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Sportsman's Warehouse Holdings, Inc.

First Quarter 2017 Earnings Conference Call

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CORPORATE PARTICIPANTS

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CONFERENCE CALL PARTICIPANTS

Peter Benedict, *Robert W. Baird*

Stephen Tanal, *Goldman Sachs*

Seth Sigman, *Credit Suisse*

Andrew Burns, *DA Davidson*

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PRESENTATION

Operator:

Greetings and welcome to Sportsman's Warehouse Holdings, Inc. First Quarter 2017 Conference Call. At this time, all participants are in a listen-only mode. 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 would now turn the conference over to Ms. Rachel Schacter of ICR. Thank you. Ms. Schacter, you may now begin.

Rachel Schacter:

Thank you. Good afternoon, everyone. With me on the call is John Schaefer, 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 10-K for the year ending January 28, 2017.

We will also disclose 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 would like to turn the call over to John Schaefer, 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 first quarter 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.

Before I begin, I would like to comment briefly on the recent activity within our industry as it relates to Gander Mountain. As you all are aware, Gander Mountain filed for bankruptcy on March 10, 2017. We have been watching and monitoring Gander Mountain for several years and knew that they had some well positioned stores. Therefore, when the opportunity arose after they filed for Chapter 11, we evaluated a subset of stores and placed a value on the inventory and assets through a very disciplined approach.

We made a bid for these assets and inventory as part of the bankruptcy auction. However, when the price of those assets exceeded the price we were willing to pay for the assets, we chose not to continue with the auction process. I would really like to thank all of our partners for their collaboration through the entire process and our lenders in particular, who stood ready to work with us to increase our term loan and ABL and provide us with covenant flexibility for us to finance the proposed transaction at the price that we were willing to pay.

With that process behind us, we are pleased to announce today that we have entered into an amendment to our term loan agreement with our lender which provides us with increased covenant flexibility. This is a testament to the strong relationship we have with our lender partners and their confidence in our business. Kevan will discuss this amendment in more detail shortly.

Now, looking at our first quarter financial performance. Net sales grew 3.5% to $156.9 million, and same store sales decreased 6.9% with a loss per share of $0.08. On the top line, while we saw continued softness in firearm demand as we anniversaried difficult compares post the San Bernardino shooting and executive orders that were issued at the beginning of 2016, net sales and same store sales were better than our expectations as the demand for firearms and ammunition improved in the back half of the quarter.

The same store sales decline of 6.9% versus the prior-year period reflected a combination of the following factors. First, for the first quarter the NICS data showed a continuation of slowed firearm demand post-election. Our hunting and shooting department, which includes firearms and ammunition as well as related gear and equipment, contributed 4.5% of our 6.9% comp decline in Q1. As we said previously, the underlying demand in this department remains strong when compared to historical levels, partially driven by increased participation rates in outdoor shooting sports as more women and children participate, despite the year-over-year decline in hunting and shooting.

We are also encouraged to see that a significant portion of our sales continued to be generated from the use category, especially in our rural markets which are typically more stable and consistent over time compared to protection purchases and skews toward the historical 5% to 8% annual growth rate. To that end, in the first quarter our non-MSR rifle and shotgun unit sales were up 6.9% versus the prior year.

Second, the new store competition cohort within our store based, which is the segment of stores with same store sales that are negatively affected by new competition in a particular market until approximately the 18 months mark, at which point the impact begins to diminish, saw a competitive headwind of 120 basis points in the first quarter. For fiscal year 2017, we continue to expect only two stores to be impacted by new competition which is down from five stores in fiscal year 2016. We anticipate the competitive impact to our comp to begin to lessen to approximately 100 basis points for fiscal year 2017 versus 170 basis points impact during fiscal year 2016.

Third, the impact to comp from our seven oil and gas stores in the first quarter was 27 basis points, a sequential improvement from the 60 basis points impact we saw in the fourth quarter. We are monitoring these stores and continue to expect continued improvement in the remainder of the year as we anniversary easier companions.

Turning to our category sales performance for the quarter.

We are pleased with our clothing and footwear business which represents roughly 15% of our sales mix and saw increases of 10.3% and 8.6%, respectively, on a same-store basis. These increases are a direct result of the improvement in our inventory position in these two categories. As expected, we saw a slow start to the fishing season in the first quarter as a result of the snowpack that has melted and flooded rivers in the West. Our fishing category was down 10.8% on a same-store basis for the quarter and we expect to see a continuation of this soft performance in the first half of the second quarter as the snowpack continues to melt which will lead to high water levels.

While the tough anniversarying of firearms hurt us on a same store sales basis, it is important to note that the NICS data for states in which we operate declined on a unit basis by 0.4% versus the prior year, whereas our actual unit performance increased 5.4% versus the prior year. This data clearly shows our continued ability to find underserved markets for new stores and our increasing share on an overall basis in the states in which we operate.

Gross margin decreased 100 basis points for the quarter from the same period of the prior year, primarily due to increased promotional activity that continued from the fourth quarter. Given the oversupply of firearms, we saw high promotional intensity from both mom and pops and national competitors. As a result we increased our promotional activity during the quarter in order to maintain our market share position.

Our operating expenses in the first quarter included cost related to our Shooting Spectacular advertising campaign that ran for two days in the first quarter and will run for eight days in the second quarter with all associated costs incurred in the first quarter. Kevan will discuss this in more detail shortly.

Operating loss for the quarter was $3.7 million compared to operating income of $2.4 million in the prior-year period. Adjusted net loss of $3.4 million or $0.08 per diluted share compared to adjusted net loss of $0.1 million or $0.00 per diluted share in the prior-year period.

We continue to believe we are the best positioned retailer in our niche to continue to capture market share in the category despite the recent slowdown in firearm demand across the industry and we believe we are benefiting from a consolidating competitive environment which provides us with increased market share opportunity. Our customers continue to enjoy our in-store shopping experience, given our extensive offering of brand-name products, everyday low pricing strategy and knowledgeable customer service, combined with our convenience as a neighborhood store in larger markets, our big-box appeal in the smaller markets. Given the nature of our product offering, we continue to believe that we are well positioned against online only retailers as our customer likes to touch and feel the product prior to purchasing, which continues to make our stores very important.

As we have noted before, approximately 30% of our revenue has some element of online restriction so our customer must buy these products in store. Our everyday low pricing is competitive with and sometimes better than pricing offered by other online players. Given all this, we continue to believe we are well positioned to build on our market share gains. Looking ahead, we remain focused on our strategic growth initiatives and key priorities. Let me discuss a few including progress made in the first quarter.

First, we continue to see significant whitespace opportunity for our stores. With the opening of four stores in the first quarter, we are on track to open the 12 stores that we have announced for fiscal 2017 or square footage growth of approximately 350,000 square feet or an increase of approximately 11% year-over-year. Looking ahead to fiscal 2018, while we continue to believe in the 300 store potential that exists for Sportsman's Warehouse nationally, given current industry conditions and continued market consolidation amongst the national players, we are moderating our store opening plans and expect to open between five and nine stores in fiscal year 2018. We believe this moderation is prudent and will also allow us to allocate more free cash flow to debt pay down next year.

Second, we remain focused on maximizing the potential of our loyalty program which continues to post strong gains. As of the end of the first quarter we had approximately 1.3 million members, an increase of greater than 38% over the prior-year period, and transactions from our loyalty members continue to grow, representing more than 46% of our net sales in the first quarter. During the first quarter, we held events that were catered to our loyalty members which were very successful. We have also begun developing and utilizing more personalized and effective marketing strategies targeted to our loyalty member customer base.

Third, we continue to be pleased with our private-label performance that represented 2.6% of our net sales during the first quarter. During the quarter we increased our private-label penetration by 6.3% from the first quarter last year. Our private-label product not only offers our customers better quality at better price points but also carries a higher gross margin.

Fourth, we continue to enhance our e-commerce platform and increase our digital presence through continued investments. E-commerce, though still a small segment for us, grew to $1.8 million in the first quarter from $1.4 million in the prior-year period, an increase of 28.1%. We are pleased with the increased traffic to our site as customers use our product as a research tool in addition to making certain purchases.

Our 5500 gun assortment online continues to drive traffic to our site as well as in-store sales within the firearm category, as customers need to complete the final purchase in store. As we'd said in the past, approximately 30% of our guns sold online and picked up in-store are special make-ups, which expands our already substantial online firearm offering even more and provides our customer with one of the most extensive online selections available.

Since Jon Barker has been on Board as President, he has been working to enhance the overall e-commerce experience and analyzing ways to drive more revenue from this channel.

And fifth, we are continuing to invest in our store teams and associate training to maintain our high quality customer service that differentiates us from the competition. In the first quarter, we continued to promote from within for our new store manager positions. The store manager's previous in-store experience allows us to continue to cater to our customers and reinforces our service-oriented culture.

So overall, the softness in the firearm and ammunition category continued into the first quarter though began to improve particularly in the second half of the quarter, combined with a heightened promotional environment resulting in better than expected top line and adjusted EPS within our guided range for the quarter. We are encouraged by the progress we continue to make against all of our strategic growth priorities in the first quarter.

For the remainder of the year, we are maintaining a conservative approach for the second quarter until we anniversary the unfortunate events that took place in Orlando in June 2016 and the pre-election run-up that caused increased demand in our firearm and ammunition categories. We expect the industry inventory oversupply to result in continued high levels of promotion and resulting margin pressure in Q2.

As a reminder, we expect 56 of our stores will be impacted by minimum wage increases in fiscal year 2017 that will drive up our SG&A cost for the year. Given this, combined with some of the abating headwinds I just discussed for the back half of the year, we continue to expect year-over-year trends in the second half of 2017 to show improvement relative to year-on-year performance trends in the first half of the year.

Before I end, I want to thank all of our team members for their tireless work and dedication to executing with discipline every single day. They are the reason our customers enjoy shopping in our stores and reward us with their loyalty.

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

Kevan Talbot:

Thanks, John. Good afternoon, everyone. I will begin my remarks with a review of our first quarter results and then discuss our outlook for the remainder of fiscal year 2017. My comments today will focus on adjusted results. We have provided these results, as well as an explanation of each line item and reconciliation to GAAP net income and earnings per share in our earnings press release which was issued earlier today.

Net sales for the quarter increased 3.5% to $156.9 million from $151.6 million in the first quarter of last year with a same-store sales decrease of 6.9%. We opened four stores during the first quarter and ended the quarter with 79 stores in 22 states or a square footage growth of 10.7% from the end of the first quarter of fiscal year 2016. The four store openings in the first quarter were, Cedar City, Utah; Moses Lake, Washington; Wilmington, North Carolina; and Morgantown, West Virginia. Subsequent to the end of the first quarter, we opened a store in Yuma, Arizona, and we will open a store this weekend in Henderson, Nevada, putting us half way to our 2017 store opening plan.

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 first quarter, excluding the five stores in our comp base that were subject to new competitive openings, our same store sales decreased to 5.7% compared to the first quarter of last year. Our 43 base store saw same store sales decreases of 6.3% in the first quarter. In addition, our 19 new stores saw a same store sales decrease of 3.5% in the first quarter compared to the corresponding quarter of the prior year. Finally, our five stores that were subject to new competitive openings experienced a same store sales decrease of 17.3%.

As John mentioned, our competitive headwinds were 120 basis point during the quarter, representing a 50 basis point improvement in the competitive headwinds when compared to the first quarter of last year.

Gross profit was roughly flat at $48.6 million compared to $48.5 million in the first quarter of fiscal year 2016. During the first quarter of fiscal year 2017, gross profit as a percentage of net sales decreased 100 basis points to 31% from 32% in the prior-year period as a result of increased promotional activity, particularly in the firearm and ammunition categories.

Excluding the $1.7 million of cost associated with our participation in the Gander Mountain auction, adjusted SG&A increased 9.8% to $50.6 million for the first quarter of fiscal year 2017 from SG&A of $46.1 million in the first quarter of fiscal year 2016 due to minimum wage increases, continued investments in our personnel and stores, and approximately $135,000 of expenses that will not recur in the second quarter associated with our Shooting Spectacular advertising campaign, which John mentioned.

As a percentage of net sales, adjusted SG&A expenses in the quarter increased approximately 190 basis points to 32.3% from 30.4%. Adjusted loss from operations for the quarter was $2 million as compared to adjusted operating income of $2.5 million in the first quarter of fiscal year 2016. Our net interest expense in the first quarter of 2017 decreased to $3.2 million compared to $3.6 million of interest expense in the first quarter of 2016. We recorded an income tax benefit of $2.4 million for the 13 weeks ended April 29, 2017, compared to $1.5 million in the corresponding period of fiscal year 2016.

Adjusted net loss for the quarter was $3.4 million or $0.08 per diluted share based on a diluted weighted average share count of 42.3 million as compared to an adjusted net loss of $0.1 million or $0.00 per share based on a diluted weighted average share count of 42.3 million shares last year. Adjusted EBITDA for the first quarter decreased to $4.2 million compared to $7.4 million in the prior-year period.

Turning to our balance sheet. As of April 29, 2017, ending inventory was $288.3 million as compared with $251 million as of the end of the prior-year period. On a per-store basis, inventory decreased by 2.6%. We are satisfied with the quality of our inventory position as we enter the second quarter of fiscal year 2017.

As John mentioned, we are pleased to announce that we have amended the debt covenants on our term loan. We increased the maximum leverage ratio in each quarter remaining on the term loan by amounts ranging from 0.2 times to 1.3 times with an average quarterly increase of 0.75 times. The largest increase in the covenant level is in fiscal year 2018, which includes increases of 1.1 times to 1.3 times. We believe these amended maximum leverage covenant levels provide us with sufficient flexibility to continue to successfully execute our key strategies.

As a result of the amendment, the interest rate on our term loan will increase 25 basis points to LIBOR plus 6.25% with a 1.25% LIBOR floor, up from LIBOR plus 6% with a 1.25% LIBOR floor previously. For additional details regarding the amendment, please see Exhibit 10.1 included in our 10-Q filing that will be filed with the SEC within the next few days.

Our liquidity remains strong as we ended the quarter with $78.1 million in outstanding borrowings on our $135 million credit facility leaving us with excess availability of approximately $33 million under the terms of this agreement. We also have access to a $15 million accordion feature on this facility that we intend to exercise this summer which will bring the size of our line of credit to $150 million. This increase will improve our liquidity as we build our inventory to meet our seasonal needs as well as continue to execute our store growth plans.

During the first quarter, we incurred approximately $13.2 million in capital expenditures. Turning to our outlook. As we look towards the rest of the fiscal year 2017, we are considering the following items in our guidance. We expect the second quarter of the year to perform below the prior-year period as we face tough comparisons created by the increased demand that resulted from the unfortunate events that took place in Orlando, Florida in June of 2016. We expect our fishing category to remain weak in the second quarter as the significant snowpack in the Western United States continue to melt which will lead to high water level. We expect the industry inventory oversupply to result in continued high levels of promotion and resulting margin pressure in the second quarter.

We expect the impact of new competitive stores to our same stores sales to be approximately 100 basis points for the full year. We expect modest improvement in the headwinds faced by our stores in the oil and gas markets in the second half of the year. We anticipate a $1.5 million to $2 million impact to SG&A

for the fiscal year as a result of the state minimum wage increases that will impact 56 of our stores, the majority of which were effective January 1, 2017. Lastly, as a reminder, fiscal year 2017 is a 53 week year. We estimate that the extra week will add approximately $10 million to $12 million in revenue, which will result in approximately one penny in EPS for the year.

Taking these factors into account, our outlook for the second quarter is as follows. Revenue in the range of $189 million to $194 million. A same-store sales decline in the range of down 8% to down 10% compared to the second quarter of last year, and diluted earnings per share of $0.12 to $0.14 on a weighted average of approximately 42.8 million estimated common shares outstanding. For the full fiscal year, we are reiterating our outlook which includes 12 new store openings with square footage growth of approximately 350,000 square feet in 2017 or an increase of approximately 11% over the prior year. We expect revenue of $825 million to $845 million which includes $10 million to $12 million of revenue from the 53rd week. On a 52-week basis we expect same store sales decline in the range of down 4% to down 6% compared to fiscal year 2016.

Our fiscal year 2017 expectations for adjusted earnings per diluted share are $0.60 to $0.68 on a weighted average of approximately 42.8 million estimated common shares outstanding. Our earnings per share guidance includes approximately one penny from the 53rd week in fiscal year 2017. As it relates to capital expenditures, we continue to expect to incur approximately $35 million to $40 million in capital expenditures in fiscal year 2017, which includes the 12 stores in our 2017 class of stores, as well as work on our 2018 class of stores that will begin at the end of this fiscal year.

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

Operator:

Thank you. We will now be conducting a question-and-answer session. If you'd like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys.

Our first question is from Peter Benedict of Robert W. Baird. Please go ahead.

Peter Benedict:

Hey guys. A couple of questions. Kevan, can you help us with the cadence on gross margin. I mean I know you guys are expecting more promotions in the second quarter here. Should we expect that the gross margin declines are similar to what we saw in the first quarter or should they moderate?

Kevan Talbot:

They should moderate. Last year, if you will recall, during the first quarter we had an inventory shortage in our clothing and footwear departments which caused us to miss significantly on sales but we had extremely high gross margins in those two categories in particular. This year those two categories returned to a more normal gross margin. So as we go into the second quarter, I mean that was really manifest itself last year in the first quarter, so we shouldn't have significant declines in those two categories as what we experienced in the first quarter. So it should moderate in the second quarter.

Peter Benedict:

Okay. Great. And then within footwear and apparel, any specific lines are working? I think, John, you had mentioned your better in-stocks; you are able to take advantage there. But maybe a little more color around what's working in those categories for you?

John Schaefer:

I think, in our women's category we were significantly under stocked last year and I think we have the right mix of inventory not just in the number of skews but in the color waves (phon) we are showing in the women's area, and the camo we have in the women's area. And then I think our activewear is much better positioned this year than it was last year. Camouflage, we have always been strong. We continue to make improvements in the private label with the Rustic Ridge label and with the Killik brand. So I think all sections of the clothing business are doing well but the big change over the last year is the availability of good product in the activewear side, which I think is pretty complementary for us.

Peter Benedict:

Okay. Great. And just two more. One on SG&A. Just as we think going forward, I mean you guys held your full year plan, gross margin tough here, interest expense going up a bit. So are you finding some incremental areas to save in SG&A? I mean you talked about the minimum wage increase which is already in there but as you kind of go through this, how should we think about the growth rate? I think it was roughly 10% in the first quarter at some of those items. How should we think about that for the balance of the year?

Kevan Talbot:

It's pretty consistent. And as far as our guidance goes, the incremental interest expense is going to be over roughly the last three quarters of the year. While there is an increase there on the interest expense side of things, it didn't round to a full penny for the year so we left the guidance the same for the year. SG&A, we are doing everything that we can to save cost there and those cost savings are baked into our guidance. A lot of that is in personnel areas. It's in overhead. Obviously some of those costs are variable expenses that as the revenue goes down, also the dollars go down. So it's a Management perspective and we feel like we have baked all of those areas of savings into the guidance that we have provided there.

Peter Benedict:

Okay. Perfect. Last question, I promise. On next year for cap ex, obviously with the store growth coming down you are going to save some money there. Are there any other capital requirements that we should be thinking about in 2018 that would maybe prevent the cap ex from stepping down year-over-year? Thank you.

John Schaefer:

We have talked in 2018 about bringing a new distribution center online for opening in 2018. This decision to slow our growth in 2018 is a relatively recent decision that the Company has made. We have not yet evaluated our needs from a distribution perspective but there potentially could be an impact in terms of a delay of the necessity to expand our distribution center. So we still need to further analyze that but there could be some savings from a capital expenditure perspective in 2018 as well as a result of what we decide to do with our distribution center.

Peter Benedict:

Okay, terrific. Thanks so much guys.

Operator:

Thank you. The next question is from Stephen Tanal of Goldman Sachs. Please go ahead.

Stephen Tanal:

Hi. Good afternoon guys. Thanks for taking the question. I just wanted to understand a little bit more about the promotional environment. Obviously sales have come in a bit better and NICS was actually stronger too. I was wondering how much do you guys think promotional activity has started helping the environment out there. Is there a way to maybe size it in the context of the comp or anything like that?

John Schaefer:

You know, I am not sure that we can articulate an actual number for that. What we have seen is, we have been watching promotional activities from our national competitors going on well over a year now and this over supply it's not the first time we have seen this rodeo in terms of a short-term oversupply of firearms and ammunition. So what we decided to do this year was add a Shooting Spectacular promotion which we haven't done before. That's really the only thing different that we have done. In the second quarter I don't see us doing anything outside of our normal cadence for promotions. There might be a little bit of a mix change in the promotions but I think we have pretty much zeroed in on what we need to do. We are already the low price leader here and people still haven't really come down to our prices in certain categories.

So I think with the one addition of trying to jumpstart hunting a little bit which worked very well for us, frankly, I think that our promotional cadence is going to be about the same. So I don't know that I could have articulated it a year ago but I don't think it's going to be any different than a year ago.

Stephen Tanal:

Got it. Has the environment changed much like into exiting the quarter. It looks a little like your inventories are maybe a bit heavy but you had good things to say there. Maybe just comment on kind of the current state of things.

Kevan Talbot:

So with respect to inventory, as we look at our inventory on a per-store basis, we are actually down 2.6%. So we are pleased with where that is and that's even a little bit higher than where we would have expected it simply as we had a few vendors come to us with some opportunistic purchases. We have talked about this in the past and indicated that we have expected those to come this year as vendors try and hit their numbers as well. We did see a few of those and so we took advantage of some of those early purchases. But overall, as we look at our inventory on a per-store basis, we are down year-over-year. So we are pleased with that.

John Schaefer:

Yes. Steve, I think from a global standpoint, what we are finding and I think we are really pretty pleased with the way our inventory sits today because there is a couple of things going on. Number one, we are getting some opportunistic buys, as Kevan just alluded to, which we have always taken advantage of and which we will continue to take advantage of. Secondly, we are delaying purchases on certain categories and certain items as we believe and continue to believe that the oversupply in these certain categories will result in opportunities from a purchase standpoint later on in the year.

And most importantly, I think our buying group has done a sensational job in maintaining price protection on the inventory that we currently have. If in fact some of the categories that we're deeper on today that we want to be deep on should they result in price concessions later on in the year our group of merchants and buyers has done an outstanding job making sure that we have price protection on the inventory we have today.

So, overall, I think we knew this was going to be a tough year going in and we knew the inventory had to be maintained at a very disciplined level and I think we are executing that pretty well.

Stephen Tanal:

Got. Thanks a lot guys.

Operator:

Thank you. The next question is from Seth Sigman of Credit Suisse. Please go ahead.

Seth Sigman:

Thanks. Good afternoon guys. I just had a couple of follow up questions here. I guess first on Gander Mountain. The liquidation of those stores, given the minimal overlap, is that something that you would expect to impact you? And then I guess on the upside, once they do close, do you think you get a benefit from that?

John Schaefer:

One, fortunately no, the other unfortunately no. There is really not going to be much of an impact to us as these liquidation sales go on. They had three stores that overlapped with us, two of which were in their first 32 that they were closing. So that impact has been non-existent, frankly. When they do close, I think the benefit to us will be in opportunities from a store growth standpoint and opportunities from a vendor product standpoint, because they are going to a lose a significant amount of purchasing with Gander going out.

The one area of benefit that I think we and others will probably see is gandermountain.com is now no longer there. And gandermountain.com with 60 years of a name behind it was a pretty powerful e-commerce site. And that has now shut down and that demand has to go somewhere and we are seeing some of it, I am sure others are seeing some of it as well. So net-net, I think it's going to be a positive to us for a number of reasons.

Seth Sigman:

Okay. And in general, as you think about the market for opportunistic purchases and the vendor benefits you have been talking about, is that something that you expect to show up in the margins this year or do you think that gets reinvested?

John Schaefer:

You know, I think because we buy for a longer period of time in certain of these key categories, I think it will show up in the second half of the year and into 2018. But it's not going to be like a all of a sudden you get a blip. It's going to be a gradual consistent improvement over the course of four to six or seven months.

Seth Sigman:

Okay. And then just regarding store growth, the five to nine that you are planning for next year now. Can you just give us a sense of the types of stores and the types of markets? Is it going to reflect any sort of shift maybe to smaller stores, smaller markets? Any color would be helpful.

John Schaefer:

You know, the strategy we have always had even prior to now with Gander Mountain and our participation in the auction, was to continue to find smaller, very profitable places to go in the west with the 15,000 square foot format and we will probably do a couple of those. Two or three of those. And then we have continued to say that the south and the southeast is a very attractive market to us and we have opened some stores there this quarter. There and I think we will continue to move along that strategy as we go forward with our 30,000 square foot stores. In terms of the mix, we have always kind of been a 60:40, kind of 30 to 15. I think that will probably be very close to the same kind of ratio as we move into 2018.

The big deal for 2018 and going from a 15 store or a 12 store growth to a five to nine is two-fold. One, with the Bath (phon) and Cabela's thing going on, they have to play it, so far it has taken quite a long time for it to play itself out. With the Gander Mountain being purchased by a player outside the industry, we will see how that transforms. If it transforms into an outdoor company or into a recreational company more of an REI type company. We will have to see how that goes but certainly there is going to be opportunities in the Midwest that will be there. And with the fallout of numerous stores, you've got rue21, hhgregg, Gordman's, is like a 27,000 to 30,000 square foot box that would work very good for us.

All that real estate becoming available, I think it just makes sense from our standpoint to—we know the markets we want to be in. You know, at any given time we have 30 markets we can just jump into whenever we want, it's in our best interest to kind of watch and see how all these things play out both from a location standpoint. A market standpoint, a location within a market standpoint, and just as important, an ultimate pricing standpoint. And I think that makes the most sense for us, which is kind of the—you put all those three things together and you say, listen, I might as well start paying down some debt because that's always been—the strategies have always been growth and paydown of debt consistent with each other and will morph a little bit more into paying down debt in 2018 and then back to the normal cadence.

Seth Sigman:

Okay, great. Thanks very much.

Operator:

Thank you. The next question is from Andrew Burns of DA Davidson. Please go ahead.

Andrew Burns:

Good afternoon. Congrats on the solid performance in a tough environment. It's encouraging to hear your firearms units were up in the quarter. Clearly, pricing is a headwind given all the discounting. Where do you think we are in that process of finding inventory balance? I saw a lot of manufacturer sponsored mail-in rebates in 1Q and clearly mom and pop stores were also promotional. Just wondering how we should think about pricing in that category going forward. Thanks.

Kevan Talbot:

You know, Andrew, as we have talked in the past, the manufacturer rebates that you have referenced there is really what we have seen historically when we have gone through these down cycles as manufacturers have tried to, if you want to refer to it as 'prime the pump.' So we did expect the manufacturers rebates, expect those to continue. We think that another two to possibly three quarters to get through this cycle. And as we get to the end of the year, we think that we will possibly be through this. So it has a little bit left to go still but that's kind of the first step as we start to see these manufacturer rebates come through.

Andrew Burns:

Great. Thanks. And if you look at the first quarter guidance, revenue coming in a bit above the high end there, EPS at the low end of the range. Just wondering what the variance was there, if there is anything to call out. Whether perhaps the promotional activity was a bit higher than planned or was it on the operating expense side or mix side that caused that variance. Thanks.

Kevan Talbot:

A lot of it came in at the margin perspective. As John mentioned, the Shooting Spectacular ad that we did towards the end of the quarter, we are pleased with the results there but that led to some product margin pressures that were there. We have already talked about the product margin pressures that came in the clothing and footwear department. As we look at our SG&A as well, we try to make the adjustments where we can. There was certainly an impact on the earnings per share from the stock price. And what I mean when I say that is, the stock-based compensation is recorded from a book perspective at the fair value on the date of the grant. Because of the decline in our stock price we took a tax shortfall in our income tax provision, that's a discrete item that was there. It was roughly $275,000 that goes straight to earnings per share. It's a rounded penny that negatively impact us during the quarter that wasn't factored into our guidance.

So a couple of factors there from the gross margin line as well as on the tax line.

Andrew Burns:

Great. Thanks. And then one quick one, just on the loyalty program that's proven to be a great customer retention tool. Any updates there, how the membership growth is looking and you monetizing that program? Thanks.

Kevan Talbot:

We are almost up to 1.3 million members. We saw an increase in the percentage of transactions and the percentage of the dollars that went through that program. As John mentioned in his prepared remarks, we had some events that we did that we felt were very successful drawing upon that loyalty component of those customers in that customer base there. We have tried a lot of different things and we are continuing to try new things to see what works. And some of them don't but we have been very pleased with that program as we continue to modify and draw upon that affinity that exists amongst those customers.

Andrew Burns:

Thanks and good luck.

Kevan Talbot:

Thank you.

Operator:

Thank you. The next question is from Daniel Hofkin of William Blair. Please go ahead.

Daniel Hofkin:

Good afternoon guys. I'd just ask you to elaborate a little bit on a couple of things. First, you mentioned that the Shooting Spectacular event that you ran, you are pleased with it, yet was more margin dilutive. I guess what aspect of it were you pleased by? Was it more just in terms of gaining market share or why were you pleased with it given the dilution on the margin side? That's my first question.

John Schaefer:

The reason we are pleased with is it drove traffic and it continued to show us a couple of things. One, there is lot of promotions going on there so we have to play the game. We didn't promote. While there was margin degradation, it wasn't—on a percent basis it wasn't that severe in terms of regular gross margin dollars, there was actually a nice increase in gross margin dollars and the ad was paid about—88% of the ad was paid for through co-op, which only left us with about $135,000 of expense on that. So if you look at all those dynamics in terms of increased traffic, in terms of real margin dollars, in terms of cooperation from our vendor partners in the co-op side of it, and the continuation of having to play in a promotional environment, I think it worked out very well for us from a bottom line standpoint and obviously a top line standpoint.

Kevan Talbot:

A couple of additional things to add with respect to that. This ad campaign was right at the end of the quarter and so all of the cost got recognized in the first quarter. We will continue to see the benefits because the revenue came in as well at the beginning of the second quarter.

The second thing that I would like to add is, as we look at the various ad campaigns that we run, there is a certain shelf life that you can tell there is a lift in the sales and then it starts to fall off the longer that that ad remains on the shelf. This campaign had a much longer shelf life than some of our traditional, historical ads. And so we are very pleased with it from that perspective. This campaign drove traffic, as John indicated, it drove revenue for the entire duration of the ad and didn't fall off at the same curve that we normally see. So for that reason, we were also pleased with the ad.

Daniel Hofkin:

That's very helpful. And then I guess I don't know if I missed this, did you quantify the cap ex benefit, of presumably both this year and next from cutting your store opening plan for next year?

Kevan Talbot:

We have not quantified that yet. The 2017 growth plans are fixed. We have committed to those stores. There potentially could be a reduction in 2017 cap ex as it relates to the timing of the stores that we do open in 2018. While those openings have not been set yet as a result we have not revised that, if you want to call it a 'tail cap ex' in the end of the fiscal year related to 2018 but there potentially could be a reduction of the cap ex guide in the fourth quarter as a result of when the timing of the stores that we do open actually occurs in 2018.

Daniel Hofkin:

And then just for the sake of—just on a total basis whenever it happens, should we just look at kind of historically what it's been on a per-store basis or can you quantify how much cap ex savings you expect whether it's this year or next year, from your reduction in openings next year?

Kevan Talbot:

We don't anticipate the amount per store is going to change. So back historically on a 30,000 square foot store we have put into roughly $2 million investment of which I think $300,000, $350,000 is pre-opening expenses that would not be capitalized. So on average $1.7 million to $2 million. Our smaller format stores average about $1.5 million including the pre-opening expenses. So you back that down by another couple of hundred grand, that's probably $1.3 million. And again that's a net number, net of any landlord incentive dollars that we receive. So I would—those amounts have not changed, so I think those are good guides to use as you look through the 2018 models that you do.

Daniel Hofkin:

Okay. And then finally you talked about all together, I guess hunting, shooting and related that includes ammo and related accessories representing 4.5 percentage points of the overall comp decline. Is that fair to say that collectively if those categories would have comped down roughly 9%, just in isolation, and if so, any major differences within whether it's firearm versus ammo etc.?

John Schaefer:

I am not going to opine on your number, Dan, I will let you and Kevan work that one out. But clearly we are following the same pattern we always do which is we're—on firearms and ammo, they both decrease together and then firearms start to rebound, followed by three to five months later ammunition comes back. So as we see the bottoming out of the firearms, I think we are still seeing a decrease in the ammunition. And as we go through the second half of the year when we start seeing an increase in the firearms, we will see a lag again in the ammunition. So in terms of mix, ammo is still a bigger negative than firearms or the ancillary categories in the hunting and shooting area.

Daniel Hofkin:

Okay. Thank you. On private label, my last question, where does that stand currently and where do you see it going long term and what type of benefit can that provide to margins?

Kevan Talbot:

This quarter our private label sales were 2.6% of our revenue. Still a small percentage but it was up over last year. So we are still headed in the right direction. We still have private label strategies that we believe will over time take us somewhere into the 7% to 10% number. Again, we tried to do this very methodically, very deliberate, as opposed to just doing it—jumping in and making some mistakes. So we are doing it very slow but we are seeing growth there. From a margin perspective, we see 7% to 8% higher gross margins on our private label products than we do on our non-private label products. So we are very pleased with that. We think that once we get to a certain scale when we can source directly overseas, we think that number can go a little bit higher than the 7% to 8%. But currently that's what we are seeing on our private label products.

Daniel Hofkin:

That's great. Thanks. Best of luck.

Operator:

Thank you. The next question is from Peter Keith of Piper Jaffray. Please go ahead.

Peter Keith:

Hey, thanks. Good afternoon guys. Congratulations on renegotiating the debt terms. I just want to make sure I have the numbers straight. So if the covenant limit steps down in early 2018 to 2.5 times (inaudible) on average 2018 is now an increase by 1.1 to 1.3. So leverage ratio, covenant limits come in, call it maybe 3.7 at this point?

Kevan Talbot:

Yes. Specifically Q1 of 2018, it's 3.6, Q2 of 2018 it's 3.7, Q3 of2018 it's 3.8. The exact amendment will be in our 10-Q that we anticipate filing sometime tomorrow. So you will be able to look at those specifically. But yes, those quarters that I know were of concern to certain individuals, we saw a really big lift in those covenant levels.

Peter Keith:

Yes. Congratulations on that, that's good. And then just maybe pivoting to another topic. So Jon Barker started at the end of March as COO. Maybe now that he's been there for a month and half, are there any operating initiatives that he has brought out that he sees as maybe early opportunities that he could have an impact?

John Schaefer:

Yes. I think the movement forward in a very disciplined and effective approach to our e-commerce strategy, all the way from content to page search, to organic search to product presentation, to content campaigns, all of those things that we were sort of good at, we are going to be really good at. Now these things don't occur overnight but I would say in the first couple of weeks that Jon was here, he saw a whole lot of low hanging fruit. And as we go through our strategic planning through this year, we will see just how fast we want to capitalize on that low hanging fruit and what it will mean to our e-commerce business. But it's been very enlightening to me and I think to our whole team and frankly our whole e-commerce team is very excited about the things that Jon just knows intuitively that that will benefit us greatly.

Peter Keith:

Okay. That's good. And maybe on the e-commerce topic. So I would certainly agree that your business is going to under index to the shift to e-com over time. But at this point you have pretty high shipping rates on individual items. I was wondering if you could talk about the structure with your distribution center. Is that—are you shipping it yourself? And is there any thought to bringing down the rates or maybe putting in some limits where you get free shipping at a certain dollar amount?

John Schaefer:

Our distribution center is uniquely positioned based on the size we were back in 2009 in that we have an ability that a lot of brick and mortar retailers don't have, which is the ability to item pick. So the transition from a distribution standpoint, from a shipping and handling standpoint to item pick product from our DC has always been an advantage of ours. We have approached the shipping rates probably more like a cataloguer than a pure play online e-commerce player, and that is clearly one of the things Jon is looking at in terms of how that impacts our traffic, how that impacts our conversion, and what the optimal point of shipping is, or at what point we should give free shipping. So that's a perfect example of the types of things that Jon can quickly bring to the table. I am not suggesting we are going to implement them tomorrow but there's certainly things that we can address now with a high degree of confidence that we are getting the right payback for doing some of these things.

Peter Keith:

Okay. Great detail. Thank you very much and good luck.

John Schaefer:

Thanks.

Operator:

Thank you. The next question is from Patrick McKeever of MKM Partners. Please go ahead.

Patrick McKeever:

Okay, thank you. John, I know back prior to the election or perhaps right around the election, you said that republicans in Washington that that was a good thing for the firearms business over the longer term.

So now we are five, six months post the election, and I am just wondering what your view is now based on some of the things that have been happening in Washington. I am wondering if—is Washington sort of out of the picture now as it relates to some of the day to day trends with firearm sales and I am thinking of, for example, I know concealed-carry is a big issue in some places right now and some states are looking to do away with the permit requirement. Does that sort of thing have any kind of an impact on your business? I guess my question is, are you seeing any response from a demand standpoint to anything that's going on at Washington right now or even at the state level.

John Schaefer:

Well, I mean a relatively long-winded response would be that what I said back in after the election I think still holds true. I think the fact that Washington is not talking about specific legislation that relates to preventing firearms to be sold is a good thing because what it does is it gets rid of these peaks and valleys that are caused by panic when politicians start pontificating about potential legislation and it really turns the focus on what the true market size is and what the true market growth rate is for firearms which we have said is 5% to 8% and we are skewed toward the use side. So the fact that it's a republican-controlled Washington I think is still a good thing for us because it takes away those peaks and valleys and it shows, in our states especially. If you look at the NICS data for the first quarter, for all states it was down like 3.6%, for our states it was only down 0.4%, and for us it was up 5%.

So it really skews the buyers to the ones who are really passionate about the outdoors, who want to buy the firearms for use. As it relates to concealed-carry and there is a lot of states that are basically allowing concealed-carry without significant class time or the much reduced class requirement or permit requirement. Which also, I think, bodes well for the people that are into the protection mode. We don't do as much protection as certain other states, in our states, but that certainly doesn't hinder us at all. So I think what you see here—and we got to get past—we are past San Bernardino and the executive orders. We got to get past Orlando, we have to get past the run up to the election. And what you are going to see is what we can already see is a relatively steady, good growth in the categories of firearms that we excel in, which is shotguns, long rifles and certain MSRs, and certain categories of handguns, but really those products that are more use related than protection related. So we see it as a good thing.

Patrick McKeever:

Okay. Sounds good. And then just a question on fishing and the comments about the snowcap, the melt. I was just wondering if you could talk through that a little bit more just to help us understand what's happening there and how that might play out over the next few months. I mean when would things normalize just in terms of the impact to rivers and streams and whatnot?

John Schaefer:

Well, the dilemma—there's a couple of dilemmas going on. One, the snowpack was so great and it melted and is melting relatively quickly that certain streams and rivers are inaccessible. And that's problem number one. Problem number two is, the high water results in colder water which delays the salmon from running. The salmons still have to get to spawning grounds but they are going to get there at a little slower pace and a litter later and that really delays the fishing season. And the fishing season basically it's kind of a use it or lose it kind of a period of time. Once it's done, it's done. So you lose the first quarter it's not like you are going to make that up at the end of the second quarter. And that's been kind of the negative on the fishing side. There is still going to be a salmon run but it's just taking forever to get there and when it comes, it's going to be very short.

John Schaefer:

Great. Okay. Thank you.

Operator:

Thank you. There are no further questions in queue at this time. I would like to turn the conference back over to Management for closing remarks.

John Schaefer:

Appreciate everyone listening to us today and everyone have a good day. Thank you very much. Bye-bye.

Operator:

Thank you. Ladies and gentlemen, this does conclude today's teleconference. You may disconnect your lines at this time and thank you for your participation.