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LB.N - L Brands Inc Virtual Investor Meeting for Victoria's Secret & Co.

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PRESENTATION

Jason Ware

Good afternoon, everyone, and welcome to Victoria's Secret & Co's 2021 Investor Day. I'm Jason Ware, Vice President of Investor Relations, and I'd like to thank all of you for joining us today. We are excited to be here for the first time at VS&Co as we embark on our journey as a new independent public company. The go-forward, VS&Co will include our 3 lines of business: Victoria's Secret Lingerie, PINK and Victoria's Secret Beauty. We believe that this spin-off will enable the company to maximize management focus and financial flexibility to thrive in the evolving retail environment and deliver profitable growth for all shareholders. Before we get started, I want to remind everyone that any forward-looking statements we may make today are subject to the safe harbor statement found in our SEC filings. After our presentation, we will conduct a question-and-answer session. We will not be commenting on third or fourth quarter guidance today as our earnings call is coming up in a few weeks.

Thanks. And with that, it's my pleasure to turn things over to Martin Waters, CEO of VS&Co.

Martin P. Waters - *L Brands, Inc. - CEO of Victoria's Secret Business*

Hello, everybody, and welcome to our inaugural meeting of Victoria's Secret and Co, our first public meeting. Thank you for joining us. I'm joined this morning by Amy Hauk, the CEO of PINK; by Greg Unis, the CEO of Victoria's Secret Beauty. We have Tim Johnson, our CFO; and Brad Kramer, our Executive Vice President of Finance, joining us, and you'll hear from all of them today.

By way of agenda, we have -- First of all, I'm going to start with a company overview and give you some headlines about how the company looks right now. And then we'll tell you about each of the 3 lines of business, beginning with me talking about lingerie and then we'll hand over to Amy, and then we'll hear from Greg. And then I want to cut the business in a different way and talk about the 3 channels of distribution. We'll start with digital, then we'll talk about North America, and then I'll talk a little bit about the stores before handing off to TJ and to Brad. So that's the format for today. I hope that works for everybody. I thought a good place to start the presentation would be to focus on the transformation that we have at Victoria's Secret.

And it begins with the admission that we got it wrong that we lost relevance with the modern woman, and she told us very clearly to change our focus from how people look, to how people feel, from being about what he wants to being about what she wants and to support her in her narrative, in whatever way that she chooses. So to win her back, we'll celebrate and inspire her, and we'll support her desire to show up however it is that she chooses. So following up from that, we've redefined the vision and the purpose and the mission of the company. And our vision is pretty ambitious. It is to be the world's leading advocate for women. And that's about creating lifelong relationships with women reflecting their journey and their community and creating positive change for the world through the power of our platform and through our products and our services. And in doing so, our purpose is to uplift and to champion women.

So when thinking about where we are as a company, I'd like to talk about 3 phases in our journey. And I'll take you back in time to the year 2009 to 2015, which I refer to as the growth years when the company was growing extremely quickly, very profitably and everything was working really, really well. And then rather politely, I call the period 2016 to 2019, our execution missteps. And those 3 -- those missteps for me are in 4 buckets. The first bucket is around losing closeness to the customer. Some wrong product, some missteps in fashion. The second bucket is around acknowledging an underinvestment in digital and an overinvestment in stores, stores that were too large, that were too expensive to build. The third bucket in that missteps era is about a series of management changes that were frankly destabilizing for the company.

And then the fourth and final area of our missteps was around the inactivity related to brand repositioning that frankly made us show up in a way that was tone-deaf and culturally inappropriate. So our job now is to rebuild the foundation, go back to the fundamentals, and that's where we start right now. And I'll tell you how I intend to lead us through that process. Firstly, it's about activating Victoria's Secret around 4 key pillars of the brand: The first is the Brand Revolution, that's how we show up in terms of imagery and branding. The second, which you may have read about in the last 10 days or so, is about the VS Collective and the announcement of us convening a body of women who will help us to become more culturally relevant. The third is the continuation of where this brand has been historically, which is about creating an entertainment platform.

I think we have a better opportunity than anybody in specialty retail to create entertaining content for her. And the fourth is around aggregation, the notion of using other people's content in addition to our own in a way that's complementary to our brand, and I'll explain a little bit more about that later in the presentation. Let me say more about the first 2, the brand revolution. When we announced the Victoria's Secret Collective, a lot of people asked me, "Oh, great, so when can we expect you to start showing up in a different way?" The answer is, we have been doing for 8 months. We started the revolution in terms of our imagery back in January with the preamble to Valentine's Day, then with the swim launch, with all of our spring merchandising, and then perhaps the epitome of it all was in Mother's Day where for the first time in our history, to my knowledge, we celebrated Mother's Day with Grace Elizabeth showing on the cover of Vogue as a pregnant woman.

So the revolution in terms of our imagery is very much on way and in flight. And we know that it's working. How do we know it's working? Well, from the way that social media is responding to us and the way that the consumer is responding to our stores and our digital channels. To say a little bit about the VS Collective, the idea here is to work with a body of women from different walks of life and different experiences who bring different strengths to help us to reposition the brand to change the narrative, to use the power of their platforms, to inform the world about a new Victoria's Secret that shows up in a very different way than we have done historically. And whether that be through using women who are active in sports or in politics or in any aspect of life. Take for example, Stella McCartney helping us with positioning ourselves in breast cancer awareness. These women can show for us in far more advanced ways than we've used historically.

So let me turn now and shift gears and talk a little bit about the overarching perspectives for why it's a good idea to be invested in Victoria's Secret? Why we think this is a great company? And I have a 7-sentence elevator speech that I like to use to define why I think this is a great company. And it starts with the fact that we have 2 category-defining brands with global awareness and very high satisfaction ratings. We have a growing digital business, and we have a right-sized stores business that gives us great credibility with our customers and the opportunity to connect in an omnichannel environment. We have a world-class supply chain supporting us, and we have a management team that has a track record of delivering on a profit improvement plan that's very much on track led by a talented management team, who I'll introduce you to today.

So those are the 7 bullet points on my prospectus and I'll tell you a little bit about each of them in a minute. But before I do, let me dimension the company in numbers. And all of the numbers that are on the chart here are consistent with what we shared in the Form 10 document and they're also consistent with what we announced at the end of Q1 2021. So let me cover those, then I'll say a bit more about where we are in the timeline. So at that point in time, the end of Q1 2021, we were a $6.1 billion company with $919 million in EBITDA with about 43% of that coming from digital penetration in our North American business. And this is a business that's supported by 700 million website visits per year, by 77 million Instagram followers and an active base of customers of 27 million people in North America. And of course, our story is global, not just domestic, with a physical presence in 70-plus countries and shipping to over 200 countries around the world.

So that's the business by the numbers. I mentioned that, that's good to the end of Q1 2021. Well, you know that last week, we announced our June figures. And as part of those June figures, we gave a forecast for how we expect Q2 to end up. So the end of Q2 is 2 weeks away. And we announced last week that sales would be about $500 million greater in Q2 of 2021 than they were in Q2 2021 -- of '20. And more importantly, we would be throwing off about $285 million more operating income than we were a year ago. So I think -- I hope that you can use this slide to advance what our trailing 12-month numbers would look like and will look like when we announce them, in the middle of August. So very strong Q2 to date, and we forecast, we estimate about $285 million worth of incremental operating income.

Okay. Let's turn now to some validation points on the 7 sentences in my perspectives. First, I said, that we're in good categories. And I say that because the lingerie business globally is about -- pre-COVID about $120 billion, been growing at 3% per year and is forecast to grow even faster than that. The global loungewear and apparel market, more than double that size, also growing at 4% historically and forecast to grow at 2x that rate going into the future. So we are in good categories. And we have a very strong position in those categories, evidenced by this slide, which on the Y-axis shows our awareness and on the X-axis shows our Net Promoter Score. And you see that both Victoria's Secret and PINK have really, really strong positions in the far right-hand corner of those charts.

Let's take a look now at our customer base. I mentioned earlier, 27 million customers in our file. We have 6.2 million users of our app and 5.5 additional users of the PINK Nation app. And something we don't talk about very often within our credit card base, the Angel credit card, we have 6.3 million active users. So very strong statistics supporting this business. We also have a growing digital business that's very strong across all 3 lines of business. So you see on the top of the chart to the right-hand side, our digital sales growth over time from 2018, but also the penetration change to a very healthy position of between 40% and 50% depending on which business we're talking about. And Greg will come on to talk about even in Beauty, which historically is a difficult category, to penetrate in digital, we've seen exponential growth in the last year or so.

We also, as I mentioned, have a very strong base of physical stores that we're incredibly proud of. I'm going to tell you more about this later in the afternoon. But for now, let me hit the headlines, which are of the 867 stores that we have, 94% are cash flow positive. And on average, they are turning up $900,000 worth of profit from each of those stores. And we have agility in this part of our business. In that, I'm happy to say that the average lease remaining is just 3.8 years. So to the extent that 867 needs to be a different number, we have agility, more about that later on.

And then our business is, of course, supported by a very agile supply chain. I think over the best years of L Brands, you've come to know that we have an impressive track record of being able to move merchandise around the world in direct response to consumer demand. And those long-term supplier relationships have endured the COVID crisis and are even stronger than they ever were, a very diverse base of supplier relationships that give us flexibility in terms of our ability to deliver. We also during COVID were able to adapt our supply chain to move out -- move merchandise out of the store channel and into the digital channel. And that told us a lot about agility and speed going forward.

And then there's our progress against the profit improvement plan where we're on track to deliver annual savings of $300 million, and that's a combination of the savings from reorganizing our corporate office, but also from margin rate enhancement and improvements that we've made at store profitability as well. I also like to -- today we'll tell you a bit about international and two very significant improvements we've made to the overarching profitability of the business. And then finally, I mentioned the compelling management team. And this is my top team, which includes a very diverse management population that has between us over 120 years of L Brands experience. So some really good legacy talent, but also 3 new players coming to the table in Tim Johnson, our CFO; Laura Miller, leading HR and; Mel McAfee, as our Global Chief Legal Officer.

So a very good mix of experience and new talent coming to the organization, supported and guided by a brand new Board that includes 2 members of the L Brands Board in Donna James and Anne Sheehan, who rolled over from L Brands onto the VS&Co Board. And then 4 new women joining our Board, who bring us a great approach to governance, but also a terrific exposure to using their business experience in ways that are relevant to our categories. So that's the overarching tier for the company, as we know it. I'd now like to give you a deeper dive look at how the 3 lines of business perform. And I think we're going to share with you a deeper level of reveal than you've seen from us historically. I believe in transparency. I think it's important that you, and following our company, know as much as is possible about the way that we're running the business. So I'll tell you about lingerie and then I'll hand over to Amy to talk about PINK.

So I have about 10 slides or so that dimensioned how the lingerie business is looking. And of course, it's the #1 intimate brand in North America and the best-known intimate brand in the world. At the time of the end of Q1 2021, you'll hear that a lot, at the end of Q1 2021, we were $2.7 billion in size, and that's about half of the VS&Co business. And about half of our lingerie business is coming from digital. And that's spread across the 6 core categories of bras, panties, lounge, sleep, swimwear and sport. And the way in which we're approaching the rebuild of the lingerie business is around 4 key pillars: The first is elevating our assortment architecture; it's then about enhancing our customer experience; it's also about brand repositioning, which I talked about earlier; and then finally, simplifying the operating model. And I have a slide on each of these to share with you to give you a bit more information about how we intend to do that.

So let's think about an elevated assortment architecture. In my mind, that's about reintroducing and reinforcing and being disciplined about the idea of good, better, best principles and being clear about what role every aspect of merchandise will do for us. It's also about a shift towards storytelling, more storytelling rather than product-specific depth. It's also about a reduction in SKU count in order to drive more depth around the best-selling SKUs. And that shows up in some of our smaller stores where we've just not been able to offer the breadth of fashion that, that customer has been looking forward -- looking for from us. And then finally, it's about extending merchandise categories, not contracting merchandise categories, extending merchandise categories, particularly in a digital environment.

So second is about enhancing the customer experience. And I think about this in 2 ways: firstly, our stores, and that's about having the best profit experience in the world. But secondly, about digital, whereas I'll come on to talk about later on in my presentation, how we're enhancing our capability in the digital channel with a digital channel -- digital-first mentality. But importantly, it's about bringing those 2 channels together in an omnichannel experience, which I think we are better positioned than anybody else in our market, anybody else in our competitor set to execute against. The third of the 4 areas where we're gaining ground is about repositioning the brand. I talked a bit about this earlier, inclusive communication and branding to strengthen customer loyalty, really building on the emotional connection that we have with customers in a relevant and modern way. And the 2 words that I would keep coming back to when we talk about the brand positioning is cultural relevance.

And then finally, least important from the customer's point of view, but very important from a management's point of view, is rebuilding the operating model for speed and simplicity. That means getting back to our best in terms of fast cyclical launches. It means investing in merchandise at about 50% of the season at the start of the season, and then using our agility in the supply chain to chase like crazy. It's about reducing the number of weeks forward cover. It's about reducing our assortment in order to drive faster turns and focusing on superior talent and execution at store level. So you should expect to hear us talk increasingly about how we will simplify the business model going forward.

And then as my last slide before I show you a video on our lingerie business, I want to talk about where we think growth might come from. And honestly, I could talk for an hour just about this slide. There are so many growth opportunities and initiatives within the lingerie part of our business. The most important of which is growth from the core. Our biggest and most important category is bras. When this business was at its best, we had at least 2 bra launches per year. We haven't been doing that during those years of execution missteps. We will get back to launching new bra frames on a very regular basis. And that's the single biggest opportunity for us to regain share and to grow. In addition to that, there's this idea of aggregation that I talked about earlier. And I think about it in 3 ways: one, working with brands that get us to access customer groups where we're currently underway; secondly, working with brands to get to product opportunities or categories where we're currently underway; and thirdly, using aggregation to get brands that just help us with a halo that help the overarching positioning of Victoria.

In addition to that, we reentered the swim business. It will be at least $100 million in year 1 and has plenty of growth opportunity. There's size expansion, both in-store but particularly online. There's maternity, a business that we've not previously been in because in defining the business as being solely about sexy, maternity wasn't appropriate. When we define the business being about advocacy for women, of course, maternity is an important part of the business. And then there's shapewear, where we have a very exciting collaboration activity on way and a smaller opportunity.

But an important opportunity from a positioning point of view is bridal and that's about supporting women in every aspect of their journey through life.

So that's all for me on lingerie. I do just want to play a short video for you that sums up how we think about this repositioning and how you should expect us to go to market. And then I'll ask Amy to come up and talk to us about PINK. Thank you.

(presentation)

Amy Hauk - *L Brands, Inc. - CEO of Victoria's Secret Pink*

Thanks, Martin. I'm really thrilled to be here today to provide more color on the PINK brand, our core customer and the opportunities go forward. But first, a little bit -- just a little bit about me, Amy Hauk. This September will be 13 years with L Brands, the first 10 with Bath & Body Works, and the last 3 with PINK. So before we get started, though, I wanted to do a little context setting by showing you a video of some of our spring campaigns, partnerships, and positioning, focusing on our Gen Z customer. Hopefully, this makes the evolution of PINK crystal clear.

(presentation)

Amy Hauk - *L Brands, Inc. - CEO of Victoria's Secret Pink*

Okay. So every time I see that video, I just smile. And everything we do at PINK focuses on empowering and supporting young adults led by our values of people, purpose and planet. More on this later as these 3 guideposts are so critically important in telling the brand story of PINK. With the #1 Intimates Mindshare and 95% brand awareness with 18- to 22-year-old customer, we are a brand that resonates and leads in our categories of expertise. While that feels really good, we know that this is a continuous journey and to maintain relevance with the Gen-Z customer, we must see them as our best friend. Other data points are that we represent over 1/3 of total North American sales in Q1 with a rolling 12 represents -- digital represents approximately 40% of our sales. I think it's a really important though to note here that digital as a percent of total is moderating due to the reopening of stores and increased traffic.

So let's talk about PINK key pillars. There are 4 that guide our PINK strategy. And they are: one, standing for our brand values of people, purpose and planet; two, leveraging stores in digital; three, constantly mining for next around innovation and whitespace; and adhering to our retail disciplines, part of the secret sauce at L Brands. So people, purpose and planning. When we speak about the 3 Ps at PINK, we are about -- we are focused on promoting diversity, equity and inclusion with both our external and internal customers. At PINK, they are really one and the same. When we talk with them and listen to them, they tell us that brands that are engaged are brands that care about investing in tomorrow's leaders, the health and wellness of our planet and having a purpose beyond the products we sell. Really important to note is that Gen-Z is the most diverse generation, 46% of them identifying as race other than white, and 60% of them believe that gender is a spectrum, which you see reflected in our marketing and social media platforms.

Their core values are femininity as empowerment, vulnerability as a strength, elevated self-care, pragmatic priorities and really accessible activism. So PINK also supports mental health awareness through its JED Foundation partnership and empowers others through the PINK with purpose project contest, which has awarded over $800,000 to 45 winners in support of initiatives that encompass community, sustainability and support mental health. As far as the planet goes, we are setting the goal of 80% of our product being sustainably sourced by 2023. And so I mentioned product, but this also concerns thinking about our store refixturing, thinking about recycled mannequins, our shoppers, tissue paper upon request, polybags being recycled and recyclable as well as in-store signage and more. We are proud of the steps that we have taken to support our broader community. And that this is the beginning.

This is a journey, and we know that we still have much to do and accomplish. As we move forward, we will continue to help our customers experience healthy lives, foster positive mental health and create customers, create products -- sorry about that, that our customers can feel good about. I do feel good about our customers as well though. So our second pillar. This is really about leveraging stores and digital. PINK has a revitalized platform for growth, and as mentioned earlier, is maniacally focused on that Gen-Z customer. So some interesting facts to note that are on the slide are

Instagram is about 8x industry average. And so far, that's engagement. And so far in 2021, we have had 9 billion total campaign views on TikTok. Fascinating. Most exciting is the planned relaunch of our PINK Nation app as we continue to evolve programs and its benefits, a huge driver of sales and engagement that really needs a reboot.

And before I go to the next slide, I just want to add, we have industry high productivity in our stores, and we are planning to continue to grow that going forward. So when I talk about our third pillar, that's really about delivering on innovation. In order to remain relevant, we must continue to innovate and explore new spaces. This is critical component of maintaining the life cycle of a brand and relevance with the customer. Some of that looks like a continual reimagining of our intimates categories, whether that has to do with sustainability, alpha sizing, better technology, as for example, in our Period Panty launch this past spring. Also using speed to pivot and chase into what's working and adapt to a constantly changing environment. That is also really innovating in a brave new world. That's for sure.

So fourth and final pillar, adhering to our retail disciplines, which means continued focus, rigor and discipline on everything we do at PINK and most significantly accountability for delivering results. This is the PINK mantra that we live and breathe as a team every day. So what does that really mean for us? We have simplified and streamlined processes, edited the assortment in PINK by over 30% in order to stand for key business drivers and increase productivity as well as to drive share, an important part of our strategy. And we've integrated a robust test-and-learn agenda we must constantly be mining for next. PINK believes that these principles allow us to stay relevant and consistently deliver the solid results I mentioned earlier.

So this is my last slide before I close with a video, and I love this one because it really focuses on our growth initiatives for 2021 and beyond. I know I spoke about the innovation pipeline earlier, but there are some category highlights that I am really excited about and would like to share. So Logo, when she buys and wears your logo, that is a really good thing. And I'm happy to state that it is our #1 franchise. Size expansion, diversity, equity and inclusion. XXL on digital this fall. We introduced XL in 2020. 38 brands have been on digital. They launched Wear Everywhere franchise this fall. And then the Period Panty, really a category disruptor and innovative, and we couldn't be more thrilled. We launched it initially in spring. We've been chasing the extra inventory, and this fall, we're making a bigger splash than ever.

And then lounge, I wanted to mention this because gender is a spectrum at PINK. And as you saw in the video, and as you'll see in the upcoming video, we now fit much of our product in men as well and we are seeing more and more of them come in and engage with the PINK brand, which we think is incredibly exciting and empowering. And then last but certainly not least is the reintroduction of swim and PINK's innovation around gym to swim in 2019. We know that this customer is incredibly valuable and halos quite largely.

So with that being said, I would love to close with one of our back-to-campus videos. You guys are the first to see this, and this is PINK.

(presentation)

Amy Hauk - *L Brands, Inc. - CEO of Victoria's Secret Pink*

Back to normal. I can't wait either. So I will now turn it over to Greg, but I want to thank you all so very much for your time and interest in PINK.

Greg, take it away.

Greg Unis - *L Brands, Inc. - CEO of Victoria’s Secret Beauty*

Thanks, Amy. Let's move into our third line of business: Beauty. Victoria's Secret Beauty is an established and proven market leader with exciting growth potential. I've been leading the VS Beauty business for the last 5 years, so I know it well. I love starting on this page because it says it all. As you can see, we're a clear leader in the fragrance market with strong brand loyalty. We're officially America's #1 fragrance brand, and Bombshell is America's #1 fragrance, selling more units than any other fragrance in America. We have this unique business model as the leading direct-to-consumer fine fragrance brand, which sets us apart from our competitors who primarily operate within a wholesale framework.

VS Beauty comprises about 15% of total North America VS&Co sales and reported nearly $1 billion in sales over the last 12 months. We're truly an omnibusiness with a solid store base and a robust digital business. And we have a highly engaged customer who are among the most loyal in the shop. I'll talk about this more later, but to top it off, we've developed a unique supply chain that we control from start to finish, which gives us incredible speed and agility to drive our business.

Let's turn to our 4 key pillars of VS Beauty. This slide gives you a good overview of our playbook. We lead the market with clear competitive advantages which are amplified by our integration into the broader VS and PINK brands and the great thing is, we have room to grow even further. As I've mentioned, we're a leader in the fragrance market by a long stretch. To quantify that, as the #1 fine fragrance brand, we sell about 25% more units annually than the #2 brand. In fact, based on revenue, we have 6 of the top 30 fragrances in the U.S. across our sub-brands like Bombshell and Tease. And while VS accounts for nearly 10% of the $4.5 billion U.S. fine fragrance market, there's plenty of opportunity for us to capture more of the market and continue to grow. So what sets us apart? First, we're driving our business from a place of strength and scale. We have the unique positioning as the leading D2C fragrance brand in America, which enables us to wholly own and deliver emotional brand content from concept to customer without relying on a wholesale partner.

Second, we have a balanced assortment with clear, good, better and best segments and proven best sellers. Our good is our opening price point Mist business, which has both a loyal following and attracts the most new customers. Our better is our mid-priced emerging Body Care line, which is proving to be an incremental growth business. And our best is our Fine Fragrance business, which is the jewel in our crown. Lastly, we're able to do all of this with incredible speed and agility as we have the advantage of owning our supply chain with strategic partners who are physically in close proximity to each other in what we refer to as the Beauty Park in the central Ohio area. The third dimension is our integration into both the broader Victoria's Secret and PINK brands. We know that when she mixes across category and adds beauty into her basket, she spends more money with us, visits more frequently and is more loyal than lingerie and PINK-only shoppers and that phenomenon happens in both our stores and on our digital site.

The great thing is that we still have room to grow. The 3 ways we think about future growth are: first, through extensions to our core fragrance business within the VS brand, expanding the portfolio and going after complementary adjacencies; next is expanding into new categories like home fragrance that build on our market leadership position; and the biggest growth prospect is accelerating growth within the PINK brand. Let's talk about the PINK Beauty opportunity a bit more. For context, in 2018, we reset PINK Beauty, which was a very small part of the total Beauty business. While Victoria's Secret is positioned at -- as best at fragrance, PINK Beauty has complementary positioning as best at body care. In very short time, we've created best sellers with things like coco lotion, honey scrub and other efficacious body care items that drive a concentrated part of the business.

PINK Beauty has an incredible opportunity to grow into the Body Care leader for Gen-Z, and we're just at the beginning of unlocking even more significant growth. So in the immediate future, we're feeling good. We have nice chunks of future incremental growth that we're striving for, building on our place of strength in fragrance. As I mentioned, we're in the process of building out a home fragrance business. We see accelerated growth in our VS Body Care business. And lastly, we see PINK Beauty as a significant growth driver.

Now let's take a closer look at a couple of recent launch videos for our Bombshell and Tease campaigns.

(presentation)

Greg Unis - *L Brands, Inc. - CEO of Victoria's Secret Beauty*

I'll hand it back over to Martin to discuss our channels in more detail. Thank you so much for your time today.

Martin P. Waters - *L Brands, Inc. - CEO of Victoria's Secret Business*

Great. Thanks, Greg. That was terrific. Thank you, Amy also. So I said it earlier in the presentation that we want to give you as much of a reveal about VS&Co as we possibly can. So I want to do a deep-dive into each of the 3 channels of distribution that support the business. And we're deliberately starting with digital as we're moving to a digital-first mentality. There are 3 distinct areas of the business, as you know. Digital represents now nearly 40% of North American business. Our North American stores represent 53% of the business. And international, 7% of the business. Significant decline due to COVID, but also remember this is recognized revenue rather than retail sales, and I'll explain more about that in a moment. But 3 powerful channels, all well-positioned for growth.

So let's start with digital. Just a few fun facts about our digital business. At peak, later this year, this business will be delivering 2,000 orders per minute. We will throw up 150 million units a year. We'll process 33 million different parcels. This is a business at absolute scale. And it's a business that has been underinvested in over time and is now positioned to gain the benefits of those years of investment. So let's look at the growth that we've seen over the last few years. So building from a position of $1.7 billion to $2.4 billion. And as I said earlier, the penetration moving from the low 20s to the low 40s, the most critical part to know though is about the $400 million worth of investment that are now behind us. And that investment has been in both the front end, meaning the user experience and replatforming the entire business, but it's also been in creating state-of-the-art distribution centers supported by robotics that enable us to fulfill faster and more efficiently than we have done previously.

But I think the real opportunity for this business is having an omnichannel focus. We know that digitally native competitors would kill for the opportunity to have 800 points of distribution around North America as we have. And we also now are only just beginning to unlock the benefits of AI-driven commerce and that opens up an enormous area of opportunity for us. So just to dimension the extent to which this marketing engine is supported by customer engagement, so 77 million Instagram followers, 45 million people on Facebook. And our apps are very well populated, as I mentioned earlier. Importantly, almost half of our traffic comes to us organically and that's an enormous benefit for this business. And our file about 21 million is growing again after periods of some decline. So we're feeling very good about how we're positioned from a numbers point of view.

And the engine for all of this business is really about commerce -- is about mobile commerce. 80% of our business coming from mobile, and it's mobile that connects her to the in-store experience. And it's that digital platform that creates our enduring relationship. It's also that platform that provides for the entertainment pillar in our strategy that I mentioned earlier. So all roads lead back to development of the digital environment. So let's talk about how we're planning to elevate the digital experience. And again, I said that 80% of our engagement comes from mobile, 60% of all of our sales actually come from mobile. And we know that consumers who are using us on an omnichannel basis visit us more than 2x the average consumer. So where does the growth come from? Well, from personalization. We're only just able to offer personalization. In our [AB] tests, we're seeing significant increased volume coming from our ability to personalize the messages to her and the way in which our digital experience shows up for that consumer.

We're also now invested in the area of omnichannel with 200 stores having shipped from store and 200 stores by the end of August, having buy online pick-up in store. We're, from a long time, being able to process returns in-store. And our returns rate, you should know, is significantly lower than the fashion industry between 15% to 20%. But about 60% of those returns are actually processed at store level, which gives us the opportunity to obviously drive traffic but also drive repeat merchandise. And finally, it's about increasing mobile and app penetration where, again, we've been relatively constrained by the fact that we've been investing in the replatforming of our business, and we haven't had the opportunity while that replatforming was going on to invest in user experience.

Let's move now to North American stores, where our goal is to create a unique, engaging in-store experience, a truly differentiated in-store experience with a signature profit that defines us in a modern and feminine and appealing way. And we have work to do in terms of the way that our stores show up. No question, I'll talk more about that in a second. But just to go back to where I came in at the beginning of the presentation, 867 stores throwing up nearly $1 million each with a lot of flexibility in terms of our lease liability. So let's talk about the vulnerability of stores and how many stores we closed. So during 2020, during COVID, we closed permanently 241 stores. We feel very good about that decision. In that, there was significant transfer of sales from those stores that closed to stores that remained open and our digital business. But also, if you look at the distribution of the stores that we have, we're nicely broad-based across A, B, C and D malls.

And within the Other category, we include off-mall. And I would tell you that we think there is significant opportunity for us to improve and increase our penetration in off-mall locations. So while it is true to say that there are probably about 150 vulnerable malls in North America, we also believe that while there is possibility to close some of those stores that we have opening opportunity in off-mall locations. Let's take a deeper look at the numbers by looking at how the numbers have changed over time. So I think our peak was 2016 at 1,143, let's call it, 1,150 stores, now down to 867 stores, with renegotiated leases for every one of those properties. So during COVID, we took the opportunity to renegotiate every store in that portfolio. I've deliberately left the beyond 2021 column blank, not because I don't want to tell you how I'm thinking about it, but just because I don't know.

So to repeat, there is downward pressure from about 150 vulnerable malls where we currently make money, and we don't want those malls to close. But if the mall is closed, obviously, we close, and we expect that those malls will continue to be vulnerable for about 3 years. So some elements of degradation in the current 867 stores, offset by opportunity around store of the future, more about that in a second, and this idea of off-mall locations where we currently are underpenetrated against the Bath & Body Works company, for example, which has significantly higher penetration in that kind of location. So we will be testing up malls in the coming 18 months. So I'd say a little bit more about refreshing the existing store locations. I said that we have got work to do in stores. And that's because the stores a year ago showed up in the same way as the way we were marketing the brand, in a way that frankly, was tone-deaf and starting to become, if not already, culturally irrelevant.

So we want to change that in the store footprint. And we saw that as an immediate priority for the year that we're currently in. So the photos don't really do it justice, but at the top of the screen, you should see 3 slides that show you what the stores look like maybe 6, 7 months ago, and I would characterize them as being dark and driven by imagery of fashion show that could be any year in the last 10 or 15 years. I would describe them as heavy and overladen and that the merchandise doesn't come through as the hero. So earlier this year, we updated almost every store in the fleet. Most has been done, a few still need to be done, but almost all or every store in the fleet has been upgraded in some way, shape or form. And the after-photos try to show how we've done that. And it's about removal of the layering, it's about removal of images that no longer reflect the positioning of the brand.

It's about removal of the excessive dots around the PINK brand. It's about making the product the hero and giving a blank platform for the merchandise to show up against. So that work is behind us. We've already done it. But it isn't the end of the road. I think what we should really do is, we should have a north star to aim for and that's what we're calling the store of the future. And that's where I think our physical retail strategy will be defined. So what a store of the future look like? Well, it's about an omnichannel experience where it's obvious that we have a significant digital presence and we have a store's presence, where it's easy to buy online and pick-up in store, where it's easy in-store to go to our digital presence, which offers infinitely more merchandise across a broader range of categories and a larger range of sizes.

It's about a flexible environment where we can move merchandise around based on what's selling best and selling least, not defined in the way that it is now in such a way that it's hard to move between categories. It's about having a lower level of investment in physical CapEx. It's about having rightsized inventories. It's about having deeper depth in most popular sizes. So we will be experimenting with 3 stores in the fall of this year, where we will take existing stores where we obviously know what the performance of those stores look like. We'll rebuild it from the ground up and we'll watch and we'll monitor and we'll build them in a way that we believe is sustainable and gives us growth opportunities for the future. And one of those 3 stores will be in an off-mall location.

And in addition to that, in 2022, we will test about 10 new stores, the majority of which will be in off-mall locations, including value centers where we don't need to show as a clearance store, but we can take advantage of the traffic that's in those clearance and off-mall locations. So a lot of work to do around that. But rather than me just talk about it, why don't I play you a video that we use for internal purposes to explain to our associate population, how we're thinking about store of the future. And then, after that, I'd like T.J. and Brad to come up and give a deeper dive to the numbers. Let's roll the tape, please.

(presentation)

Martin P. Waters - *L Brands, Inc. - CEO of Victoria's Secret Business*

Great. I hope you enjoyed that video. So TJ, not so fast. I apologize I forgot to talk about international. How on earth could I have not talked to you about my favorite subject. So I have 5 slides that talk about where we are with the international business, which I'll do quickly, so you can hear more about the numbers. But suffice to say, we feel like we're very well-positioned for long-term growth. So this is a slide that I've shown our investor community previously. And it dimensions how many stores we have around the world across the 2 formats of Victoria's Secret. So there's the small-store format, also known as Victoria's Secret Beauty and Accessories, which is now 375 stores in total. And then there's the full assortment stores, which were typically about 10,000 square feet in size, and we have 145 stores in -- of that format.

And then for the first time I'm showing the digital business, which ships to over 200 countries and territories around the world from North America and also is present in some of our partner businesses. Now what I would say before I move on from this slide is, you should expect going forward that the distinction between a VSBA and VSFA will go away. Meaning that I think it's perfectly okay for us to show up in an international environment with lingerie and potentially with PINK in significantly less than 10,000 square feet, in fact, 4,000 or 5,000 square feet. And if we're prepared to present our full assortment in 4,000 or 5,000 square feet, we don't really need to have as many growth opportunities in the VSBA format. I see those 2 merging together more closely in the future than they have done historically. So let's talk about what our international operating model looks like.

So I mentioned earlier, $400 million worth of recognized revenue, and that equates to about $1 billion in retail sales. And that comes from 5 distinct parts of the business: First and the biggest part is the franchise network, where we operate our business from 7 second franchise partners around the world. Secondly, there's the Travel Retail business, which is where the VSBA started. And that business, of course, has been very badly hit by COVID with only about 75% of stores reopened, 25% of stores temporarily closed still. And business not returning happily, that's the smallest part of our business. There's then our business in the U.K., which is now a joint venture and our business in China which has been restructured, which I'll talk more about on the next slide. And then finally, there's a really profitable part of our business, which is international digital.

And over on the right-hand side of the chart, you can see a pie chart that dimensions how that business shows up. So we show that 20% of our international business actually comes from digital. But know that some of our China business, about 1/3 comes from digital and some of our U.K. joint venture business comes from digital. Now at the moment, our historical segment reporting shows Victoria's Secret Digital International within the North American segment. So we're deliberately showing it in this way. Over time, we will move all of International to be within the International segment. Hopefully, that gives you more clarity on how we're thinking about that business. I want to make a deep dive into the U.K. and China because this is really where the game changer has been from a profitability point of view. And we took the opportunity through COVID to materially change our business models in these markets. So the U.K. was characterized by very large stores with very long leases and very expensive leases.

And partnering with Next, we've been able to significantly dial back the expense of the lease liability. We've been able to renegotiate all of the leases. We've been able to take advantage of their scale in the U.K., and their property expertise. And we've opened up the opportunity of shop-in-shops within Next's enormous footprint as well as taking advantage of Next's ability to go to market in a digital environment that's probably, in my humble opinion, the best in Continental Europe, in Europe as a whole. So in partnering with Next, we have all of the benefits of the best retailer in the U.K. And in moving to a JV operation, we've changed the economics fundamentally and dramatically. So we derisked the U.K., which is good. In China, we haven't moved to a partnership operation. We haven't found the right partner there.

We continue to own the business. But what we have done is exited the onerous lease terms that we had in our flagship stores and permanently closed the Hong Kong store, which was a drain on our resources and we've moved the model away from managing from America -- managing China from America to more of a China-for-China, in-country approach. And you should expect to see more of that going forward. Merchandise developed in China, sold in China. Marketing campaigns developed in China, executed in China. And by doing so, we exited a very significant loss for the company. So my final slide, before I finally hand over to Brad and to TJ, just shows where the geography shows up for those 520 countries -- those 520 stores in 70 countries. So 124 in the Americas, and those are largely driven by our Travel Retail footprint.

Middle East and Africa is actually our most dominant geography in terms of sales and penetration, and we're increasingly moving forward in a digital environment there. Asia, we have good strength across the key markets there. Europe is the area where we're least penetrated and where we see the biggest opportunity. That's all from me. That was a lot to cover in terms of the overview of the business, in terms of introducing VSL before Amy and Greg, and then talking about the 3 channels of distribution. You probably heard more than enough for me, but I will come back for Q&A and look forward to going wherever your energy is. But now let's take a look at the numbers. Thank guys.

Timothy Johnson

Thanks, Martin, and good afternoon, everyone. As Martin mentioned, I'm the newest member of the VS&Co leadership team, but I'm not new to retail. As CFO at Big Lots and also working at the Limited Inc., and the Structure brand earlier in my career, retail is in my DNA. I'm excited to be here at VS&Co with a first-class leadership team as we revolutionize the brand. I'm also very thankful to have a very experienced finance team, and I want to introduce you to Brad Kramer, who is our EVP of Finance. Brad has been with L Brands in terms of Victoria's Secret and Bath & Body Works for over 17 years now and has great experience and knowledge of our business and how we operate and where we've been. So Brad's going to cover some of the current activities going on in the business and some of our historical results, and I'll be back a little bit later to talk about the future. Brad?

Brad Kramer

Thanks, TJ, and good afternoon, everybody. I want to provide a quick recap of our recent financial performance. We're almost 1-year into our journey to reposition this business, and we are pleased with the progress we've made and the momentum we are seeing. Looking at our results on a Q1 trailing 12-month basis, which includes 1 quarter impacted by COVID, we delivered about $920 million of adjusted EBITDA. That outcome reflects about $425 million improvement versus 2019 and EBITDA as a percent of sales improved to 15% or about 800 basis points above 2019. On the far left, you can see that in 2018, this business generated adjusted EBITDA of about $900 million with an EBITDA rate of 11%. Our Q1 TTM profit rate of 15% is 400 basis points above our 2018 profit rate and profit dollars are outpacing 2018 slightly. We're particularly proud to share that we have seen 3 consecutive quarters of significant EBITDA growth to 2019 and our strong momentum has continued into the second quarter.

Turning to Q2. We recently released revised guidance for the Victoria's Secret segment. It's a forecast based on VS segment reporting as part of L Brands financials and as shown on an operating income basis. If you compare our guidance of more than $200 million in the second quarter to the same quarter in the prior year, you can see that we expect to pick up nearly $300 million of additional profit. As Martin mentioned earlier in the presentation, if you add up our Q1 TTM profit beat to 2019 and combine it with our Q2 guidance. You can see how we are on track to deliver well over $1 billion in EBITDA as a stand-alone business. This outcome would equate to nearly $700 million of EBITDA improvement versus 2019. Let's talk about what's driving the $700 million profit trend change in more detail. This is where we really see our momentum highlighted.

Our projected results through Q2 represent the first full year of our turnaround results and our comparison period is to 2019, which is a pre-COVID time frame. You can see that of the $700 million EBITDA improvement versus 2019, we forecast that on a go-forward basis, about $600 million or 85% of it annualizes. Specifically, we expect about half the $600 million run rate improvement to come from margin growth in the North America segment. We are forecasting 4 consecutive quarters of comparable margin growth versus 2019 through the end of Q2. And this assumes and includes performance improvement trends across all channels and lines of business. The other half of the run rate improvement comes from discrete actions from our profit improvement plan that I'll outline on the next page. In addition to the run rate improvement, we've also realized about $100 million of onetime benefits predominantly driven by COVID-related occupancy concessions.

Looking at our results over the last year, it's clear while there is some benefit related to the pandemic. The work we have done to reposition the business is driving our momentum. Let's look at the key drivers of the profit improvement plan on the next page. We developed an action plan in the middle of last year to optimize our cost base and improve and simplify the operating model. We -- as Martin mentioned earlier, we are on track and pleased with the results and targeting to deliver $300 million in annualized savings. Our path to this level of profit improvement relies on 4 key initiatives, and I'll hit some highlights of each one: The first is that we dramatically restructured the organization in the middle of last year and migrated all corporate functions under 1 VS leadership team. That team is actioning a common set of goals and is operating on a common incentive plan.

That restructuring substantially improved the effectiveness of the VS organization and reduced headcount by about 25%. Secondly, we drove merchandise margin rate expansion through a combination of disciplined inventory management and negotiated product cost savings. The third area that we improved the profitability of our North America stores channel for fleet rationalization activities combined with optimizing store selling cost through a simplified operating model. And lastly, we restructured our U.K. and China businesses to eliminate losses in the International segment. Within the U.K., we migrated to a joint venture structure with our retail partner Next. And in China, we targeted discrete actions to reduce stores, negotiate rent savings and execute overhead home office reductions. Through the end of Q1, we have actualized about 75% of the $300 million of savings.

As a management team, we are pleased with the progress we've made over the past year, and we are confident we have solid plans in place to continue our growth into the future. Now I'll hand it back to TJ to discuss our financial outlook and growth opportunities going forward.

Timothy Johnson

Thanks, Brad. That's a great summary of what's been an incredible turnaround over the last 4 quarters and has us well-positioned for growth going forward. As we look forward, we see sales up in the mid-single digits. You heard from Martin, Amy and Greg earlier today about our lines of business, and Martin just covered the channels that we operate in, North American stores, digital and international. From a digital perspective, we have a lofty goal of 50% penetration over time. Much work has been done. We've seen great results and there's still a lot of work to do. From an operating income perspective, we see growth in the high single digits. So sale is up mid-singles, operating income up high-singles, highlighting for you the opportunity for further leverage in the model. From a rate perspective, we see the operating income rate in the mid-teens, acknowledging the growth and also representing that we know there will be a further investment needed in the business to continue to grow the top line and the customer experience.

On the next slide, we see specifically aligning our vision with our growth, and there's 4 key items noted before you. First and foremost, evolving our merchandising and marketing strategy, acknowledging that it's her journey, not his, and our merchandising and marketing efforts need to support that. Additionally, growing the omni and digital presence that we have. As I mentioned earlier, a lofty goal of 50% digital penetration over time, but we recognize it's a relationship with her and that includes stores, omni as well as in-store pickup. From an international perspective, Martin got the business off to a great start from an international perspective. Arun is building on that, and we see an opportunity for growing global network over time. And last, but certainly not least, the customer experience. In addition to the omni and digital opportunities, we believe we have a store experience opportunity as well.

We've seen refresh activity in our stores, and we're really excited about the store of the future journey that we look forward to taking you on over the next few seasons. The next slide highlights some of our thoughts around financial policy and capital allocation. Earlier today, you've heard about the significant EBITDA and cash flow generation potential of our business. Additionally, our partners at L Brands have helped us get started from a liquidity and leverage perspective. We'll launch with approximately $250 million in cash and an undrawn $750 million ABL. Additionally, in recent weeks, we've had a very successful debt offering, raising $1 billion. So you've heard about our EBITDA performance $1 billion of debt raise, so a very low leverage point to begin our journey as a public company. Additionally, disciplines around good inventory management, cost management and being good stewards of our shareholders' cash will continue to be a priority.

Partnering with our new Board of Directors, we'll be looking at and evaluating new targeted investments to drive future growth, and we'll also consider investing in VS&Co first, but we recognize that there'll be excess cash generated. And again, as a management team working with our Board, in the future, we'll determine how best to utilize that cash. So I'll close with the last slide that Martin actually detailed earlier in the presentation and just hit on a couple of quick points: First, we believe we have a clearly defined new vision, purpose and mission for VS&Co. We have incredible brand awareness and customer satisfaction is on the rise. We have a growing digital business, but we're also enhancing our store experience. We have a highly responsive supply chain and speed to market is a competitive advantage for VS&Co. All of this gives us confidence and the opportunity from a top line and a bottom line perspective.

We have a highly talented management team with significant industry experience to drive this opportunity going forward. I'm excited about our future, and I'm humbled to be part of such a talented leadership team. So with that, on behalf of the entire leadership team, we would like to say thank you for joining us today.

And with that, we'll turn the call over to the moderator to start to take your questions.

Jason Ware

Thank you, TJ. We will now open the lines for about 45 minutes of Q&A.

(Operator Instructions)

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Simeon Siegel.

Unidentified Analyst

So I guess maybe, Martin, Amy and Greg, any color you'd like to share on the different segment revenue expectations built into that consolidated 3- to 5-year targets, maybe speak to your respective margin profiles? And then, Greg, I think you might be more insulated from BBW than we necessarily think. But with Beauty, you have some of the greatest dis-synergies from the split, how does Beauty Park work post-split, maybe speak to that dynamic? And then what changes for you, if anything? Just any color we need to know regarding operations or P&L?

Jason Ware

Thanks, Simeon. We'll go to Martin first.

Martin P. Waters - *L Brands, Inc. - CEO of Victoria’s Secret Business*

Yes, great. Thank you, Simeon. Thanks for getting in the first question. That's great. So I would say as it relates to the mix between the 3 categories, the 3 lines of business that we don't anticipate that changing. We think that the broad level of participation we described earlier for the 3 brands is about where it will continue. So don't expect any change there. As it relates to margin, Greg is going to get the microphone in a minute, and he can comment further. But I would say that we believe there is no reason why no fundamental structural reason why each of the 3 lines of business can't get back to the historical high rates. Now we're not terribly far away from that on a trailing 12-month basis, as you'll have seen. But I think as it relates to planning into the future, expect us to be goaling ourselves to get back to historical rates. Greg, what's say you?

Greg Unis - *L Brands, Inc. - CEO of Victoria’s Secret Beauty*

Yes. What I would add is, if I think about it from 2 perspectives, one would be in terms of the product margins. With regards to product acceptance, we're seeing very strong product acceptance and, therefore, commanding higher AURs than we've seen historically, and it's rolling through in the margin. In terms of the supply chain, the Beauty supply chain, we have been working on the split with BP and BBW for the last year. And what I can tell you is that we are not seeing any shift. We are not seeing any deleverage in the supply chain as a result of splitting the supply chain up. And there's really -- there's been no impact on the Beauty Park as a result. So we're feeling good about our future as it relates to that unique, and I talked about it as our strategic advantage. So feeling good.

Jason Ware

Thanks, Martin. Thanks, Greg. Amy, anything you want to add?

Amy Hauk - *L Brands, Inc. - CEO of Victoria's Secret Pink*

No. I mean, I think, Martin spoke to it all. So there's no need for me to add any color, but if PINK can contribute more, we're happy to do so.

Operator

The next question comes from Roxanne Meyer.

Roxanne Felice Meyer - *MKM Partners LLC, Research Division - MD & Senior Research Analyst for Specialty Retail*

Thanks for all of the information today. You talked about Victoria's benefiting. We know Victoria's has benefited from speed and agility, which has been competitive advantages. What percent of the business is on the speed model? And how should we think about the opportunity? What are you targeting in terms of growing the portion of the business that can react in a shorter time frame?

Jason Ware

Great. Thanks, Roxanne. We'll go to Martin.

Martin P. Waters - *L Brands, Inc. - CEO of Victoria's Secret Business*

Yes, Roxanne. Good to hear from you. So the way we think about it is that the business was at its absolute best. We would start the season about 50% committed and about 50% open. Meaning that we would set the floor sets or the screen sets and then chase like crazy into what was working and get out of what wasn't working. That served the business well and we've been on a tier to get back to that rate. We didn't quite achieve it as it related to the spring season, but we were much more agile than we've been in the past 3 years, certainly from a BSL perspective. All -- so that would be the high-level answer. All of that said, I would tell you that, to enter the fall season with that kind of openness will not serve us well. Why? Because there's just too much noise in basic supply.

It's too risky to leave merchandise unboard and uncommitted. So this season, this fall season will be an outlier, I hope. In that, we'll enter the season with more like 75% or 80% commitment and a lower level of agility than we had in the spring. You may be curious about where that pressure is. We think that the pressure is in distribution. We think the pressure is in the factories. We think it's evenly spread across the different geographies we operate in. We think that we're just as exposed to it as other competitors are. So as we talk to our base of supply and we get the lay of the land from them, they tell us to expect that this is the way that retail -- fashion retail will be in the back half of this year. So a long answer to a short question. I hope that helps, Roxanne.

Roxanne Felice Meyer - *MKM Partners LLC, Research Division - MD & Senior Research Analyst for Specialty Retail*

Thanks for the color and best of luck.

Amy Hauk - *L Brands, Inc. - CEO of Victoria's Secret Pink*

I also would just add to that. With tighter inventory management, the percent open is one to shrink as a percent to total, and we'll be chasing into the upside. So we're managing slightly differently than we have in the past.

Operator

The next question comes from Matt Boss.

Matthew Robert Boss - *JPMorgan Chase & Co, Research Division - MD and Senior Analyst*

So maybe from a product perspective, at Victoria's Secret and PINK, how would you rank whitespace market share opportunities across categories from here?

Jason Ware

Great. We'll go to Martin first.

Martin P. Waters - *L Brands, Inc. - CEO of Victoria's Secret Business*

Yes. So thanks, Matt. I actually had a slide in my presentation from earlier today that talked about those opportunities. I was going to pull it up, but the biggest opportunity, frankly, is in the core of the business. It's in the bra business, the area where we walked market share, an area where we lost sales during those period of execution miss that was in the bra business. So that's the number one overarching item to get after. Thank you for pulling that slide up, whoever did that. I don't think I go to aggregation as being a significant area of opportunity. That's the thought that we can work with other people's brands, where they're complementary to us or where they get us into a space where we're currently underweight or get us to categories where we're currently underweight.

Swim, obviously, to dimension swim, I think at peak, it was $400 million this year as our reentry will be about $100 million. So that gives you some idea on that, Matt. And then while Maternity is a small business, we think it's an important business for us to be in. Shapewear probably has more opportunity than one might imagine, and we're going to go after that. So across all of those different categories, we think there is opportunity. But overwhelmingly, the bra business is the goal to go after. Amy, do you want to take it from here?

Amy Hauk - *L Brands, Inc. - CEO of Victoria's Secret Pink*

Sure. I mean I think our best start is Intimates, as Martin spoke to, for VS&Co. So constantly spending our energy to reimagine and robustly test against an innovation pipeline, as we talked about earlier is going to be critical. And I would slice whitespace slightly differently when I think about it for PINK. I think slice expansion is a huge area of whitespace, so not necessarily specific product categories. And I talked about how we're rolling out size. And extra large, for example, is currently 15% to 20% of our business, depending on the category. And then innovation in technology, so the launch of our Period Panty, recycled and environmentally friendly swim, which we launched this year, I think all of those initiatives will also help to drive incremental sales in categories that we currently already own through either sustainability or innovation. If that helps to answer question.

Matthew Robert Boss - *JPMorgan Chase & Co, Research Division - MD and Senior Analyst*

It does. It does.

Martin P. Waters - *L Brands, Inc. - CEO of Victoria's Secret Business*

Great reminder. The slice point is equally applicable in Victoria, of course. The other thing, and it's not directly about product, but it's about how she shops is personalization. So I talked about it a little bit earlier. Personalization in a digital environment is a very big opportunity for us that we think of as whitespace.

Operator

(Operator Instructions)

And our next question comes from Susan Anderson.

Susan Kay Anderson - *B. Riley Securities, Inc., Research Division - Analyst*

I'm curious, as you look at the business to grow it again and like you said, to have new bra launches every year, et cetera, how do you ensure that you don't get over inventoried again, like you had in the past?

Jason Ware

Thanks, Susan. We'll go to Martin for that one.

Martin P. Waters - *L Brands, Inc. - CEO of Victoria's Secret Business*

Do we have to go to Martin for that? I mean that's a really difficult question. How do you do that, we don't know. Honestly, Susan, that's the outcome. That's what gets us up at 5:00 on a Monday morning every week and diving into our numbers to figure that out, what is optimal in terms of breadth and making sure that we don't buy too long and to get deep on inventory. I can't tell you any more other than that's the work of the work. That's the skill of the business. We have great talented leaders around us who help us with these metrics. And it's a very fine judgment, but one that we enjoy. Leaders, anybody else, welcome to chime in and add in if you could.

Amy Hauk - *L Brands, Inc. - CEO of Victoria's Secret Pink*

Yes. I would love to.

Martin P. Waters - *L Brands, Inc. - CEO of Victoria's Secret Business*

Yes. Please do, Amy.

Amy Hauk - *L Brands, Inc. - CEO of Victoria's Secret Pink*

Yes. I mean, I think, it's important to add it to amplify, right? So a bra launch is only going to be successful in that if you can see it clearly, and it cuts through. So VSL and both PINK have done a lot of cutting of bottom producing SKUs and product areas. And in PINK, specifically, it's 30% over the last couple of years. And that leaves us room to amplify around the big new ideas, whether it's the Period Panty or shapewear for PINK, and the bra launches that Martin talked about for VSL. So I think just as important as the launches is and what you're going to do, is what's going to go away to make room for that.

Greg Unis - *L Brands, Inc. - CEO of Victoria's Secret Beauty*

And what I would add on, Amy, to that is when we're at our best, we have a very rigorous testing agenda. And with launches and businesses that we incubate, they rarely are a ta-da. They are things that we have tested with customers and ramp-up based on customer acceptance.

Martin P. Waters - *L Brands, Inc. - CEO of Victoria's Secret Business*

Greg, you might want to explain what a ta-da is?

Greg Unis - *L Brands, Inc. - CEO of Victoria's Secret Beauty*

It's not just kind of throwing it out into the marketplace and crossing your fingers and hoping that it sells. It's a kind of, yes, it's a very disciplined approach to understanding from the customer, what her level of acceptance is. An example of that, that I would throw out in the beauty business is, I talked about the growth that we're seeing in our Natural Beauty category. And that is something that we tested first in digital, then in stores, and then we ramped it up based on customer response and made adjustments accordingly. So we have lots of examples of that throughout the business.

Operator

That is from Lorraine Hutchinson.

Lorraine Corrine Maikis Hutchinson - *BofA Securities, Research Division - MD in Equity Research and Consumer Sector Head in Equity Research*

I had a question about the Victoria's Secret sport and lounge business. The strategy around that business has changed a few times over the years, and I was just wondering how big was that at peak? And what are the go-forward actions you're taking to make sure that they don't overlap too much with PINK's lounge business and that it is truly differentiated?

Jason Ware

Great. Thanks, Lorraine. Martin, back to you.

Martin P. Waters - *L Brands, Inc. - CEO of Victoria's Secret Business*

Yes. And maybe, Brad, you can keep us honest in terms of the size of those categories. I think about the two together, honestly, sport and lounge. I don't think of them as distinctly different. I think there is an enormous amount of opportunity for us in these segments. I think we can expand considerably from where we've been. I think we can use our superior development, creative development. I think we can use superior access to fabrics and fabrications and cuts and knits in a much better way than we did do historically. And so I don't want to speak to what was wrong with previous strategies, but I can tell you what's right with where we are now. It's about listening to the customer, understanding exactly what it is that she wants from us. and showing up in an innovative way.

How do we make sure that we don't cross over with PINK? Well, we now run the business as a single management team. So starting with Stuart's appointment over a year ago, this management team is together all the time. We work together on a Monday at 10 a.m., and then we're together on a Monday at 1 a.m. On Tuesday, we have a full day meeting, so we're joined at the hip in a way that wasn't the case previously. And yes, sometimes we lean into each other's area of expertise. So Amy leads in a very cohesive way on some categories for us. And Greg leads on others and I lead on different areas. So that's the main way in which we intend to avoid that kind of overlap. Amy?

Amy Hauk - *L Brands, Inc. - CEO of Victoria's Secret Pink*

Yes. I mean I think it's -- there will always be overlap, but it's clear to understand what our roles are, right, each of these brands. And PINK's role is really to introduce the customer to Victoria's Secret and create longer-term loyals. So we are really focused on the 18- to 22-year-old, squarely in the Gen-Z area, and we really target the 14- to 24-year-olds, of which there are about 26 million, if we're just looking at the female population. Then we happily hand it off to VSL. Are there going to be some similarities in what they want? Yes, but hopefully, our positioning, our [aesthetic,] all of that is a reason to be to capture our customer for a longer period of time.

Operator

That comes from Ike Boruchow.

Irwin Bernard Boruchow - *Wells Fargo Securities, LLC, Research Division - MD and Senior Specialty Retail Analyst*

Two questions for me. Just on the CapEx, is there a way to think about capital spending? I'm mainly curious you guys have a lot of reinvestment and brand building taking place, should we expect a ramp over the next couple of years as you invest back into the brand strength? And then as we think about margins, I think, I see the target mid-teens. I mean, it seems like you guys would probably be there this year. My question is, do you expect margins to be somewhat volatile over the next couple of years? Because, again, you've got this brand momentum back, but I imagine there are areas of the business that need more investment or have been underinvested in, so could there be a step down before we go back? But just trying to think about, is that a straight line kind of margin or could this bounce around a little bit over the next couple of years?

Jason Ware

Great. Thanks, Ike. Going to TJ for that.

Timothy Johnson

Yes. Thanks for the question, Ike. I think from a CapEx perspective, what we've talked about historically is in the range of 2% to 2.5% of sales. If you think about this year and kind of where we've been trending on sales, you get CapEx in the range of probably $160 million to $170 million. Majority of that CapEx is going to be around stores or technology -- stores and technology and, particularly, as we think forward in some of the separation activity around technology that will continue to be a focus, along with the customer store experience that Martin talked a fair bit about earlier in the presentation. I think the second part of your question, maybe I'll tag team a little bit with Brad, but from a margin perspective, I'm assuming you mean operating margin perspective, go-forward in the mid-teens. On a 12-month basis through the first quarter, we're a little bit short of that goal. If you layer in the good performance in the second quarter, we're getting closer to it.

From our point of view, we're giving you a heads up here in the model, we think there's an opportunity to continue to leverage. I think that's the most important thing. Recognizing we've already said we want to grow this business. We want to partner with our new Board. We've got -- there's no shortage of ideas. If I've learned anything in the first 6 weeks that I've been here, there's no shortage of ideas from leaders in the business on how to grow, and it's our job as leaders working with the new Board to kind of prioritize, as Amy said, make sure that we're focusing on the most important things and not everything. So I think that's how we're thinking about it currently. I don't know, Brad, if there's anything that you want to speak to that from a margin perspective as well.

Brad Kramer

Yes, just one other color would be that, at peak level, this business at one point was in the high-teens operating margins. So even though we've made a lot of improvement in the last 12 months, we still have a long way to go to get back to historical peak levels. And so as we think forward, team is working really hard to drive expansion on profit rate and believe there's opportunity on the horizon.

Operator

That comes from Adrienne Yih-Tennant.

Adrienne Eugenia Yih-Tennant - *Barclays Bank PLC, Research Division - MD, Senior eCommerce & Brand Retailing Analyst*

Martin, I wanted to go back to the slide about the 20% North American market penetration. I seem to recall a slide long ago that showed sort of one where the Walmart was like a distant second. So I wanted to understand sort of who you are competing against? It seems like, Vicky, even after all of these years and during executional misstep, still has really the dominant play in terms of your particular look and feel? And then Amy, it's not as obvious to me where is misstep, the executional misstep what came from. So can you talk about the course correction that you're facing relative to maybe Victoria's Secret, where did they go and then who are you taking share back from?

Jason Ware

Great. Thanks, Adrienne. We'll go to Martin, first.

Martin P. Waters - *L Brands, Inc. - CEO of Victoria's Secret Business*

Yes. Thanks, Adrienne. I think you kind of answered your own question, and thank you for that. Yes, we had a dominant position, particularly in bras, also in panties, but in the other categories as well. The customer did not give up on us at all. The customers always love Victoria's Secret. Once we sorted ourselves out, happily, the customer has come back strongly. So yes, we have dominant market share positions. At the same time, we are not at all complacent about competition.

The competition in this marketplace has intensified significantly in the last 3 or 4 years, partly because of inactivity on our part, but also just as COVID has impacted the market during 2021. So the 3 big areas of competition I think about are the big-box operators who are excellent in the digital environment. Pure-play digital players who emerged and are good at what they do, and we need to be better, we need to be best-in-class in the digital space. And the third, the pure-play retailers that have always been there. So there is a lot to look at in the area of competition, and we try not to get too fussed by it. We're more fussed by being as close to the customer as we possibly can be, knowing her like she's our best friend and providing her with the best possible experience. If we do that, all will be well. Amy?

Amy Hauk - *L Brands, Inc. - CEO of Victoria's Secret Pink*

Yes. So well, the missteps haven't been as publicized or as obvious maybe to the general public. I would say, in general, we had lost step with the customer and most significantly as PINK started capturing the Gen-Z customer, which is not 5- to 25-year-old range. Right now, we were a brand that was about exclusivity when everything for the Gen-Z customer is about inclusivity. We had a stereotypical kind of view of beauty dated when it's all about diversity and inclusion, different body types, come as you are. Really making everyone feel welcome and comfortable, comfort in kind of your weaknesses almost, let them become strength. And I think it's about not really understanding our customers. So we have spent an enormous amount of time out in stores, on college campuses, doing our research, talking to our target consumer to make sure that our product is relevant.

And I don't -- we all know that Aerie has been growing rapidly. They were ahead of us on this. But we also have had campus reps and being close to our customers, and other ways that we initiated, and we still do have a much larger market share, though they are growing. So it was just about modernizing the brand evolution to be more inclusive versus exclusive, less beer pong and pool parties and more about giving our college students and our customers tools to be successful. And then standing for more than just product, these days, it's not just about product for brands, it's about having a cause and standing for something internally and externally, a term we coined at PINK called [Cosmers.] And so all those things were relevancy that we needed to approach from the PINK perspective. Hopefully, that answers your question, Adrienne.

Adrienne Eugenia Yih-Tennant - *Barclays Bank PLC, Research Division - MD, Senior eCommerce & Brand Retailing Analyst*

That does.

Operator

That is from Janine Stichter.

Janine M. Stichter - *Jefferies LLC, Research Division - Equity Analyst*

I wanted to ask about marketing. So you made some pretty big changes in product and positioning. Curious how you communicate that to the consumer. Maybe you can speak to marketing as a percent of sales now versus where it's been at peak? And then maybe a bit more on the mix of marketing, what you're doing differently now versus how the brand has been communicated in the past.

Jason Ware

Thanks, Janine. Maybe we'll go to Brad for kind of the historical perspective and then hook back to Martin.

Brad Kramer

Yes. From the quantitative side of the marketing investments, the business has been on a journey over the last several years and has flexed in and out of different media types and has had different levels of investment. I'd say fundamentally, looking at our investment levels over the last 3 or 4 years, there's been a big shift out of print media into more digital-based advertising. Our goal, as Martin has outlined, is to get marketing investment back in the 5% to 5.5% of sales range for Victoria's Secret and the company. We believe that is in line roughly with the historical investment levels and we're tracking to be somewhere in the range of that through fiscal '21.

Martin P. Waters - *L Brands, Inc. - CEO of Victoria's Secret Business*

Well said, Brad. I think you hit the highlights. I agree 5% would be our goal going forward and, of course, it's all about digital and social. That's the big change. So one thing I might mention, additionally, just because we're on the subject of marketing and advertising would be the fashion show. So we have historically had a very significant amount of our marketing spend that was around the fashion show. And we saved that money in the last 2 years. Our intent is to get back into the fashion show business. Of course, we should. It's an outstanding equity and one that we can use to our advantage, we just need to do so in a way that's culturally relevant. And we're not in a hurry to announce when that will be or how that will be. We're going to figure it out. We spent a lot of time talking to our customers and working out how she wants us to show up in that environment. But you should anticipate that fashion show will continue to be part of our marketing armory, and we will redefine it in a way that's cultural relevant in the coming years. Hope that helps.

Operator

Next question is from Omar Saad.

Omar Regis Saad - *Evercore ISI Institutional Equities, Research Division - Senior MD and Head of Softlines, Luxury & Department Stores Team*

Most of my questions have been answered, but I do have a follow-up around margins and promotionality. The Victoria's Secret franchise has seen such a significant turnaround in its profitability in the last year or so. And a big piece of that has been reduction in promos. It's obviously been something we've been hearing kind of throughout the industry. I'd love to hear you address why you -- if and why you think those improvements are sticky? How much is embedded in your long-term margin guidance to give back some of that improvement in promotionality? And maybe talk also about if and how your market -- your promotion and markdown strategy has evolved from prior years.

Jason Ware

Thanks, Omar. I think we'd go to Brad first.

Brad Kramer

Thanks, Omar, for the question. Obviously, a big subject in a subject we spend a lot of time internally talking about. We have seen significant merch margin rate expansion over the last year. I know a lot of retailers are seeing similar dynamics, I would say, I would start with we're seeing very balanced growth across almost all components of merch margins. So on the pricing side and the AUR side, we're seeing elevation happen. We're also seeing benefits from cost negotiations that we've done with our vendor base. And we're also seeing some tailwinds from a mix perspective. AUR is the primary driver, and we've been actioning a fairly aggressive pullback and promotionality of the business. And we've had a lot of success with the price ups.

I would say it starts with the quality of the assortment and the customer engagement that we're seeing in the business, and the teams and the merchant leaders and CEOs have done a lot of work to make adjustments to our merchandise assortments, and we're getting paid for those adjustments. And then what was covered earlier is that, in part, a big portion of our savings is getting back to some of those inventory disciplines that we had in the VS business for over a decade. And it's not a new thinking on how to manage inventory. It's just getting back to the rigor that we had in this business for many, many years. And I'd say, broadly, that relates to a more conservative mindset, not only on how we position inventory, but also how we position the P&L and expense investments in our business as well. And then we use the chase mechanisms in place and the read and react mechanisms in place to optimize the collections that are working and selling.

Looking forward, I think we're comfortable with the merch margin rates in terms of positioning of the business, I think we would anticipate some volatility going forward. The teams are also working hard to find other savings within merchandise margins that can help offset possible headwinds and then the omni capabilities that are coming into our business here this year. We're also very excited about as they will provide some unique opportunities for us to possibly sell at a higher rate, some of the trapped inventory that could be within one channel or the other. So I think we're confident with where rates are, and we're optimistic about the go-forward outlook.

Omar Regis Saad - *Evercore ISI Institutional Equities, Research Division - Senior MD and Head of Softlines, Luxury & Department Stores Team*

Got it. That's very helpful. So it sounds like the BOGO days -- the ramp at BOGO days are over?

Martin P. Waters - *L Brands, Inc. - CEO of Victoria's Secret Business*

Yes. We're going to, obviously (inaudible)

Operator

There are no other questions at this time.

Jason Ware

Great. If there are no other questions, that concludes the Q&A portion of today's presentation. Thank you for joining us and for your interest in Victoria's Secret & Co.

Martin P. Waters - *L Brands, Inc. - CEO of Victoria's Secret Business*

Thanks, all. Enjoy the rest of the day. Thank you.

Amy Hauk - *L Brands, Inc. - CEO of Victoria's Secret Pink*

Bye-bye. Thank you.