products is, frankly, going very, very well. So that will continue through this second quarter. The other thing I'd add, though, is even though the wholesale business in the basket area is not going where we like, we think we have fixes in place that will turn our business around and start to grow it again. That won't be seen until next year. We're in that -- we're just starting that sales process now for next year. So we're hopeful and expectant that the wholesale basket business, which has suffered for the last couple of years, will improve next year, and we hope to be able to report that great results against that -- those efforts this time next year. And we're in that process now. But the better news is that the direct-to-the-consumer piece where we have much more control is going very nicely. And we actually think that, that will have a bearing on the wholesale business as we share that data with the merchants and retailers who are the customers of our wholesale product. When they see the success we're having with these products for the consumers, I think that will give them the initiative and the confidence to order those products on a wholesale basis because we have demonstratable evidence that our customers are embracing this product and really accepting and our sell-throughs are terrific. So that's a long answer to the wholesale piece, but -- the gift food business doing well, the basket business on the wholesale struggling and the basket business on the direct-to-the-consumer side doing very well.

**Operator**

This does end our Q&A session for today. I'd like to turn the conference back to your host for any concluding remarks.

**James Francis McCann**

*Founder & Executive Chairman*

Well, thank you for your questions and your interest. And if you have any additional questions, please contact us. As a programming note, I just mentioned that in embracing our floristness, it behooves us to do things that are beneficial for our retail floral partners in BloomNet and in franchising. And we mentioned sympathy and wedding. And wedding is an important category, and to help build our brand which benefits our florists, we have a new initiative called -- a new TV initiative called I Do Over, a TV show that's launching Sunday, November 13, at 10 p.m. on the WE network. And I encourage you to tune in to see what our florists can do to really make a wedding something extraordinary over the top. So to help our florists, to help our brand to be positioned well to participate more aggressively in the wedding category, we've created this TV show called I Do Over in partnership with Rainbow Media. And you'll see the evidence of that November 13 at 10:00 at night. I hope you tune in to the WE network. Thanks for your time and attention today and look forward to helping you with any of your last-minute Halloween needs as it's just this weekend. Thanks.

**Operator**

Ladies and gentlemen, this does conclude your conference. You may now disconnect and have a great day.