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Sportsman's Warehouse Holdings, Inc.

Third Quarter 2015 Earnings Conference Call

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Peter Benedict, *Robert W. Baird*

Peter Keith, *Piper Jaffray*

Stephen Tanal, *Goldman Sachs*

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PRESENTATION

Operator:

Greetings, and welcome to the Sportsman's Warehouse Third Quarter 2015 Earnings 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, please press star, zero on your telephone keypad. As a reminder, this conference is being recorded.

With no further ado, I would now like to turn the conference over to our host, Ms. Rachel Schacter. Thank you. Ms. Schacter, you may begin.

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 includes 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 risk and uncertainties, including those described in the Company's most recent 10-K filed with the SEC on April 2, 2015.

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 comparable 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, President and Chief Executive Officer of Sportsman's Warehouse.

John V. 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 the progress we are making against our strategic growth initiatives. 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, which came in within our guidance. The sequential improvement in the hunting categories that became evident last quarter continued into Q3. However, our clothing and footwear business was impacted by the unseasonably warm weather that we have seen in most of our markets.

A few Q3 operational highlights. We opened our final 2015 new stores during the third quarter in Albany, Oregon, Flagstaff, Arizona and Sheridan, Colorado and once again saw strong initial results. As with the previous several quarters, we met each of our financial performance objectives, despite the just mentioned weather headwinds and continued competition in many of our markets, the latter of which has been a consistent theme.

We continue to do better against the competition as we grow our store base, increase our brand awareness and peacefully co-exist with our peers.

While the warmer-than-normal weather has been a headwind, we have stuck to our pricing and promotional calendar and have once again maintained margins, despite the shortfall in the higher margin categories of clothing and footwear. Our differentiated approach focusing on everyday low price, high customer service and concentration in both neighborhood locations with short drive times and rural areas where product availability is lacking has allowed us to continue to deliver on our goals in each quarter that we had been at public company.

These attributes continue to differentiate us from both our major competitors as well as the mom-and-pop segment of the industry, as our concept is almost complementary with the former and we offer a significantly broader and more relevant selection versus the latter.

Net sales for the quarter increased 9.4% to $199.7 million. Same-store sales were flat at 0% versus the prior-year period, despite the unseasonably warm weather which again caused our clothing area to post negative comps on a same-store sales basis. Excluding the 12 stores that were impacted by new competition, our same-stores sales were up 1.4% in total, with the majority of our stores without competition generating positive comps, once again confirming our expectation that the normalization of the industry will begin in the second half of this year.

Looking more closely at our store sales performance for the quarter; firearm sales on a same-store basis were basically flat with the third quarter of last year due entirely to mix. The warm weather and drought conditions in many of our western markets caused multiple streams and small ponds to dry out, impacting the fall—waterfall hunting season and causing a year-over-year decline in shotgun sales. This mix impact notwithstanding, we believe firearm sales from both a mix and price perspective are returning to historical trends and are moving with the overall growth in the industry.

From an overall basis, NICS data in the states in which we operate had a unit increase over the prior year of 5.7%. Our unit increase was 8.1%, showing we are continuing to gain market share. While ammunition sales on a same-store basis were down slightly over the prior year, we still see indications that this is due to customers reducing their stockpile of ammunition. This is based on our observation of relative strength in ancillary categories like cleaning supplies and targets for example that tell us ammunition is being used far more than the sell-through metrics for the category would suggest. Our store growth, performance in the firearm and ammunition categories and ancillary businesses, as well as the growth in our non-hunting categories, all point to continued share gains and traction in markets of all sizes as either complementary alternatives to major competitors in larger markets or at the expense of mom-and-pops and the direct channel in smaller markets.

From a composition standpoint, conversion and average order size improvement offset customer frequency declines. Relative strength in camping and fishing categories offset the weakness in clothing and footwear, while overall hunting categories were relatively flat year-over-year as I just mentioned.

Clothing and footwear on a same-store sales basis were off 8.2% versus the prior year, representing the vast majority of the delta between our actual Q3 sales performance and the high end of our guidance range. While not evident from our clothing and footwear category same-store sales performance this quarter, our brand focus supplemented with private label, our good, better, best product offering and pricing strategy and our consistent presentation within the store is resonating with customers based on our analysis of both customer feedback and shopping behavior.

Now, on to profitability. Gross margin increased 10 basis points from the same period last year, as we saw an increased mix of higher margin camping sales, partially offset by a decreased mix of clothing and footwear sales versus the prior year. Once again, we delivered on our sales goals and held individual product gross margin across most of our categories.

Adjusted operating income for the quarter was $19.9 million with adjusted earnings per share of $0.24 at the high end of our guidance and an improvement over the adjusted earnings per share of $0.21 in the prior-year period.

Looking at competition; in the third quarter, we saw the presence of new competition within the last 18 months in 12 stores or 19% of our store base. Stores facing competition once again performed better than planned during the quarter. This has been a consistent theme throughout the year and is a testament to our differentiation and focus on providing both the outdoor enthusiast and the first time participant a memorable outdoor experience.

It is also becoming clear that our customer base enjoy shopping in our stores based on our convenience as a neighborhood store in larger markets or our big box appeal in smaller communities where we provide a greater assortment than the mom-and-pop competition or enjoying Advantage versus online-only options by providing outdoor enthusiasts with the touch and feel of product they may not have been physically exposed to before.

Our pricing is similar to and in many cases better than the prices that can be found online and as we've noted before, many key product lines are not available or very difficult to purchase via the direct channel.

Looking ahead, we remain focused on our strategic growth initiatives and key priorities. First, we remain focused on the significant store growth opportunity we see in existing and new markets that we expect will support an expected unit growth rate of greater than 10% annually for the next few years. With the opening of the final three stores in the third quarter, we have achieved our store opening objectives for this year on time and prior to the start of the all-important hunting and holiday seasons.

Our operating discipline and prudent use of cash has continued to allow us to self-fund our store growth and we expect to continue our pace of new store openings into 2016.

Second, we have seen consistent performance out of our 45,000 square foot boxes and executed a successful fixturing strategy rounded in analytics around SKU productivity and customer preferences among other things that has enabled our success in smaller 30,000 square boxes as well.

As I discussed last quarter, in Q1 this year, we opened our first 15,000 to 17,000 square foot stores in Klamath Falls, Oregon, and Heber City, Utah and are pleased with the performance we are seeing at these stores which has given us the confidence to continue to pursue this unique strategy going forward.

Number three, another priority continues to be enhancing operating margins through increased sales of our private label products while simultaneously expanding our programs in clothing and footwear with major brands.

While sales in clothing and footwear were down versus the prior year, due entirely to the impact of weather our fixturing presentation and store design continues to successfully drive traffic to those areas of the store as we highlight our brand focus and supplement our branded offering with private label options and the attractive associated price points and product categories where this makes sense.

Number four. We continue to focus on maximizing the potential of our loyalty program which continues to post strong gains. We now have over 750,000 members and the transactions from the loyalty members continues to increase.

Number five. We will continue to focus on the in-store customer experience by ensuring our great associates receive adequate training so they can continue to deliver the very high service levels our customers have come to expect from us. Despite the difficult conditions faced by some in our industry, we have been able to add over 500 employees to our team over the past year, while continuing to grow with free cash flow. This will continue to allow us to develop the bench strength we need to continue to grow and build our Company.

Number six. Our commitment to offer our customers service, convenience, pricing and enhance their outdoor experience has never wavered and our disciplined approach to our cost structure has allowed us to continue to offer everyday low prices to our customers without resorting to incremental promotions that negatively impact profit objectives.

So, in summary, we are pleased that we delivered Q3 results that were within our range of expectations, despite some headwinds, and are encouraged by the progress we continue to make against all of our strategic growth priorities.

As we look forward toward the all important fourth quarter, we see both positive trends as well as some headwinds. On the negative side, the weather and weather forecast do not bode well for a rebound in the clothing and footwear categories in the fourth quarter. Even though Q4 of 2014 was warm, the weather this year is expected to be even warmer and the winter weather gear that would normally be sold at the start of the hunting season has not yet materialized.

However, more importantly, on the positive side we feel very good about the continued positive momentum we have seen in the past few months in the used categories of hunting, fishing and camping, indicating our customers are continuing to take advantage of the activities available to them in the outdoors. We are also excited about the work we have done with our vendors to provide our customers with exciting products at exceptional value for the holidays and we are confident in our continued ability to adhere to our operating discipline going forward.

Before I end, I 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 driven our success to date and will enable our success going forward.

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

Kevan P. Talbot:

Thanks, John. Good afternoon, everyone. I'll begin my remarks with a review of our fiscal year 2015 third quarter results and then discuss our outlook for the remainder of fiscal year 2015. My comments today will focus on the adjusted results for the third quarter of fiscal year 2015, which excludes the offering costs associated with the secondary offering that closed during the third quarter. We do not have any similar adjustments for the third quarter of fiscal year 2014. We describe these results in the financial tables in our earnings press release issued today. A reconciliation of GAAP net income and earnings per share to these numbers is contained in these tables along with an explanation of each adjustment.

As John said, our top line results came in within our guidance. Net sales increased in the third quarter by 9.4% to $199.7 million from $182.5 million in the third quarter of last year on flat same-store sales. From a category perspective, our same-store sales were led by strong results from our camping and fishing categories, offset by weaknesses in clothing and footwear categories. Overall, our hunting categories were relatively flat.

We continue to be excited about our opportunity to grow our store base by not only increasing the number of markets in which we are located, but also by increasing our market penetration within our existing market. We recently announced two additional store openings for 2016 in Slidell, Louisiana and Las Cruces, New Mexico, which will be our first store in Louisiana and our third store in New Mexico respectively. We now have announced six locations for our 2016 class of stores. We have many stores in our pipeline, and will be announcing additional 2016 locations soon as we continue to execute on our plans for unit growth of greater than 10% next year.

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 12 stores in our comp base that were subject to new competitive openings, our same-store sales increased 1.4% compared to the third quarter of last year. Our 26 base stores saw same-store sales increases of 0.8% in the third quarter compared to the third quarter of last year. In addition, our 17 new stores saw same-store sales increase of 2.7% in the third quarter compared to the corresponding period of the prior year. Finally, our 12 stores that were subject to new competitive openings experienced a same-store sales decline of 5.4% in the third quarter of this year compared to the third quarter of last year, again, ahead of our expectation.

During the third quarter, we experienced an underperformance of those stores located in markets with exposure to the oil and gas industry versus the rest of our store base. Similar to the second quarter, the impact was minimal which we continue to believe reflects the importance and use focus of our product assortment to our customers in those markets.

Gross profit in the quarter was $66.6 million compared to $60.7 million in the third quarter of fiscal year 2014. During the third quarter of fiscal year 2015, gross profit as a percentage of net sales increased 10 basis points to 33.3% from 33.2% in the corresponding period from last year. We are particularly pleased with this gross margin and performance, given it was delivered against the backdrop of the continued promotional environment in which the national players also participated as well as the weather-driven mix shift towards the lower margin hard goods categories.

During the third quarter, our loyalty patrons increased by more than 15% or to approximately 750,000 members. Over time, we expect to increase frequency of customer visits, grow average ticket, and materialize benefits associated with these metrics as we continue to grow the program across our customer base.

Adjusted SG&A expenses for the quarter were $46.7 million compared to SG&A expenses of $42 million in the third quarter of fiscal year 2014. As a percentage of net sales, adjusted SG&A expenses in the quarter increased to 23.3% from 23% in the corresponding fiscal quarter of 2014, primarily as a result of the preopening expenses of three stores opened during this quarter when compared with only one store opening in the same quarter of the prior year.

Adjusted income from operations for the quarter was $19.9 million as compared to income from operations of $18.6 million in the third quarter of fiscal year 2014. The year-over-year increase was driven by an increase in the number of stores opened, offset by the SG&A factors I just described.

Our net interest expense in the third quarter of fiscal year 2015 was $3.7 million compared to $4.1 million in the third quarter of fiscal year 2014. Our interest expense decreased when compared to the prior year as a result of the refinancing of our term loan during the fourth quarter of fiscal year 2014 and amending of credit facility to lower our interest rates by 25 basis points earlier in this quarter.

For the quarter, our effective tax rate was 38.5%, the same effective tax rate in the corresponding quarter of last year.

Adjusted net income for the quarter was $10 million and adjusted earnings per share was $0.24 based on a diluted weighted average share count of 42.4 million shares as compared to net income of $8.9 million or adjusted earnings per share of $0.21 based on a diluted weighted average share count 41.9 million shares last year.

Adjusted EBITDA for the third quarter of fiscal year 2015 was $24.1 million, compared to Adjusted EBITDA of $21.8 million in the prior-year period.

Ending inventory was $253.9 million as compared to $230.6 million in inventory as of the end of the third quarter of fiscal year 2014. On a per store basis, our inventory at the end of the third quarter was approximately 5% lower than at the end of the same period of the prior year. We are pleased with our inventory position, including soft goods, which based upon last year's results were purchased conservatively this year.

Turning to our outlook, as John mentioned, we expect the weather to continue to have an impact upon our soft good sales in the fourth quarter. As a result, our outlook includes fourth quarter revenue to be in the range of $203 million to $208 million. We expect same-store sales to be approximately flat compared to the fourth quarter of last year, and earnings per diluted share of $0.24 to $0.26 on a weighted average of approximately 42.4 million estimated common shares outstanding.

For the full fiscal year 2015, we are narrowing our outlook initially provided with our fiscal year 2014 year-end release. We expect revenue of $720 million to $725 million; same-store sales of approximately flat and earnings per diluted share of $0.58 to $0.60 on a weighted average of approximately 42.3 million estimated common shares outstanding.

We ended the quarter with $206.7 million in outstanding borrowings, and $63.7 million in borrowing availability under our credit facility. During the first nine months of fiscal year 2015, we incurred approximately $29.8 million in capital expenditures.

Not including the receipt of any landlord incentives and proceeds from the sale leaseback transactions, we expect to incur additional capital expenditures of approximately $5 million to $7 million during the remainder of fiscal year 2015, which will include work on our 2016 class of stores. We expect that this growth will be funded with our free cash flow, and we do not anticipate any additional debt financing to be able to carry out our growth strategies.

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

Operator:

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 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 key. One moment, please, while we open the line for questions.

Our first question comes from the line of Seth Sigman of Credit Suisse. Please proceed with your question.

Seth Sigman:

Good job, guys, navigating a tough environment. I wanted to focus first on weather, because it's a common theme this quarter. Is there a way to give us a sense of how the business was trending until you started to face that weather issue to get a sense of the underlying trends in the business?

John V. Schaefer:

Well, it's kind of a tough question to answer, Seth, since in the spring the weather was warm and never really got cold, so it's kind of acting pretty similar to the way it did starting in Q4 of last year or just never got cold and snowy in Q4. So I don't know that we can actually compare to what we would consider normal once you consider all the different things we've done in the past year with clothing. What we can say about clothing is that the weather is causing a certain type of customer to not shop in our store; and what I mean by that is we've done a lot of analysis of the clothing and footwear transactions, and the people that are buying from other departments except clothing and footwear, meaning if they're buying some ammunition or cleaning supplies or something and are buying clothing as well, that continues to do well. It's those people that have only bought clothing and footwear last year compared to this year that's gone down.

What that really means is it means, when there's bad weather people come to our store and just buy some clothing and footwear. When there's good weather they don't buy that stuff and that's where we're seeing the shortfall because of the weather and that's why we can feel pretty confident that our store design, our layout, our brand focus, our product offering is really where it needs to be because those people that are coming in with a different priority are buying clothing and footwear, it's the people that are coming in because the weather is bad that aren't coming in.

Seth Sigman:

Okay, that's helpful. Then, so if we shift to margins, you guys were able to grow margins in the quarter. There does seem to be a lot of noisy out there on promotions in Q4, it seems to be a little bit beyond just apparel and footwear. Obviously you've shown you can navigate that but just curious what you're seeing out there in the competitive landscape and what you may be assuming in Q4 for gross margin. It doesn't seem to embed really that much pressure in Q4, so any color would be helpful.

John V. Schaefer:

Yes, I'll let Kevan talk about what it means in terms of the margin number, but you hear a lot of stuff about increased promotional environment. I'm not exactly sure what that means, if it means that more days in the quarter will have items that are at good prices that's certainly the case and it's mainly because a significant number of retailers including us are moving more good value product pre-Thanksgiving and I think that's an industry trend as everybody is seeing that. You're losing a lot of customers on Black Friday because of the large crowds, so you want to try to get those customers earlier, so you're starting to do things earlier and we're doing that as well.

The second area where people might be talking about an increased promotion is simply going lower in price and lower in margin, and that's usually a result of excess inventory. We don't have excess inventory, so we're not really going on that—into that area.

The third area that could potentially impact margins, and I think this is a relatively important one, is the deals you do with the vendors. So if you all of a sudden have a 30% or 40% off item in normal course, you take half of that margin hit and the vendor would take half of that margin hit and it'd be something that you would do year-over-year so you'd have consistent margins.

We're seeing that continuing amongst some of our competitors, but then there are other competitors that appear to be going even deeper and that's going to impact margin. Now, we believe we peacefully co-exist with these other major competitors and we believe we have a unique position in the smaller rural markets such that we don't have to do that. So we're pretty much sticking to our normal promotional calendar with the exception of moving some good opportunistic buys into the pre-Thanksgiving period similar to other retailers.

Kevan P. Talbot:

With respect to the actual gross margin, we saw benefits in two key areas that I want to call out, specifically we've seen declining freight costs. The freight and transportation of our inventory flows through our gross margin; freight as a percentage of revenue this year versus last year was a 20 basis point favorable uptick as fuel prices and fuel surcharges have declined. We definitely saw an impact there with respect to that.

Also as we talked last quarter, we under-bought our spring soft goods, which from a liquidation perspective helped us during the third quarter, and so while our sales declined in our soft goods categories we saw increases in our gross margins to the tune of about approximately a point and a half in our gross margin just on our product categories that helped us.

So as we look at the fourth quarter, we—again as I indicated in my comments, we bought conservatively on our soft goods, we feel good about our inventory position despite the sales shortfall, so we don't expect significant liquidations in the fourth quarter. But as you've indicated, we—and as John as well, we expect a little bit of the competitive pressures, the promotional environment. So our guidance embeds a flat to slightly down gross margin year-over-year when compared against the fourth quarter of last year.

Seth Sigman:

Got it. All right, thanks very much.

Operator:

Our next question comes from the line of Peter Benedict of Robert Baird. Mr. Benedict, please proceed with your question.

Peter Benedict:

Hey guys, thanks for taking the question. Couple of questions. First, I know you're not going to give us the monthly cadence for comps in the third quarter but just curious how big the swing may have been from the beginning to the end when the seasonal products came—became a bigger part of the business. Can you give us any flavor for that, John?

John V. Schaefer:

Well, I think as you've heard from other retailers, the beginning of the quarter through the Labor Day timeframe was pretty good, that back-to-school which we don't really have back-to-school but that period of time was pretty good. But then as you expect to get incremental mix benefit as the weather turns colder into late September/early October I think that's where we really kind of started seeing the mix benefit that you would hopefully get where the weather change didn't occur.

Peter Benedict:

Yes, no that's fair. Okay, and then any sense for how long customers will take working off those stockpiles of ammo before they have to restock, is there a way to kind of frame how much they actually have in stock? Have you guys seen this before in the past? What can you tell us about that?

John V. Schaefer:

We haven't seen it in the past to the extent that the hoarding was going on in 2013 and 2014. What we can tell you is that there is still good supply and good demand of ammunition. I think we're getting at the point where the supply is where it needs to be and the demand is now starting to, at least looks to us to be almost back to historical levels. I'm not going to sit here and say that the fourth quarter we're going to be back to normal, but I think I'm pretty comfortable saying as we move through the rest of this year those stockpiles will be at a point where incremental—the incremental sales of ancillary products are more in line with the incremental sales you see in the ammunition products as we get further into the fourth quarter.

Peter Benedict:

Okay, thanks for that. My last question is just on the small market stores. Can you give us a sense how many of those do you plan to open in 2016?

John V. Schaefer:

Well, I think with the opening of Sheridan, Colorado and kind of filling in that Denver market for us and our knowledge base of the small markets and the continued—as we look to the South and we look to the Southeast there are a lot of large markets that have very strong presence either by one or both of our national competitors. So it would only make sense for us in states other than California to continue to pursue a rural strategy as opposed to a metropolitan strategy. While we have numerous opportunities for stores far greater than the number we're going to actually build in 2016, so I can't tell you how it's actually going to define itself. I can tell you the vast majority of those opportunities are in the smaller markets.

Peter Benedict:

Okay, great. Well, and then good job managing a tough environment out there. Thank you.

Operator:

Our next question comes from the line of Peter Keith of Piper Jaffray. Please proceed with your question Mr. Keith.

Peter Keith:

Hey, thanks a lot and good afternoon. Just to follow-up on the apparel and footwear inventory, so it sounds like you're in pretty good shape for the fourth quarter not anticipating a gross margin hit. Is there anything that we should be thinking about though that could carry over into Q1 from a markdown risk perspective?

John V. Schaefer:

Well, I think the—let's back up a second. When you buy—when we bought short for spring we didn't know we're buying short for spring. So we bought short for fall kind of assuming spring and fall would act similarly. Spring, we had mentioned that we had run out of product especially in the women's and kid's area. So we were a little short in terms of opportunities there. In the fall with the weather, it's actually been a benefit that under-buying has actually been a benefit. If the weather stays the same I think what we will see is we'll see normal January Red Tag environment that we've seen in prior years, and that is actually our expectation. If however the weather all of a sudden gets really cold and we have great sell-through in December then we're probably not going to have a whole lot of stuff for Red Tag sale in January.

So from an inventory standpoint, I think we're in great shape. From a maximizing sales opportunity I think we need to understand both conditions and the impact they could have.

Peter Keith:

Okay, very good. You had mentioned also the exposure to oil and gas markets. Could you just give us a commentary there again? Are you seeing any of this slowdown spreading out to maybe markets that are more exposed to agriculture or mining as well?

John V. Schaefer:

We haven't seen it at all in agriculture and mining. When it gets right down to it, we have a mixed bag in the oil markets, so it really kind of depends on how you define it. If you look at Casper, Wyoming and Vernal, Utah, which are drilling communities, that has one set of circumstances that is clearly with drilling being down that has an impact. If you look at markets like Grand Junction and Cheyenne which are not drilling markets, and Cheyenne in fact being a refining market, those aren't being impacted all. If you look at a market like Fairbanks which has got a large military presence that offsets any downfall you have in the oil market.

So you could define our oil markets as eight or nine stores or you could define them as little as two or three. In any case, no matter how you define it it isn't that big of a deal.

Peter Keith:

Okay, very good. One last question for you, John, is on the loyalty program. So now that you've developed a pretty large base and you've annualized the program, it sounds like you're starting to see some early benefit. I guess could you help us understand the initiatives behind that to drive transactions and ticket growth that you might see carrying into 2016 as well?

John V. Schaefer:

Yes, I mean we're starting to do the first ones in which what we're trying to do is we're trying to encourage our customers to either use their loyalty rewards or continue to buy in our store to earn more loyalty rewards. So the promotions we've given to date as it relates to the loyalty program as we've done loyalty member only special pricing on certain products at certain points in time. We've done a couple of those and they've had really nice results. As a result of that, we've had people coming in and accumulating more points and we've actually had a nice uptick in terms of new people coming.

So I think the focus as we move forward will still be relatively modest but as opposed to trying to get the people to spend more by using their loyalty points I think what we'll end up doing is encouraging people to earn more by giving them opportunities because they are members, because at the end of the day we still want to grow membership.

Peter Keith:

Okay, sounds good. Thanks a lot and nice job managing the tough environment.

John V. Schaefer:

Thanks.

Operator:

Our next question comes from the line of Stephen Tanal of Goldman Sachs. Please proceed with your question.

Stephen Tanal:

Okay, thanks guys for taking the question. First I just want to follow-up on another point that was made on the freight benefit. Is it fair to say that that probably happens on a lag as you sell through the inventory that you have there and given your inventory turns the lag would be something like five months or so?

Kevan P. Talbot:

I think that's a fair assessment.

Stephen Tanal:

Okay. Then for 4Q it looks like the weather, particularly in the first week of November then it got better and the outlook seems okay in the West. Is there an element of conservatism here or how would you at least frame kind of upside, downside to approximately flat guidance that's obviously a pretty tight range there? If the weather were to break or get worse, how should we think about kind of where you could come out?

John V. Schaefer:

Well the dilemma, unfortunately, remember the product we sell in clothing and apparel is used product. There is three opportunities starting late Q3 and into Q4 to have some benefits in the clothing and footwear area and that's the normal pre-hunting buy time which is late Q3 early into Q4, and that has come and gone with not very good results. The second opportunity is when people actually go hunting, when the season starts which started basically a couple of weeks ago and by this time next week they'll all have started and all of a sudden you get a big cold spell and people say, holy cow, it's cold, and they run in and buy something because they didn't buy it early enough.

The weather has been warm, the weather next week is supposed to be warm, so I think that's water over the dam as well, which then really for us because it's use-driven again, only leaves the holiday period. So we've only got one out of three opportunities to really spike up the sales in clothing and footwear, and as a result I don't know that we're being conservative, I don't know that we're being aggressive, I think we're being pretty realistic in terms of what we can expect out of clothing and footwear as we go through Q4.

Stephen Tanal:

Okay, that's very helpful. Lastly, just sort of first public forum I think since one of your major competitors announced reductions of the footage growth, obviously some other rumors around consolidation. How are you thinking about how that may affect the space? Is that—you know, clearly should be a good thing for you guys here. Any thoughts on how that might affect your expansion strategy or strategy in general?

John V. Schaefer:

I don't know that we know enough to comment on industry consolidation. I mean when you're in this industry you hear chatter all the time about that, we'll just kind of let that thing play out, it's certainly not a negative to us. I would say its' probably a non-issue to us mainly because if the two biggest competitors would choose to get together they're in 53 markets that overlap each other, they have to deal with that issue and they're in much larger markets than we are.

As it relates to smaller markets, the deal with a 40,000 or 50,000 square foot store is that it's not the size of the store that you have to worry about, it's how do you make money at $8 million. If you can you're your money at 50,000 square foot at $8 million, you know, which we can, great, but if you can't then you can't be in those markets and those are the markets where we're really good at, and our national competitors have chosen not to develop or attempt to get into those markets, which is why we continue to talk about peaceful coexistence. I really firmly believe that what those guys at the larger market level and the big national players do is they create awareness in this industry and they bring new people into the industry. To the extent everybody stay separate or there is some consolidation, to the extent that that dynamic is enhanced, I'm all for it because it certainly helps us in the smaller markets.

Stephen Tanal:

That's great. Thank you guys.

Operator:

Our next question comes from the line of Lee Giordano of Sterne Agee. Please proceed with your question Mr. Giordano.

Lee Giordano:

Thanks, good evening everyone. It might be a little tougher to discern (phon) this quarter but any sense of private label versus branded on the footwear and apparel side? How is private label performing and what's kind of the mix these days and what are your expectations going forward? Thanks.

Kevan P. Talbot:

Our private label initiatives remain intact despite the weakness in these categories. We actually saw a slight increase in a percentage in the penetration of our private label goods. We were approaching 3% for the quarter versus I think it was 2.6% or 2.7% the prior year. So we remain committed to our private label initiatives, we see those continuing to improve and to move forward and that is a key part of our strategies going forward.

Lee Giordano:

If you could remind me, do you have shop-in-shops in all your stores at this point or is that something that you can still expand upon?

John V. Schaefer:

No, we do have shop-in-shops in all of our stores at this point. We were able to realize that at the end of 2014 with our additional fixturing strategies, we were able to find the additional space with the better fixturing. So yes, we do have shop within the shop within all of our stores and have had for the past year.

Lee Giordano:

Great, thank you.

Operator:

Our next question comes from the line of Andrew Burns of DA Davidson. Please proceed with your question.

Andrew Burns:

Thanks, good afternoon. I was hoping if you could spend a little time on store growth from a regional perspective. I was a little surprised to see Louisiana come up in the 2016 store class. What do you like about that market? What are you seeing there in terms of your adding second, third, four stores in the broader region there? Then secondarily, you touched very briefly on California and there's still some larger MSAs that you could potentially have stores and I'm wondering about the appetite there.

John V. Schaefer:

Sure. Just as the 30,000 square foot store and the 15,000 square foot store were contemplated certainly months and even years ahead of implementation. So too has been our analysis of where to go once we determined that the west was adequately supplied. So we've been looking at the south, we've been looking at the southeast, we've talked numerous times about drawing a connection between Phoenix, Arizona and Chattanooga, Tennessee maybe hopping over Texas because Texas is a kind of a weird beast. We've been looking at that for a few years now and investigating those markets and making sure we understood those markets.

So while it seems, because we're doing one store in Louisiana next year of the stores we've announced, it may seem like that's an isolated incident but it really is just step one in a pretty—you know, a strategy that's been—been part of our strategies for quite some time. So I think you'll see more of that coming because it just makes sense. There is a lot of users there and there is a lot of small markets there that are pockets of opportunity, so it just makes sense for us to go there.

As it relates to California, the dynamic with California is proceed at your own risk and we understand the risks very well and we've had very good success. We've opened stores most recently in Rancho, Cordova and Chico and Fresno. So we understand the California market but the California laws continually talked about changing and sometimes they even do change. So it's a measured pace at which we will continue to expand into California because there is other dynamics associated with being in that state' on the other hand there is a whole lot of people with a whole lot of demand so it's a nice little market once you understand it and you can deal with it to be in.

Andrew Burns:

Great. Thanks and good luck.

John V. Schaefer:

Thanks.

Kevan P. Talbot:

Thank you.

Operator:

Our next question comes from the line of Patrick McKeever of MKM Partners. Mr. McKeever, please proceed with your question.

Patrick McKeever:

Yes, thank you. So on the—I just wanted perhaps to run through the firearms numbers that you talked about earlier. I think you said firearm sales on a comp store basis were flat but unit sales were up a little bit north of 8%. Is that right?

John V. Schaefer:

That's correct.

Patrick McKeever:

Okay. So, and then the delta there was weakness and shotguns related to dried out water lakes and rivers and whatnot and no duck hunting?

John V. Schaefer:

Yes, let me clarify a couple of things. Number one, when we look at NICS data that's overall, so that's looked at overall unit increases for the entire company. When we talk about same-store sales being flat, that's dollars on only the same-store sales that you can compare apples-to-apples with the prior year. On a unit basis same-store sales we were fine, on a handgun and long rifle I'm not going to give you specific numbers, we were up. The dilemma with shotguns is that when you're talking about a $2,000 firearm versus an average price of $300 on a long gun and $200 on a handgun, you're talking about a relatively significant delta on a relatively small unit decrease.

Because the weather was so bad there were two things happened. The streams and ponds and marshes just dried up but the birds had no reason to come down from Canada either. So, they were sitting up there and half of them are still sitting up there not making their way south yet, and those two things are really kind of what caused the shotgun sales to lag, and because the price point on shotguns is so high compared to the average price of firearms, it has a disproportionate impact when the units go down.

Patrick McKeever:

Okay, okay, yes, I didn't realize the shotgun…

John V. Schaefer:

Yes, which is also why I can say with confidence that we're getting back to normalization because everything else is doing the things that it should be doing if you see a normal environment.

Patrick McKeever:

Okay, okay, I didn't realize your ticket on shotgun was so high and you must be selling a lot of Berettas.

John V. Schaefer:

Well, a lot of good stuff, yes.

Patrick McKeever:

Yes, it sounds like it. Another quick one on just wage pressure. Are you seeing any wage pressure? Is that embedded in the forecast? Is it not an issue?

Kevan P. Talbot:

It's not a significant issue; we continually monitor those fronts. There are changes at various state levels; we try and stay ahead of them and work those into our plan such that they're not going to be catching us by surprise. So, yes I think California has got one wage increase that's coming and that's the most significant one that I'm aware of but those numbers are all—as we try and stay abreast of the changes in those laws, we work those into our plans and go from there. So it is factored into our guidance.

Patrick McKeever:

Got it. Okay, thanks very much.

Operator:

At this time, there are no further questions in the audio portion of this conference. I would now like to turn the conference back over to Management for closing remarks.

John V. Schaefer:

Well, again I want to thank everybody for joining us today and have a happy holiday, and we look forward to speaking with you again on our fourth quarter call. Thanks very much.

Operator:

This concludes today's teleconference. Thank you for your participation. You may disconnect your lines at this time.