Sportsman's Warehouse Holdings, Inc.

Third Quarter 2016 Earnings Conference Call

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Peter Benedict, *Robert W. Baird*

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Andrew Burns, *DA Davidson*

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PRESENTATION

Operator:

Greetings and welcome to the Sportsman's Warehouse Third Quarter 2016 Earnings Conference Call. At this time, all participants are in a listen-only mode and a question-and-answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press star, zero on your telephone keypad. As a reminder, this conference is being recorded.

I'd now like to turn the conference over to your host, Ms. Rachel Schacter of ICR. Thank you, Rachel. Please go ahead.

Rachel Schacter:

Thank you. Good afternoon, everyone. With me on the call is John Schaefer, President and Chief Executive Officer, and Kevan Talbot, Chief Financial Officer.

Before we get started, I would like to remind you of the Company's Safe Harbor language. The statements we make today will contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, which include statements regarding our expectations about our future results of operations, demand for our products and growth of our industry. Actual future results may differ materially from those suggested in such statements due to a number of risks and uncertainties, including those described in the Company's most recent 10-K filed with the SEC on March 24, 2016.

We will also discuss non-GAAP financial measures during today's call. Definitions of such non-GAAP measures as well as reconciliations to the most directly GAAP financial measures are provided as supplemental financial information in our press release, included as Exhibit 99.1 to the Form 8-K we furnished to the SEC today, which is also available on the Investor Relations section of our website at investors.sportsmanswarehouse.com.

Now, I'd like to turn the call over to John Schaefer, President and Chief Executive Officer of Sportsman's Warehouse.

John Schaefer:

Thank you, Rachel. Good afternoon everyone and thank you for joining us today. I will begin by reviewing the highlights of our third quarter performance and then discuss our progress on our strategic initiatives and thoughts on the remainder of the fiscal year. Kevan will then go over our financial results in more detail and review our outlook, after which we will open up the call to your questions.

We are pleased with our third quarter results that finished within our guidance range on sales, same-store sales and earnings per share. We believe our unique localization strategy, efficient business model and disciplined execution allowed us to continue to outperform our peers in the third quarter and strengthen our position as the high growth retailer in the outdoor sporting goods segment of the retail marketplace.

In Q3, we once again demonstrated the consistency of our financial performance as we met each of our financial targets for the quarter while maintaining and, in some cases, improving category level gross margins. This was against an industry backdrop that remained very promotional at both the national and the local level.

The fact that we yet again successfully maintained a disciplined promotional calendar with no sales or traffic degradation despite the promotional stance of others in the industry illustrates the inherent customer appeal of our differentiated concept with our focus on having the right product in the right place at the right time and our everyday low price merchandising strategy. This accompanied by our characteristic expense discipline has consistently enabled us to meet our new store ROIC objectives and overall earnings guidance.

Looking at our top line drivers more closely, the most recent NICS data reflected the continued increased demand for firearms, especially in the states in which we operate. We were able to outperform this overall demand growth building on our track record of market share gains despite new competition impacting nine of our stores over the past 18 months.

We are pleased to report that our new stores continue to outperform our expectations. As a reminder, all of our new stores follow either our standard 30,000-plus square-foot format primarily located in larger metropolitan markets or our smaller 15,000-plus square-foot format models generally in smaller metropolitan service areas that are more difficult for our larger national competitors to enter with their big box model or in markets where our national competitors have historically chosen to avoid.

We opened five new stores in the third quarter and have completed our plan to open 11 stores this fiscal year which represents 17% annual unit growth. We accomplished our unit growth goals utilizing free cash flow from operations while also meeting our twin objectives of delivering a 20% ROIC including initial inventory costs on new stores and generating excess free cash flow to pay down debt.

Net sales for the third quarter increased 13% to $217.2 million. Same-store sales increased 2.1% versus the prior-year period. As we have discussed previously, the negative effect from new competition generally impacts same-store sales in a particular market until approximately the 18-month mark. Therefore, we analyze our store base and in three cohorts; one of which is new store competition.

Given a known competitive opening that was expected to open in mid-Q4 moved up to Q3, the negative impact from competition in newly competitive markets was 180 basis points in the third quarter. We are very pleased with the performance of our stores facing new competition, especially when considering the significant increase in promotional activity and changes in pricing strategy from some of our competitors.

Based on announced future competitive openings, we are now at a point where we believe this negative impact will begin to diminish over the next few quarters, both as a result of fewer new competitive openings as well as many stores that have faced new competition reaching the 18-month mark when the competitive impact curve reaches an inflection point.

Looking more closely at our category sales performance for the quarter. Our firearm unit sales were up 21.1% versus the third quarter of last year and versus the NICS data for our states reflecting only a 17% increase. We are very pleased with the overall growth in firearms sales as we saw nice increases in all subcategories of long rifles as well as in handguns and we believe we are the best positioned retailer in our niche to continue to capture market share in the category.

We are particularly pleased that our clothing and footwear businesses have turned positive on a same-store basis with gains of 5.2% and 2.4%, respectively, in the third quarter versus the prior year. Given the performance of this category our other industry participants whose results we are able to track, it is illustrative of our market share gains in the clothing and footwear category as well. The negative weather impact in these categories which began in Q3 of fiscal 2015 has now been annualized and our product presentation continues to resonate with our customers.

Our sales performance in these and all other product categories point to continued share gains and traction in markets of all sizes, whether as a complementary alternative to major competitors in our larger markets, or in lieu of mom and pops and the direct channel in our smaller markets. From a same-store sales composition standpoint, customer conversion and average order size continue to increase as has been the case the past few quarters.

Now on to profitability. Gross profit increased 11.6% with corresponding gross margin as a percentage of sales decreasing 40 basis points versus the same period last year. This rate decline was based entirely on a shift in sales mix as growth in firearm and ammunition sales exceeded growth in clothing and footwear.

We continue to maintain our discipline on promotions while achieving our objectives of maintaining overall margin and being the everyday low price leader in our categories. This gross margin performance is particularly impressive given it was delivered against an industry backdrop of deep discounting, including new promotional taglines and result in deep (phon) gross margin clients that we witnessed by a key industry participant.

We are especially pleased with our private label performance which generally serves as one of our main product offerings in the good category within our good, better, best, merchandising strategy. While private label is still a small portion of our business at 3.6% of our net sales, during the third quarter we increased our private label penetration by greater than 7% from the third quarter last year. This continued growth in our private label sales and the value that our customers see in these products and brands, as well as the higher Company gross margin, gives us confidence that we are on the right track with this strategy.

Operating income for the quarter was $20.5 million, a 7.2% improvement over the prior year driven by our top line performance and operating discipline. We are accomplishing our dual objectives of both investing in our future through smart unit growth while ensuring we are operating as efficiently as possible on a day-to-day basis. Earnings per share was $0.25, towards the high end of our third quarter guidance range, and an improvement over the earnings per share of $0.23 in the prior-year period.

We believe our results continue to demonstrate that our customer base enjoy shopping in our stores. They are attracted to our unique customer service and friendly environment as well as the local convenience of a neighborhood store in our larger markets and our big-box appeal in smaller communities where we provide a greater product assortment in the mom-and-pop competition.

Given the user experience is critical to the purchase decision, we continue to believe that we have an advantage versus online-only retailers as our customer prefers to come into our store to touch and feel our products prior to purchasing. Additionally, our in-store pricing generally provides the customer with similar if not better prices than those online. And, as we've noted before, roughly 30% of our merchandise is either not available or very difficult to purchase via the direct channel.

Looking ahead, we remain focused on our strategic growth initiatives and key priorities. Let me discuss a few of these initiatives including progress made in the third quarter.

Number one, we remain focused on a methodical approach to the significant store growth opportunity we see in existing and new markets and plan for continued annual square footage growth rate of greater than 10% annually for the next few years.

With the opening of stores in Las Cruces, New Mexico; Gillette, Wyoming; Rock Springs, Wyoming; Avondale, Arizona; and Fairfield, California in the third quarter, we have now opened 11 stores in fiscal year 2016. In addition, today we have announced an additional three stores for our 2017 class. These store locations are in Yuma, Arizona; Eureka, California; and Henderson, Nevada.

Our operating discipline and prudent use of cash have continued to allow us to self-fund our store growth while also reducing our leverage. We expect to continue our planned pace of new store opening into fiscal year 2017 and beyond.

Number two, we remain focused on maximizing the potential of our loyalty program which continues to post strong gains. We now have over 1.1 million members, an increase of greater than 48% over the prior-year period, and the transactions from our loyalty members continue to increase representing more than 41% of our net sales in the third quarter.

Number three, while we are—while still a very small percentage of revenue, we continue to invest in our e-commerce platform with a primary focus on increasing our digital presence to build brand awareness and drive customer interaction. Traffic on our website increased greater than 32% in the third quarter versus the prior-year period as we continue to improve all aspects of our site.

As we have noted before, driving traffic to our site is a key component of our e-commerce strategy as we know customers use our site for product knowledge and availability as much as they do for pricing information. In addition, we are pleased to now offer a gun assortment online which is something that has been in the works for several months. Our customer now has the option to browse approximately 5500 guns online. These firearms must still be purchased through one of our physical store locations, but the opportunity for our customers to view and research our firearms offering in advance and see an expanded assortment of options has been a significant driver of site visits and has enhanced our in-store sales in the firearm category.

It is also important to note three critical benefits that we expect from selling firearms online as a brick-and-mortar retailer. First, given the firearm purchase must be purchased and picked up in person after filling out the appropriate federal firearms forms and passing a background check at the store, we expect more store visits in corresponding add-on sales to the original firearm purchase.

Second, our customers see a wider selection of firearms online that can then be sent from our DC or our vendors directly to the store. This expands each store's product offering and increases the ability to customize the offering to our customers' preferences. To date, over 27% of the firearms ordered online for in-store pickup have been these types of special orders.

And third, ordering online improves store conversion and reduces payroll as these orders are already sold units when the customer comes into the store to finish the purchasing process. This allows the interaction between our sales associates and the customer to focus on ancillary items for the firearms such as ammunition, gun cases, cleaning supplies, targets, etc.

Overall, we believe we are well-positioned to build on the demonstrated market share gains that we have enjoyed. The macro and competitive backdrop in combination with Company-specific drivers will fuel these gains.

Let me spend a few minutes recapping some key performance metrics and then discussing the environment.

Since becoming a public company, we have delivered on bottom-line financial targets 11 out of 11 quarters and on our top line goals 10 out of 11 quarters. Our commitment to maintaining a strategy of high unit and sales growth has not detracted from our ability to deliver consistent earnings growth. Over the past five years, we have increased our store count from 29 to 75 stores, an increase of 158%, as we make progress toward our stated goal of 300 stores nationally.

We have increased our sales by 122% or a compound annual growth rate of 14.2% and increased our Adjusted EBITDA by 215.5% for a compounded annual growth rate of 21.1% which includes absorbing the increased costs of being a public company. We are very proud of this performance and confident in our ability to continue to grow our Company profitably as we march toward our 300-store target. The best evidence of this commitment are the 28 stores that we have added since fiscal 2011 that have been open a full 12 months. These stores have had a combined average year one ROIC including initial inventory of 30.0%.

With the election uncertainty behind us now, we believe a Republican White House and Congress is a positive for both our Company and for the shooting sports industry as gun legislation fears should be alleviated setting the stage for continued steady growth in firearms.

We believe the recent changes to the competitive landscape with potential consolidation of the two largest national players provides significant opportunity for our business to continue to grow and outperform the rest of the industry for the following reasons. First, given the approximately 40% store overlap in a 50-mile radius that these companies have, we believe the near-term focus will be elimination or repurposing of owned real estate which can be highly distracting and a significant impediment to new incremental store growth.

Second, this impediment in combination with the resulting leverage of the combined entity of over five times EBITDA we believe will curtail both our store growth plans as well as any excessive promotional behavior.

Third, there is also potential integration-related disruption and loss of experienced personnel given the significant strategic and cultural differences of the two companies that could add another obstacle to further growth.

And lastly, the resulting size of the combined entity and its position as a highly leveraged private company we believe will cause caution in the vendor community and increase the appetite for vendors to expand merchandising efforts with other players, such as ourselves, to offset this increased risk.

We believe that each of these factors presents a favorable opportunity for Sportsman's to continue its store growth plan, maintain pricing integrity, reinforce our position as the low-cost provider in our industry and compete effectively for additional market share.

Before I conclude, I once again want to thank all of our team members for the great job that they do day in and day out. It is their commitment and dedication to Sportsman's Warehouse that has enabled us, enable the strong and consistent performance you have seen us deliver. With the favorable backdrop and our continued execution we look forward to building on our track record of consistently delivering against our operational and financial goals.

With that, I'll turn the call over to Kevan to discuss our financials.

Kevan Talbot:

Thanks, John. Good afternoon everyone. I will begin my remarks with the review of our third quarter results and then discuss our outlook for the remainder of fiscal year 2016. My comments today will focus on adjusted results. We have provided these results as well as an explanation of each line item and the reconciliation to GAAP net income and earnings per share in our earnings press release which was issued earlier today.

We are pleased with our third quarter 2016 result. Net sales increased 13% to $217.2 million from $192.1 million in the third quarter of last year with a 17.2% increase in the number of stores and a same-store sales increase of 2.1%. Our third quarter revenue was driven by strong performance in four of our six major categories, namely our hunting and shooting, clothing, footwear and fishing categories.

We continue to be excited about our opportunity to grow our store base in both new and existing markets. During the third quarter, we opened the remaining 5 of our 11 planned store locations for our 2016 class of stores and now operate 75 stores in 20 states. We remain committed to growing our store base and capitalizing on the significant wide space opportunity we see available to us.

We have now announced seven store locations in our 2017 class of stores, three of which we announced today, which John previously mentioned. We expect to announce additional 2017 store locations in the near future.

Turning to our same-store sales by each of our three-store groupings which are, one, base stores; two, new stores or acquired stores that have been in the comp base for two years or less; and three, stores that were subject to competitive openings, which we define as a new competitive entrant into a market within the past 18 months.

In the third quarter excluding the nine stores in our comp base that were subject to new competitive openings, our same-store sales increased 3.9% compared to the third quarter of last year. Our 39 base stores saw same-store sales increases of 3.1% in the third quarter. In addition, our 16 new stores saw same-store sales increase of 7.4% in the third quarter compared to the corresponding period of the prior year.

Finally, our nine stores that were subject to the new competitive openings experienced a same-store sales decrease of 8.1%. The 180 basis point headwind from new competition was higher than expected during the quarter due to a competitive opening in the third quarter which had been originally planned for mid-fourth quarter and subsequently had more of an impact on this grouping than we initially had anticipated.

Gross profit increased 11.6% in the quarter to $74.3 million compared to $66.6 million in the third quarter of fiscal year 2015. During the third quarter of fiscal year 2016, gross profit as a percentage of net sales decreased 40 basis points to 34.2%, from 34.6% in the corresponding period from last year, primarily as a result of a shift in the sales mix towards lower margin firearms and ammunition.

SG&A expenses, excluding the offering costs related to the Company's secondary offering in the third quarter of last year, were $53.7 million compared to $46.7 million in the third quarter of last year, as we began to invest in personnel and resources to allow for continued growth in 2017 and beyond. As a percentage of net sales, SG&A expenses in the quarter remained roughly flat at 24.7%.

Adjusted income from operations for the quarter increased to $20.5 million from $19.9 million in the third quarter of fiscal year 2015. Our net interest expense in the third quarter of 2016 was $3.4 million compared to $3.7 million of interest expense in the third quarter of 2015 as a result of our continued efforts to reduce our debt and the related interest expense.

We recorded an income tax expense of $6.6 million for the 13 weeks ended October 29, 2016 compared to $6 million in the corresponding period of fiscal year 2015. Net income for the quarter was $10.5 million or $0.25 per share based on a diluted weighted average share count of 42.6 million shares as compared to adjusted net income of $10 million or $0.24 per share based on a diluted weighted average share count of 42.4 million shares last year.

Adjusted EBITDA for the third quarter increased 8.3% to $26.1 million compared to Adjusted EBITDA of $24.1 million in the prior-year period.

As of October 29, 2016, the end of our fiscal third quarter, ending inventory was $304 million as compared to $253.9 million as of the end of the third quarter of fiscal year 2015. On a per store basis, inventory increased by 2.2%.

During the first nine months of fiscal year 2016, we incurred approximately $28 million in capital expenditures.

Turning to our outlook, as we look towards the remainder of fiscal year 2016, we have considered the following items in our guidance; first, we expect the demand for firearms to remain strong during the coming quarter. This trend will be tempered by the $5 million pull forward in demand that occurred in Q4 of fiscal year 2015.

Next, as we have discussed in previous conference calls, we were under-inventoried in our soft goods categories in the fourth quarter of last year, which curtailed our category sales performance, but benefited gross margins in Q4 last year as we did not have adequate inventory for our normal clearance activity. Given our more normalized soft goods inventory position this year, we expect to have more normalized Q4 clearance activity and resulting gross margin this year. Also, we have planned an additional advertising event for the fourth quarter of this year compared to the fourth quarter of last year.

Taking these factors into account, our outlook for the fourth quarter is as follows: revenue in the range of $230 million to $235 million; same-store sales change in the range of down 1% to positive 1% compared to the fourth quarter of last year, primarily as a result of the comparison of the $5 million pull forward in the prior year; earnings per diluted share of $0.27 to $0.30 on a diluted weighted average of approximately 42.6 million estimated common shares outstanding.

For fiscal year 2016, we expect revenue of $789 million to $794 million; same-store sales change in the range of flat to 2% compared to fiscal year 2015; and adjusted earnings per diluted share of $0.71 to $0.74 on a diluted weighted average of approximately 42.5 million estimated common shares outstanding.

We ended the quarter with $85.3 million outstanding borrowings on our line of—or $135 million line of credit facility. As it relates to capital expenditures, we still anticipate incurring approximately $35 million to $40 million in capital expenditures in fiscal year 2016, which includes the 11 stores in our 2016 class of stores that we've already opened as well as work on our 2017 new stores.

With that, I will now turn the call back over to the Operator to open the call up for questions.

Operator:

Thank you. Ladies and gentleman, at this time we will be conducting a question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate that your line has entered the queue. You may press star, two if you would like to remove your question from the queue. As a reminder, for anyone using speaker equipment, it may be necessary that you pick up your handset before pressing the star key. One moment please while we poll for your questions.

Our first question comes from the line of Peter Benedict with Robert Baird. Please go ahead, sir.

Peter Benedict:

Hi guys, couple of questions. First, if you're willing to just a quick discussion around trends, maybe that you saw around the election. I mean obviously it's been of all a couple of weeks here, but any kind of color on that? Staying with the political side of things, any State legislation that has passed recently that we need to be aware of, we saw some stuff in California potentially just want to make sure we're understanding that all correctly?

John Schaefer:

Sure. In the—as we've said in the past in previous election years 2008, 2012, if there was going to be a surge in firearms it came a day or two before the election. This year we saw a modest increase in activity before the election that started about a week before the election and that has continued post-election.

Now the thing to understand I think is, with a Republican-controlled Congress and a Republican President, the thing that worried us before was a Democratic President and a Democratic Senate meeting that you would end up with the Democratic nominee for Supreme Court and the potential for the Heller versus Washington DC to be overturned. That's not going to happen. In fact, gun legislation is probably at a Federal level got to go down. But really the pass (phon) on the Presidential Elections have always been short-term hits. In 2012, we had some unfortunate events at Sandy Hook that's really prolonged the surge at that timeframe not really the Presidential Election.

So really the stuff that is going on is at the state as you're asking and what we see going on in the states is really kind of happening in California. The biggest thing happening in California is the requirement to have ammunition purchased with a background check. That actually is a big benefit to us as a brick-and-mortar retailer as it virtually eliminates the purchasing of ammunition online by residents of the State of California. And as you know, we have a bunch of stores in California who are opening more stores in California, so I think that ends up being a net positive.

There really hasn't been a whole lot of other legislation that has any impact. A couple of states have passed legislation about private party transfers having to be done at a Federal firearms license dealer, but those are not requirements of us to do that. And as we've talked in previous year, Colorado passed a similar law, we're not required to service those private party transfers and we have chosen not to and there are a bunch of risks associated with doing such. And then the states that passed that it is basically the same as Colorado, so they really don't –that really doesn't have much of an impact on us. So it's really just the main one's the ammunition in California.

Peter Benedict:

Perfect. Thanks for that, John. Just on the competitive headwinds, it sounds like it was probably the DICK's Field & Stream combo store, I think that opened earlier, how do you guys think about the competitive headwind now for the fourth quarter? I think before you were thinking it might have been less than 100 basis points, but given that this opened earlier maybe that is going to be higher, and then how you're thinking about it next year can you give us a sense of how you see this flowing?

Kevan Talbot:

No you're exactly right, Peter. We do expect the competitive headwinds to be higher in the fourth quarter as a result of this early opening. However, come next year in the fourth quarter, we expect to see the benefit of that as that new store approaches the tail of that competitive curve. So currently our thoughts are is that we're going to be somewhere in the 120 to 130 basis points competitive headwind in the fourth quarter.

But that it's higher than what we had hoped for, but ultimately next fourth quarter, it will come back to benefit us.

John Schaefer:

And it starts to flow down as we get into the Q1 and Q2 of next year as we hit—more stores hit that 18-month mark.

Peter Benedict:

Sure. Absolutely makes sense. Was the response in your store to the Field & Stream stores similar to what you see when you have a Cabela's or a Bass Pro?

John Schaefer:

Actually not, it was more or like what we see to a Cabela's Outpost.

Peter Benedict:

Okay, makes sense. Last question oil and gas markets. I think you spoke to some impacts in the past on that, I didn't hear it in the remarks. Can you give us a sense for maybe what those markets did in the third quarter? Thanks.

Kevan Talbot:

The oil headwinds for the eight—or excuse me, the six oil stores that were there in the second quarter decreased 80 basis points, so sequentially they came down from a headwind perspective. So we will continue to monitor those oil headwinds but for those apples-to-apples stores, they are coming down.

Peter Benedict:

Okay, thanks very much.

Operator:

Our next question comes from the line of Seth Sigman with Credit Suisse. Please go ahead.

Seth Sigman:

Thanks, good afternoon. Nice quarter guys.

John Schaefer:

Thanks.

Seth Sigman:

Just following up on one of the prior questions, John, in the past you've talked about the normalized rate for firearms sales growth in the high single digit range. Does the outcome of the election change that view at all?

John Schaefer:

No it really hasn't and one of the things when I mentioned in the subcategories of long rifles, we're seeing some really strong performance in the bolt-action rifles which really tells us that the interest in hunting is actually growing. We're seeing—you know we've seen for the past couple of years the increase in shooting sports with handguns and shooting ranges in metropolitan areas and long-range target shooting.

We've always said that 5% to 8% normalized growth which is kind like a five-year CAGR on that. We've been actually a little stronger than that post election. So I think we're in a situation where the shooting sports are becoming very popular. Those, all those people that joined that became first time purchasers in 2012 and into 2013, it is clear those people are really now buying their second, third and fourth firearm as they get comfortable with the techniques of shooting both a handgun and a long rifle and become interested in the different types of calibers of rifles, the different types of make ups of rifles whether it be a bolt-action rifle or a modern sporting rifle.

So, they are starting to act like longer-term buyers in the shooting sports and I think that bodes really well for the industry on a go-forward basis just from an organic growth standpoint.

Seth Sigman:

Okay, thanks. And then on the competitive front, I'm just wondering have you seen any changes as a result of the announced merger just yet, maybe anything in terms of store plans or I guess maybe how is it changing your dialogue with vendors at this point?

John Schaefer:

Well our dialogue with vendors has always been excellent so I don't know that it's really changing a whole lot, although we'll see how that moves as we go into parts of next year where you would normally have more dialogue with vendors. I mean the SHOT Show's in January so there's not a lot of talk going on now with vendors.

We've seen the two companies that are planning to merge continue to operate independently and you can see that all you have to do is set one of their advertising inserts one right next to the other and you will see the vast difference in how they are strategically approaching the Christmas season, both in terms of where they put product, one company is putting firearms not until Page 20, other handling ammunition, one has it at $11.99, the other has it at $6.99. They are acting pretty much as independent companies which I think is probably the prudent thing to do until they get this process completed.

From a competitive opening standpoint, we certainly haven't heard of anything new. We have heard rumblings although, I wouldn't say they've been—we have been able to verify all of them, but we've heard rumblings from the real estate community about delays and certain things like that, but that's not a lot different than you hear all the time.

Seth Sigman:

Okay. Then just on current trends, it sounds like you're pleased with where the business is now. If I look at the guidance the comp's down one to up one, if you stripped out I guess the pull forward from a year ago, the $5 million, it would still point to comps in the 2.5% range in the fourth quarter. So, pretty much in line with where you've been tracking the last couple of quarters. Just wanted to clarify that you're not really seeing any major change in underlying trends.

John Schaefer:

I think we're pretty happy with the way the entire year has gone. It's been pretty steady. It's been pretty much as we expected. We're now lapping the weather. The weather is not great, but it wasn't great in the fourth quarter last year. So, I don't think that there's—I think the steady pace of what we've been seeing in the last few quarters we have no reason to see that it will change in any material way going forward.

Seth Sigman:

Okay, great. Thanks very much.

John Schaefer:

Sure.

Operator:

Our next question comes from the line of Daniel Hofkin with William Blair. Please go ahead.

Daniel Hofkin:

Good afternoon guys. Just maybe a little bit of clarification. I may have missed this earlier, but within the quarterly results obviously kind of sort of lower end of the comp plan, could you discuss any areas that might have been a little softer than you had expected and then conversely anything that might have been stronger just within the different categories? And then I have a follow-up.

Kevan Talbot:

John called out in his remarks, obviously we're very pleased in our soft goods categories, both clothing and footwear. We were cautiously optimistic that they would turn positive and we did. Although the third quarter was warmer, we did have a few spots of weather that were right prior to the hunts that really helped us in the use categories as we've referred to in the past.

One of the disappointing categories for us was in the optics and electronics department. We're seeing a lot of price cuts in that we're selling I think roughly the same number of units if not a little bit down particularly with respect to electronics. There has just not been a lot of innovation there and the prices are coming down as is natural in a product evolution cycle. So that is hurting us from a optics, electronics and accessories department. That really has been the one underperforming department.

Our camping department which was also negative was just slightly negative; again on a two-year stack basis is a very strong category for us. So, we're not disappointed there, although we had hoped that that would turn positive in the third quarter. Those were the two primary factors there kind of weighing down the comp from that perspective.

Daniel Hofkin:

Okay. Then with regard to the kind of the components of the comp were (inaudible) and kind of distinguishing between traffic, foot traffic and transactions, were transactions themselves positive or was it all average ticket?

Kevan Talbot:

I don't have that data right in front of me, so I'll have to follow up with you on that one, Dan.

Daniel Hofkin:

Okay. Then I guess just thinking beyond the fourth quarter, by the same token the first quarter of next year, the comparison eases for the same reason that it is tough in the fourth quarter. Is there anything else just from a kind of a flow into next year that we should be aware of or with your comment before about the comp, underlying comp outlook have been pretty steady, but is there anything else from a comparison standpoint moving through the year that we ought to be aware of?

Kevan Talbot:

We'll address those specific events as we provide our 2017 guidance on our next earnings call. So as of right now we're not prepared to talk about those items, but we will do so at the appropriate time.

Daniel Hofkin:

Okay, thanks very much.

Operator:

Our next question comes from the line of Andrew Burns with DA Davidson. Please go ahead.

Andrew Burns:

Thanks and congrats on the solid year-to-date performance. During the prepared remarks you mentioned the marketing initiatives in the fourth quarter. I didn't know if there was just a shift in timing of an annual promotion or if there was incremental spend because you saw an opportunity in the marketplace?

John Schaefer:

It was a slight incremental spend. I mean we promote constantly from Thanksgiving through Christmas and everybody does. We had an insert last year that we wanted to last for 10 days and 10 days is just too long for an insert at this time of the year so we added another insert in that time period. So, we're promoting through the same length of time. We've just added a little bit more freshness to keep the newness and the freshness out there and a little more attractive and hopefully it will obviously do that to spur some incremental sales as these inserts go through their normal evolution.

Andrew Burns:

Thanks. Weather was clearly not a benefit in the quarter but there was easy comparisons relative to last season. Did the season's weather have a negative impact on hunting category performance and do we need to see a big improvement in weather for you to be able to clear out soft goods as you move through the fourth quarter?

John Schaefer:

No, I don't think we need to. I think our inventory level in clothing and footwear especially in the hunting categories is solid. We've seen some good growth in hunting as we noted with the bolt action rifles doing well in the firearms category. There are plenty of participants. It's a little—there's some things—we could use a couple of weeks of cold weather. I mean it's a little hard to sell packed foods (phon) when it is 80 degrees but people are—I don't think we're going to be over inventory. If you'll remember last year in the fourth quarter we ran out of product mid-December. We didn't overbuy this year, assuming that we had to make up for that and for a cold winter. As I said back in the first quarter when we were talking about the rest of the year I said that we are buying for the fourth quarter based on really no weather change but making sure we have enough inventory go through a normal selling cycle that includes both the Christmas selling season, the after Christmas selling season, and then the clearance sales that you normally have as a retailer in January. We bought to that and I think that's where we're sitting right now, so I don't see any issues with it.

Andrew Burns:

Thanks and good luck.

John Schaefer:

Thanks.

Operator:

Our next question comes from the line of Stephen Tanal with Goldman Sachs. Please go ahead.

Stephen Tanal:

Hey good afternoon guys. Thanks for the questions. I guess if you think a little bit longer term about how the story is evolving, certainly I appreciate the choppiness of the category kind of quarter-to-quarter, but what is in your mind at this point sort of a fair assumption for kind of a normal annual same-store sales growth rate that is achievable here going forward?

Kevan Talbot:

We've always believed that, again as you've indicated stripping out the choppiness, we believe we can achieve a long term, steady state same-store sales on a store basis of 2% to 3% at maturity. We typically see a 1.5%—1% to 1.5% price increase from our vendors that are passed along to us each year and then that combined with other things that we do inside the store, other new products as well as remerchandising or other things that we make to improve the experience for our customers, we believe we can achieve that other amount to get us to that 2% to 3% level.

Stephen Tanal:

That's helpful. Thinking about SG&A, I know you had kind of given us the heads-up there'd be a little bit of investment activity in the back half, I think on a per square foot basis or per store kind of normalized on that basis. It still looked a little more than we modelled. Is there another acceleration here in 4Q or was this the pick-up and this is kind of the trend rate that we carry forward?

Kevan Talbot:

As we've looked at the investments that we've been talking to all year long, that really—the plan is for that to be the third and the fourth quarter, so we're continuing—we're continuing on with our plans, with these investments and that will be through the fourth quarter. As we talked about before, we do expect to leverage these expenses in 2017, but we will talk specifically about that again as we provide our annual guidance at the next earnings release.

Stephen Tanal:

Got it. Just to be clear, like a similar trend rate 3Q to 4Q there is no incremental pickup per se?

Kevan Talbot:

No, no. That would be correct.

Stephen Tanal:

Got it. Awesome. Then lastly from me. Inventory looked maybe a little bit elevated. I know your competitor had mentioned potentially stocking up on firearms in advance of any sort of a spike or just generally better demand around the election. Is that a similar dynamic or can you comment on what the inventory is? I guess you're also cycling a pretty lean period on apparel, but any color there would be helpful. And that's it from me.

John Schaefer:

We increased the inventory in the firearms category. It wasn't specifically because of a potential surge or anything but we saw continued strength as we went through the year. We had some opportunities to buy ahead which we took advantage of and now we are going through the normal sell-through process that's about as we expected with these firearms.

So we—at least we anticipated an increased inventory going into Q4 which will result in the normal sell-through we see going through Q4 and into next year. So it wasn't any type of special stocking up, although we were certainly prepared with backup orders to stock up had there been a dramatic surge pre or post election.

Stephen Tanal:

Okay. Thanks a lot.

Operator:

Now our next question comes from the line of Peter Keith with Piper Jaffray. Your line is live.

Peter Keith:

Hi, thank you and good afternoon everyone. It's a little bit nuanced on the guidance, but I hope you could give us some color just on how the full year was adjusted. It looks like the bottom end was taken up by a penny and the top end was taken down by two pennies. Was there anything that transpired in Q3 or that's coming up in Q4 that's changed your outlook maybe a little bit for the worse?

Kevan Talbot:

No, there hasn't. Really that is just a narrowing of the range as a result of our activity there. As I drilled into to that activity I think there might be a penny of rounding from the fourth quarter there, but really it's the same exact guidance that we had planned on for the fourth quarter when we provided annual guidance last quarter.

Peter Keith:

Okay, that's great to hear. Sort of beating a dead horse here, but on the firearms dynamics, so it would appear the stock market has determined that your business some of the manufacturers would see a slowing of sales here post election but I guess what you are saying is that you're not seeing anything thus far and looking out you would anticipate maybe in the long term it is actually better. Just want to maybe put those words in your mouth, is that correct?

John Schaefer:

Well, yes, as I said, we saw a small surge a little bit before the election, nothing like 2012 and post election. As we said in our prepared remarks firearm sales continued strong. There is a growing number. The thing that's absolutely evident to us is there are a whole lot of people that are participating in the shooting sports, a whole lot more people than there were before. Can we quantify it? No, but we do know that 20% of the surge in 2012 and '13 was first-time buyers and we are now seeing those people joining our loyalty program. We are seeing those people coming in and buying their first long gun as well as their second handgun.

So I think the strength of the industry is here to stay. I think the CAGR of 5% to 8% is certainly achievable going forward. I think what you have is you have a Federal Government with laws that are really kind of a nonfactor and frankly the party of the President really has never been a long-term factor in the firearms industry.

As you noted in the San Bernardino effect of last year was simply a pull forward and it was only a pull forward because President Obama came out with a bunch of executive orders which scared a lot of people until they actually read them and realized that they didn't really mean much.

So what you're really trying to look at when it comes to firearms is what's the new steady state and I think the new steady state is a pretty darn good number and we're seeing that strength as we go into the fourth quarter.

Peter Keith:

Okay, that's good feedback. I appreciate that, John. Two other questions for Kevan then. First on the gross margin. There was a bit of a directional change from Q2. Just checking my notes and you guys had some freight and vendor incentive benefits. What is the more realistic trend of gross margin? Is it Q2 where you maybe some increase or Q3 where maybe there is constant mix headwinds going forward?

Kevan Talbot:

A lot of it depends. As we discussed last quarter, the freight and the vendor incentives we weren't planning for the freight benefits to continue and we didn't see those materialize in the third quarter and the vendor incentives we really started to see that in Q3 of 2015. So while the vendor incentives have continued on an incremental basis year-over-year we did not see a lift as a percentage is an impact to our gross margin.

So we do continue to expect our vendor incentives to continue. Our vendors are good partners with us and they continue to offer us incentives with their products that we take advantage of. Those plans are for them to continue, but incrementally there's not any lift over the prior year because those programs were in place a year ago.

Peter Keith:

Okay, and the mix dynamic in the quarter, was that similar Q3 through Q2 or was there an increased mix headwind?

Kevan Talbot:

No, the 40 basis point drop I think is my calculation showed 35 basis points of it was product mix which was primarily the sales mix shift to the firearms to strengthen the firearms and ammunition.

Peter Keith:

Okay thanks. Lastly from me then. My favorite question every quarter, that overtime rule with the DOL kicking in December 1, do you guys have determination on adjustments and how that might impact the expense structure if at all?

Kevan Talbot:

Well, we made the adjustments this quarter. We've been very pleased with how they've been working. We did see some additional overtime, but it was not significant enough to call out. So as a result we don't expect any additional significant pressures as a result of that change.

Peter Keith:

Okay, sounds good. Nice quarter and good luck in the fourth quarter.

Kevan Talbot:

Thank you.

Operator:

There are no further questions at this time. I'll turn the call back over to Management for any closing remarks.

Kevan Talbot:

Thank you for your time everyone and we will talk to you next quarter.

Operator:

Thank you. This does conclude our teleconference for today. We thank you for your time and participation ladies and gentlemen. You may disconnect your lines at this time. Enjoy the rest of your day.