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Sportsman's Warehouse Holdings, Inc.

Fourth Quarter and Full Year 2017 Earnings Conference Call

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Kevan Talbot, *Chief Financial Officer and Secretary*

CONFERENCE CALL PARTICIPANTS

Chandni Luthra, *Goldman Sachs*

Peter Benedict, *Robert W. Baird*

Kieran McGrath, *Credit Suisse*

Andrew Burns, *D.A. Davidson*

Peter Keith, *Piper Jaffray*

Patrick McKeever, *MKM Partners*

Ron Bookbinder, *IFS Securities*

Daniel Hofkin, *William Blair & Company*

PRESENTATION

Operator:

Greetings and welcome to the Sportsman's Warehouse Fourth Quarter 2017 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 during the conference, please press star, zero on your telephone keypad. As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Rachel Schacter. Please go ahead.

Rachel Schacter:

Thank you. Good afternoon, everyone. With me on the call is Jon Barker, 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 under the caption Risk Factors in the Company's 10-K for the year ended February 3, 2018, and the Company's other filings made with the SEC.

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 at the Investor Relations section of our website at investors.sportsmanswarehouse.com.

As a reminder, fiscal year 2017 was a 53-week year, with the impact of the 53rd week described in the earnings press release. Same store sales are a comparable number, so all figures are presented on a 13-week basis for the fourth quarter and 52-week basis for the full year. Our fiscal 2018 same store sales compares to the shifted corresponding week in fiscal 2017, which is the comparable period.

Now, I would like to turn the call over to Jon Barker, Chief Executive Officer of Sportsman's Warehouse.

Jon Barker:

Thank you, Rachel. Good afternoon, everyone, and thank you for joining us today. I will begin by reviewing the highlights of our fourth quarter and full year performance and then discuss the progress on our strategic initiatives and thoughts on the coming 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.

Let me start by saying I'm honored to be leading Sportsman's Warehouse as CEO and working along such a strong group of associates. As many of you know, I've been with Sportsman's Warehouse since March 2017. My decision to join the Company a year ago was a relatively easy one. Similar to our customers, I'm an avid outdoor enthusiast with a passion and commitment to the outdoors. I love to hunt, fish, camp and participate in shooting sports, which makes me a long-time buyer and user of many of the Sportsman's Warehouse products. As a loyal customer, I have a firsthand appreciation for the distinguishing attributes of the Sportsman's Warehouse model and continue to be genuinely excited about the business.

Since joining the Company, I've dug deep into our business by spending time in our stores, getting to know our customers, developing relationships with our employees and working closely with our vendors. I've come away with many learnings, but one asset that has stood out the most to me is the extreme passion and loyalty of our customers. Our customers thrive on the many outdoor experiences available to them and trust us to provide the products and expertise that they need for those experiences. They are drawn to Sportsman's Warehouse for our differentiated shopping environment, customized localization strategy, expansive breadth of product assortment, knowledgeable associates, and, importantly, our great everyday value. Our strong value proposition creates a special niche in the outdoor sporting goods industry for Sportsman's Warehouse. These distinguishing attributes provide a foundation that we can leverage to further strengthen our position and grow our market share.

Based on my learnings and the evolving retail environment, an important focus during the last few months has been developing an omnichannel strategy and roadmap for Sportsman's Warehouse. As the lines between brick-and-mortar and e-commerce channels continue to blur further across retail, we have a significant opportunity to strengthen existing relationships and forge new ones with customers through an improved omnichannel experience.

Given our omnichannel focus, we believe it makes sense to view same store sales holistically as opposed to a separate by channel. Therefore, starting today and going forward, we will report same store sales including e-commerce. For Q4, given we have just made the transition, we are also reporting same store sales excluding e-commerce.

Moving on to our results, for the fourth quarter, our top line results were in line with our expectation. Total sales grew 9.8% to $243.2 million for the quarter. Same store sales declined 4.5%, or 5.2% excluding e-commerce, versus the prior year.

Drilling down further on the composition of same store sales, ammunition declined 4.7%, or 5% without e-commerce, in Q4, an improvement from Q3's 18.8% decline, or 19.4% excluding e-commerce. This sequential improvement is a combination of the easier comparison in Q4, because we had already anniversaried the strong 2016 result leading up to the presidential elections, as well as vendor-supported promotions.

Our non-hunting categories declined 3.2%, or 5.1% without e-commerce, for the quarter. Within our non-hunting categories, soft goods declined 4.6%, or 5.4% without e-commerce, given the warmer than expected winter weather in the west. This weather pattern also had a negative impact on categories such as generators, heaters and other weather-driven product that fall within our camping category.

Firearm units on a same store sales basis were up 3.2%, as we continued to gain market share in the states where we serve. Firearm revenue declined 2.5% on a same store sales basis for the fourth quarter, a continued sequential improvement from the second and third quarters, as we have now anniversaried the significant run-offs of 2016.

For the quarter, our adjusted earnings per share was $0.20 per share, which was lower than our guidance, due to primarily the following three factors: number one, during the holiday season, we increased our promotions in response to competitive activity, negatively impacting our gross margins for the fourth quarter; number two, with the passing of the tax reform, we elected to pay a one-time bonus to more than 600 non-executive associates, which impacted our SG&A expenses; and third, given the rising interest rate environment, our interest expense was higher than the prior year.

Turning to our full year results, the industry backdrop remained challenging in 2017, as we lapped some difficult comparisons from 2016, and navigated a heightened promotional environment. In fiscal year 2017, which was a 53-week year, net sales increased 3.8% to $809.7 million, same store sales decreased 6.5%, or down 6.9% excluding e-commerce, adjusted net income decreased 27.1%, and adjusted earnings per share decreased to $0.50 from $0.69 in the prior year period. Despite this difficult backdrop and increased promotional activity in the second half, we increased gross margins by 10 basis points for the year. In addition, through rigorous inventory management, while opening 12 new stores, we generated positive free cash flow in 2017, that allowed us to reduce debt by $2.3 million, thereby reducing leverage on our balance sheet. We will remain focused on disciplined capital allocation to reduce our leverage even further in 2018.

Now, let me briefly discuss our operational accomplishments in fiscal year 2017, as well as outline the areas that we are focused on in fiscal year 2018.

In fiscal 2017, we completed our 12 planned store openings or an 11.3% square footage growth. We are pleased with the performance of our class of 2017 stores and we are on track to deliver our targeted ROIC of 20% with our 2017 new store class.

Our two primary measurements for customer engagement both showed nice growth for the year, with our loyalty customer base increasing by 28% to end the year at just under 1.6 million customers, and our active email file growing by 22% during the year.

Our e-commerce business, which we now define as any sale that originates online, irrespective of where it's picked up, is still in its infancy. During 2017, we grew the revenue driven from the website by 81% over fiscal year 2016, and had encouraging learnings from our testing efforts, which I will discuss in a moment. Our everyday low pricing online remains market competitive, and we are seeing that in our results across all categories.

During the fourth quarter, we increased our assortment online through expanded drop-ship relationships with key vendors across multiple categories. We are also seeing success online with our higher ticket categories, including outdoor cooking, paddle sports and high-consideration fishing products, which gives us increased confidence in our ability to sell all categories online.

In addition, we continue to make progress on our vendor partnerships, that allow us to test new categories and expand our offering online without increasing our inventory investment. We believe these partnerships will allow us to engage new customers online and drive traffic to our stores.

Our 2018 priorities are focused on three areas: number one, our omnichannel growth strategy both in-store and online; number two, our customer acquisition and engagement; and number three, our merchandising assortment.

Starting with our omnichannel strategy, we see significant opportunity ahead to build on our market share through a combination of continued measured retail expansion and e-commerce growth. As the convergence of brick-and-mortar and online has become the customer expectation, we see even more opportunity to interact with not only our existing customers, but also to attract new customers who are not within driving distance of our store base.

With the announcement today of two additional stores, our 2018 class of stores has been finalized at five locations. These five stores will bring our total store count to 92 stores across 23 states at the end of fiscal 2018, and will represent 3% square footage growth over fiscal year 2017. This prudent moderation from 2017's 12 store openings will allow us to allocate more free cash flow to pay down debt. Of the five stores, two will be our smaller format 15,000 square foot stores, a flexible store format that provides us with the opportunity to reach customers in smaller markets that are more insulated from our destination-based competitors.

On the e-commerce side, we know we can do a far better job bringing to life our unique in-store retail experience when customers engage with our brand online, regardless of their location or device used. This is our focus as we develop a more engaging and easy to use front end experience. Customer feedback has confirmed this in 2017, and we are utilizing these learnings in our go-forward plans for 2018, and beyond. As such, we will continue to make prudent investments in our e-commerce systems and infrastructure in 2018 to support our omnichannel strategy. In 2018, we will invest approximately $3.5 million of tax reform benefits into an expanded e-commerce team and a more robust customer-centric e-commerce platform.

We recently selected SAP Hybris, a complete tier-one, cloud-based omnichannel platform which will provide improved capabilities across the business. The capabilities included in the platform are a complete new user experience, adaptive web design to meet the ever-changing mobile option, the ability for the customer to see in-store inventory, ship from our stores, and same-day buy online and pick up within our stores. To ensure a smooth and methodical transition of platforms, we've engaged a third-party integrator that is knowledgeable about both our new and our existing platform. We will also be hiring key personnel that will help execute our omnichannel strategy, including a new VP of Marketing with significant industry and omnichannel experience, who will be joining us soon. We expect 2018 will be an investment year from an e-commerce perspective, with the initial improved capabilities visible to the customer early in 2019.

In terms of customer acquisition and engagement, our personalized marketing strategies aimed at our nearly 1.6 million loyalty members are providing to be effective. In the fourth quarter, we began testing and providing our loyalty members with targeted offers that included special pricing and first choices on limited availability product. We were encouraged by the initial customer response, and in 2018, we will continue to segment and personalize our marketing strategies around specific items and promotions for our loyalty customer base, as we continue to further strengthen our engagement. As of the end of fiscal year 2017, greater than 45% of total sales were generated by our loyalty members, and we expect this number to increase in fiscal year 2018. We see additional opportunity to increase transactions from our loyalty members, who are our most passionate customer segment. Furthermore, we are planning to allocate more dollars towards digital marketing, which will be included as part of our e-commerce investment that I just discussed.

Turning to merchandising, with our strong customer base and industry position, we are a valuable partner to our vendors. We will increase our collaboration with them and leverage their support in cooperative merchandising efforts. We are seeing increased participation from our vendors related to in-store visual merchandising improvement, opportunities of first-to-market goods, allocated products, as well as increased partnerships with vendor-managed inventory. We continue to expand our comprehensive assortment of brand name products both in-store and online. Our private label offering continues to resonate with our customers, as well. We have seen strong acceptance of Killik, our hunting and casual clothing private label brand, both in our camo, as well as logo Ts and hats. We have improved and increased the Killik brand offerings and will continue to build on the strong value proposition of this brand by extending its presence into the fishing clothing category. We plan to expand our offering of private label products in 2018, particularly in our camping and other hard goods categories.

Kevan will discuss our 2018 outlook, but as you saw from our reduced pace of store openings, we will once again prioritize debt pay-down in 2018, as we remain disciplined with capital allocation and operating expense management.

In summary, 2017 was a productive year for us. We achieve our store opening goal of 12 stores, generated important learnings that are informing our omnichannel strategy, delivered an over 80% increase in e-commerce-driven sales, increased customer engagement with our growing loyalty member base and targeted marketing efforts, and we generated free cash flow and reduced debt by $2.3 million. Our extensive offering of brand name products, everyday low pricing strategy and knowledgeable customer service, combined with our focused, market-specific localization strategy, continues to resonate with customers. We look forward to strengthening our competitive position in 2018, which will better position us to further our market share gain.

Before turning the call over to Kevan, I want to thank all of our passionate and committed team members for the great job they do day in and day out.

With that, I'll turn it over to Kevan to discuss our financials. Kevan?

Kevan Talbot:

Thanks, Jon. Good afternoon, everyone. I'll begin my remarks with a review of our fourth quarter and full year results and then discuss our outlook for fiscal year 2018. 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.

Before I begin, as a reminder, fiscal year 2017 included a 53rd week, while fiscal year 2016 was a 52-week year. The impact of the additional week on fiscal year 2017 was approximately $10.6 million in revenue. Same store sales are presented on a 13-week or 52-week comparative basis. As Jon mentioned, we will now be including e-commerce in our reported same store sales, given our omnichannel focus and the continued convergence of brick-and-mortar and e-commerce. Given the transition, in Q4, we are providing comps both excluding and including e-commerce, but starting in Q1, you will hear us report only one number.

Turning now to our fourth quarter results, net sales for the fourth quarter of fiscal year 2017 increased 9.8% to $243.2 million, from $221.4 million in the fourth quarter of last year. Sales were in line with expectations. Amid a heightened promotional backdrop, particularly within hard goods, same store sales decreased 4.5%, or 5.2% without e-commerce, for the quarter. We opened one store in Pueblo, Colorado during the fourth quarter and ended the quarter with 87 stores in 22 states or square footage growth of 11.3% from the end of the fourth quarter of fiscal year 2016.

Turning to our same store sales by each of our three retail 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 fourth quarter, excluding the three stores in our comp base that were subject to new competitive openings, our same stores sales decreased 3.9%, compared to the fourth quarter of last year. Our 52 base stores saw same store sales decreases of 4.1% in the fourth quarter. In addition, our 20 new stores saw a same store sales decrease of 3.1% in the fourth quarter, compared to the corresponding period of the prior year. Finally, our three stores that were subject to new competitive openings experienced a same store sales decrease of 23.7%. Our competitive headwinds were approximately 130 basis points during the quarter. We saw an inflection point in our nine stores in oil and gas markets. Not only did these stores provide a 70-basis-point same store sales tailwind in the fourth quarter, but collectively, as a group, these stores achieved a positive same store sales of 1.5%. We expect this trend to continue into 2018, as the economies in these markets rebound.

Gross profit increased 7.2% to $79.7 million, compared to $74.3 million in the fourth quarter of fiscal year 2016. During the fourth quarter of fiscal year 2017, gross profit as a percentage of net sales decreased 80 basis points to 32.8%, from 33.6% in the prior year period. The majority of the 80-basis-point decrease was due to increased promotions in an effort to remain competitive in a more promotional environment than we expected. As a result, our product gross margins were lower than the prior year and our expectations.

SG&A increased 18.6% to $63.1 million for the fourth quarter of fiscal year 2017, from $53.2 million in the fourth quarter of fiscal year 2016. As a percentage of net sales, SG&A expenses in the quarter increased approximately 190 basis points to 25.9%, from 24%, due to a combination of a $900,000 one-time bonus and a $516,000 write-off of software assets related to the transition of our e-commerce platform, the latter of which was excluded in our adjusted results. As Jon mentioned, the bonus was paid to more than 600 non-executive employees, which we issued in connection with the Tax Cuts and Jobs Act, that was not included in our guidance.

Income from operations for the quarter was $16.6 million, as compared to $21.1 million in the fourth quarter of fiscal year 2016.

Our net interest expense in the fourth quarter of fiscal year 2017 was $3.7 million, compared to $3.3 million in the prior year period. Interest expense was higher than the prior year because of interest rate increases during 2017. The rising interest rate environment also caused LIBOR to exceed the interest rate floor on our term loan during the fourth quarter for the first time, causing higher interest expense on our term loan.

We recorded income tax expense of $7 million for the 13 weeks ended February 3, 2018, compared to $7.3 million in the corresponding period of fiscal year 2016. Our reported tax expense was negatively impacted by a $2.6 million one-time charge related the revaluation of deferred tax assets in connection with the recently enacted Tax Cuts and Jobs Act, partially offset by a $400,000 benefit from the lower corporate blended rate for our fiscal year.

Net income for the quarter was $5.8 million, or $0.14 per diluted share, based on a diluted weighted average share count of 42.6 million, as compared to $10.5 million, or $0.25 per share, based on a diluted weighted share count of 42.6 million last year. Adjusted net income, which excludes the net impact of tax reform and the asset write-off, was $8.4 million, or $0.20 per diluted share.

Adjusted EBITDA for the fourth quarter decreased to $23 million, compared to $26.4 million in the prior year period.

Looking at our fiscal year 2017 results, we grew square footage by 11.3% with the opening of 12 new stores, and increased net sales by 3.8% to $809.7 million, from $780 million in fiscal year 2016. Same store sales for the year decreased by 6.4%, or 6.9% excluding our e-commerce sales, from the same period of the prior year. Adjusted income from operations decreased 20.6% to $48.8 million, as compared to $60.8 million in the fiscal year 2016. Interest expense increased 2.5% to $13.7 million in fiscal year 2017, from $13.4 million in the prior year. Our annual effective tax rate was 46%. Excluding the impact of $2.6 million related to the U.S. tax reform, our annual effective tax rate was 39.2%. Adjusted net income in fiscal year 2017 decreased 27.1% to $21.3 million, or $0.50 per share, compared to $29.2 million, or $0.69 per share, in fiscal year 2016. Both earnings per share numbers are based on a weighted average diluted share count of 42.5 million shares. For the full fiscal year 2017, Adjusted EBITDA decreased 11.5% to $72.8 million, compared to $82.3 million in fiscal year 2016.

Turning to our balance sheet, as of February 3, 2018, ending inventory was $270.6 million, as compared to $246.3 million as of the end of the prior year period. On a per store basis, inventory decreased by 5.3%. Our liquidity remains strong, as we ended the quarter with $60 million in outstanding borrowings on our $150 million credit facility. As Jon mentioned, we are very pleased with our ability to have reduced our debt by $2.3 million during 2017, while opening 12 new stores. We incurred approximately $2 million in capital expenditures during the fourth quarter. For the full fiscal year, we incurred approximately $41.2 million in gross capital expenditures, or net capital expenditures of $21.5 million, inclusive of $19.7 million in deemed sale-leaseback transactions and landlord incentives.

Turning to our outlook, as we look toward fiscal year 2018, we are considering the following items in our guidance:

We expect the promotional headwinds to lessen as the disruption from industry consolidation dissipates and inventory positions normalize in the back half of the year.

In 2018, we will anniversary more stable performance in firearms, as we believe the industry is establishing a baseline after a few years of volatility.

Given raw material cost pressures, we expect to see a 2% to 3% price increase on ammunition in the back half of fiscal year 2018, which will put continued pressure on the category.

We anticipate the same store sales headwind from competitive stores to be approximately 60 to 80 basis points for the year.

As Jon already mentioned, we are planning for an approximate $3.5 million e-commerce investment, which will largely be expensed in SG&A. We do not expect to see major revenue benefits of this investment until fiscal year 2019. The e-commerce platform initiative has started and the investments will ramp up over the first half of the year.

We expect cost headwinds primarily related to state minimum wage increases that will impact our payroll by just under $1 million.

We assume approximately $50 million in interest expense for fiscal year 2018, which factors in the expectation of two additional rate hikes this year.

We expect the recently enacted Tax Cuts and Jobs Act to result in tax savings of approximately $3.5 million to $4.5 million, as our expected effective tax will decrease from 39.2% to approximately 25.1%. As we mentioned, we have already invested a portion of the savings in our associates and will invest the remainder in our e-commerce initiative.

For fiscal year 2018, we are planning to open five stores or approximately 3% total square footage growth. This prudent moderation will allow us to continue to pay down debt in 2018, as reducing our leverage remains a priority.

Taking these factors into account, our outlook for the first quarter is as follows: revenue in the range of $173 million to $180 million; a same store sales increase in the range of 2% to 6%, compared to the first quarter of fiscal year 2017; adjusted diluted loss per share of $0.08 to $0.11 on a weighted average of approximately 42.8 million estimated common shares outstanding. Embedded in this first quarter guidance is an expectation of flat to declining operating margins, driven by SG&A deleverage, that more than offsets gross margin improvement versus Q1 last year. While we expect the promotional activity to continue high in Q1, we do not expect it to be as high as it was in Q1 of fiscal year 2017, when we lost 100 basis points of gross margin to promotional activity. Also, excluded from our adjusted net income outlook for the first quarter is a $2.6 million one-time expense incurred in connection with the announcement of the retirement of our former Chief Executive Officer, John Schaefer, in the first quarter of fiscal year 2018.

For fiscal year 2018, we expect revenue of $830 million to $860 million. We expect a same store sales change in the range of down 1% to positive 2%, compared to fiscal year 2017. Our fiscal year 2018 expectations for adjusted earnings per diluted share are $0.52 to $0.64 on a weighted average of approximately 43 million estimated common shares outstanding. As it relates to capital expenditures, we expect to incur approximately $20 million to $26 million in total capital expenditures in fiscal year 2018, or net capital expenditures of $15 million to $20 million, inclusive of approximately $5 million to $6 million in deemed sale-leaseback transitions and landlord incentives that we expect to receive for the year. Approximately $600,000 of our cap ex for fiscal year 2018 will be attributed to the e-commerce investment.

With that, I will now turn the call over to the Operator to 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.

Our first question is with Matt Fassler with Goldman Sachs. Please proceed with your question.

Chandni Luthra:

Thanks. This is Chandni Luthra on behalf of Matt Fassler. Thank you for taking my question. My question is regarding your fourth quarter gross margins, if you could throw some light on how much of margin weakness was attributed to mix shift away from, say, generators or other, basically, weather-driven categories versus promotional activity?

Kevan Talbot:

Absolutely. The majority was promotional activity. As we anniversaried the significant decline in firearm sales in the fourth quarter of fiscal year 2016, there wasn't a lot of a mix shift there. Most of it was attributable to the promotional activity.

Chandni Luthra:

Great, thank you, and just a quick one in terms of the Remington bankruptcy. Do you see any impact on your business from an inventory standpoint, or any other impact, for that matter?

Jon Barker:

This is Jon. We've had a great relationship with Remington. We expect to continue to have a great relationship with them going forward. Many of the other vendors that are in similar or the same categories, we've been in discussion with to make sure if there's any breaks in the supply chain, they're more than filled, and we've had very positive and encouraging conversations so far regarding that.

Chandni Luthra:

Great, thank you. Thank you so much.

Operator:

Our next question is with Peter Benedict with Robert W. Baird. Please proceed with your question.

Peter Benedict:

Hey, guys, thanks. First question, just on the first quarter comp, I'm curious, the calendar, are those like weeks that are being compared? So, is it the shifted calendar? I'm just trying to understand as we kind of do the—work off a different fiscal calendar in 2018, how you guys are treating that?

Kevan Talbot:

It is the shifted calendar, Pete. We compare it to the same week of the prior year, but because of the 53rd week, that's shifting one week. So, it is a shifted calendar that we're comparing to.

Peter Benedict:

Okay, good, no, good to hear that. Can you give us a sense for e-commerce penetration, where you see that, as you're making these investments. I know you said you didn't expect maybe much impact from the omnichannel stuff this year, but how should we think about e-commerce penetration maybe in 2018, as you guys envision it, and then, John, maybe longer term, where you see the business?

Jon Barker:

I would assume 2018 is going to be about 2% to 3% of our total sales when we round up the year. As far as the long-term three- to five-year plan, there's a significant opportunity in front of us to bring to life the same experience we have in the store online, and I'm really going to be looking at that in total, as far as engagement. So, I guess it'll be a little while before I'm in a position to say whether 2%, what it becomes in the out years, but there's significant upside from where we're at today.

Peter Benedict:

Yes, no, that makes sense. Then, my last question is just around the IT infrastructure that you've got there, I know there was an asset write-off in the fourth quarter, but, Jon, how do you kind of view the asset base right, the capabilities that you need to add? Do you think you're going to accomplish the majority of this in 2018, or what's kind of the roadmap we should think about beyond '18?

Jon Barker:

Great questions. So, there's a couple things that are really encouraging as far as the foundation that are in place. First of all, we have an incredible ERP system with Oracle, so that's in place and running, and that can support all aspects of the business, purchase orders, all the way to the finance considerations, both store and e-commerce. Our WMS system, that's in place already, and our fulfillment distribution center, handles both single-pick and purchase orders to the stores, so we've got those two major components in place, and to some extent, those are two of the longer poles in the tent when you're building the infrastructure and the platform, so happy to have those in place and not have to put those in. So, our focus with the new platform, with SAP, will be kind of that middle layer of business tools, front end, customer experience, in-store and distribution center, OMS/allocation module, as step one, the first components of which we expect to have live for the customer to utilize in early '19, but from there we will continue to add on other elements to optimize that. It will take, I would expect, two to three years for us to get the platform to a position where it's scalable for the future.

Peter Benedict:

Okay, great. Thanks so much.

Operator:

Our next question is with Seth Sigman with Credit Suisse. Please proceed with your question.

Kieran McGrath:

Hi, guys. This is Kieran McGrath on for Seth Sigman. Just two quick questions from me. Firstly, on the Q1 comp guide, obviously, you're baking in a pretty material improvement from Q4. Could you just talk to the drivers of that improvement, how much is firearms versus other categories? Thanks.

Kevan Talbot:

We are seeing an improvement in our firearms. Obviously, that's a large component of our business. That is no different in the first quarter. Obviously, we have a few weeks behind us, so hindsight is 20/20. With respect to various decisions made by our competitors with respect to firearms and their ongoing operations within the firearms industry, that's having an impact on our business. So, that guide indicates what we've seen thus far. We're currently evaluating whether this is a pull-forward of demand or if it's an increase in market share, so we have been cautious with respect to our full year guidance, but our first quarter guidance is based upon what we have seen thus far, and it's primarily being led by firearms, but it is also lifting the rest of the business and we're seeing good results in other categories, as well, as more and more people are coming into the stores and are shopping us online.

Kieran McGrath:

Thanks, and then just the follow-up. On the e-commerce business here, what categories are you seeing the growth most pronounced in, and then, just longer term, how are you thinking about the profit implications as e-commerce becomes a bigger portion? Thank you.

Jon Barkier:

Yes, as far as categories, we're actually see all categories rise significantly. Of course, some of the larger products, security products, etc., where the freight expenses are a little different, we're shipping those to the stores, so they may not be growing as high as a percent as great as some of the smaller unit pick items that can go parcel, but we are seeing nice solid growth in all categories. When it comes to profitability, certainly the unit economics on direct-to-consumer to home are going to be different at the unit level, compared to what's in the store, due to the outbound freight. What we are seeing, and expect to continue to see, is the overall engagement with those customers in visits, total dollars spent and wallet share from those customers are increasing. So, it will all work together in a positive form, but if you look at specific delivery to home, it certainly has a different unit economic.

Kieran McGrath:

Thank you.

Operator:

Our next question is with Andrew Burns with D.A. Davidson. Please proceed with your question.

Andrew Burns:

Good afternoon, and, Jon, congratulations on the new position. A couple of questions. Just as your store fleet has continued to grow—I remember around the time of the IPO, there was a lot of similarity, if you look at large MSAs versus small, and different store sizes, very similar productivity—have you had trends emerge in recent years, whether it's productivity by size, by geography, by size of MSA, that is worth calling out? Thank you.

Kevan Talbot:

Andrew, I don't know that our views with respect to those return metrics have changed significantly enough to call out. We are still very pleased with the returns of our smaller format stores. Obviously, those smaller format stores are going to do less from a revenue per store perspective, but we are pleased with the overall returns, and with the ability that it gives us to get to those smaller markets that are a little bit more insulated from a competition perspective, and so we're looking across all MSAs as we continue to evaluate our store growth opportunities, because they all—both our standard format store, as well as our smaller format store, have continued to perform in the ways that we would expect them to.

Andrew Burns:

Great, thanks. Then, looking at five stores this year and a greater focus on e-commerce, what will be the thought process for determining new store growth in '19, and beyond, whether to keep it at a similar pace or accelerate it? Thank you.

Jon Barker:

Andrew, this is Jon. We plan to continue to grow our store base in the coming years, so there's no strategic change away from growing. Of course, our format allows us to be successful, as Kevan was mentioning earlier, and some of the stores that we're opening this year, to kind of clarify that, we're going to very large MSAs with a few and we're going to some less scaled areas with others. The question of how many for next year and the year beyond is an each-year planning process. We're going to be evaluating the retail landscape, interest rates, and our financial objectives of free cash flow and debt reduction as part of the 2019 store growth plan, and probably in the coming discussions we'll talk more specific about how many 2019 will include.

Andrew Burns:

Great, thanks, and then one last one, just in terms of your full year guidance, the low end of the range, contemplating a negative 1% comp. You have a strong to the year unfolding from a comp perspective. What are some of the items you're thinking about when you look at the low end of that range? Is there still potential for stronger category headwinds or is that contemplating competitive dynamics? Any color there would be helpful. Thank you.

Kevan Talbot:

Andrew, as we look at the full year guidance, as far as the comp goes—as you mentioned, we are off to a strong start this year. What we don't know yet is how much of this is a pull-forward, is this just going to be a spike, or is this going to be an increase in market share and going to continue longer, so we've been cautious with respect to the back half of the year. As I look at the back half of the year, we're anticipating, as I mentioned in my prepared remarks, a more normalized environment, which is basically flat to up slightly in the firearms, and as we indicated, that primarily drives the business. The first quarter of the year is the lowest volume quarter of the year, so even though it's up significantly in the guidance, it does have the least amount of impact on the full year. So, we're being cautious with respect to the remainder of the year, until we see how long this increased activity lasts.

Andrew Burns:

Good. Thanks and good luck.

Jon Barker:

Thank you.

Operator:

Our next question is with Peter Keith with Piper Jaffray. Please proceed with your question.

Peter Keith:

Hi, thanks for taking my question, and congratulations, Jon, with your promotion. Jon, a question specific for you. With your background, which does have some e-commerce to it, I guess I'm curious, now that you've been there a year—you've laid out some interesting initiatives on what the consumer will begin to see a year from now—what do you think are the biggest opportunities, or what will the consumer see the most attention to, or where we'll see the biggest benefit?

Jon Barker:

I think, from a customer-facing user experience—you've probably been at one of our stores and you've probably shopped our site. Clearly, we haven't invested in the same level of expertise and shopping experience on the front end for the consumer that we have in the store. The specialized service that we provide, and the expertise, and the product we sell inside the store isn't necessarily shown on the site. So, that's the first thing that the customer will see. As far as how we can leverage systems to better engage customers, there's a lot of opportunity in our loyalty program, which I touched on in the script. Some of the tests we've had on specific segmentation and engagement of those loyalty customers around the products and categories they've shopped in, they've shown really encouraging results. So, thinking about that, as well as building our general outreach in email and to new areas where we don't have a presence, we've started to test that through digital marketing and other avenues, and we're starting to see a really strong response. So, I'm encouraged by what the user experience we'll see when we launch the new platform and create a new ex and expertise, and I'm also encouraged by some of the underlying capabilities we will have to reach our customers in a new way.

Finally, the underlying, which probably may or may not have come out in the script, is with this omnichannel experience, when it's fully rolled out, the ability for us to leverage 100% of our inventory across all 92 stores, or more by then, for a customer to be able to buy from that store and pick up within a few minutes, ship from that store, improved time in transit, reduced costs, all those things that can come from by leveraging existing working capital is a pretty exciting part of it. That'll take a little while to get rolling, but by mid next year, we expect to see some of that coming to fruition.

Peter Keith:

Okay, that sounds exciting, thank you. Looking maybe at this year, you had mentioned that you would see a 2% to 3% price increase in ammunition. How do you think that plays out to your customer? Is there any unit elasticity in there that would cause a slowing of sales, or is that going to be a pretty clean flow-through overall, and furthermore, is it, I guess, gross margin neutral when you just pass the price increase along to your customers?

Kevan Talbot:

Well, let me start with the last one. Yes, we believe it'll be gross margin neutral, and we expect our competitors to pass it along, as well. It's going to happen over time, this price increase. As we have mentioned, we expect it to happen in the back half of the year. It'll be interesting to see what the customer does, if they buy up ahead of it, or if it does impact the demand there. As we indicated in our script, we do expect a little bit of headwinds there, that it will impact the demand. We'll see how it plays out, but that's our expectation for the year.

Peter Keith:

Okay, sounds good. Thanks a lot, guys.

Kevan Talbot:

Thank you.

Operator:

Our next question is with Patrick McKeever with MKM Partners. Please proceed with your question.

Patrick McKeever:

Okay, thank you. Kevan, you mentioned, in talking about the sequential improvement in firearms and ammunition, some decisions made by competitors. My question is are you seeing it more—the impact on your business more on the product side, just based on some of the—what some competitors have done in terms of removing some of the MSRs, or is it on the age side, with some of the age restrictions that have been put in place by some competitors? That's my first question.

Then, on wages, you mentioned, I think, $1 million in wage pressure from minimum wage hikes in 2018. I mean, is that the extent of it, or is there some pressure beyond minimum wages in some states?

Kevan Talbot:

Let me start with the first question. With respect to that, we're seeing it on the product level and it's bringing more people into the stores, and it's across a lot of different categories, it's not just firearms. Firearms is leading the way, but it's lifting the other categories, as well, as more people are coming into the stores, so we're seeing very good traffic thus far in the first quarter.

With respect to the minimum wage increase, that is the primary driving factor of the pressure there, but there is also some competitive factors in local areas where, from a distribution perspective, there are some competitive wage pressures that we're having to match or increase wages in order to retain employees, it's a market-by-market basis, but we are facing other wages, not significantly enough to call out individually by itself, but there are other factors that we take into account when we prepare the guidance.

Patrick McKeever:

Then, just back to the first topic or question, I know there—have you had any—and I'm sure you have, but to what extent—internal discussions about putting any company restrictions on firearm purchases beyond the laws that are currently out there? Have you gotten any pressure from any of your vendors? I know there was at least one big retailer that had some pretty significant vendor pressure in that area.

Jon Barker:

Patrick, this is Jon. As far as Sportsman's Warehouse changing their policies around regulated materials, we're continuing to monitor the situation, having ongoing conversations to make sure we understand what's happening in the political arena on regulation, but we continue to support the lawful sale of firearms under the Second Amendment rights of our customer, and at this point, we have no intent or plans to change the way that we approach that. We have the very best compliance record of any retailer in the entire industry for the ATF and we have a great relationship with federal, state and local law enforcement, and we will continue to monitor and focus on being compliant with the laws that are in place in the federal, state and local jurisdictions in which we operate.

Kevan Talbot:

As an example, in the state of Florida, they recently increased their minimum age to purchase a rifle to 21. We changed our state law chart. If a customer from Florida goes to one of our stores, say, in South Carolina, nearby, we will abide by the 21 age limit for residents of the state of Florida. Compliance with the laws and regulations, whether that be state or federal or local jurisdictions, is very important and critical to our Company, and so we watch, as Jon indicated, what the law changes are and we make sure that we comply with the laws.

Patrick McKeever:

Yes, understood, and then anything on the vendor side? I mean, have you had any pressure there from vendors to do anything or change anything?

Jon Barker:

Patrick, when you say "vendors," I'm not sure—can you give us a more specific example?

Patrick McKeever:

The brands, you know, some of the brands, the manufacturers of non-firearm products.

Jon Barker:

We've had no indications from any vendor that I'm aware of, off the top.

Patrick McKeever:

Okay, great. No, good stuff. Thank you very much.

Jon Barker:

Thank you.

Operator:

Our next question is with Ron Bookbinder with IFS. Please proceed with your question.

Ron Bookbinder:

Hi, and thank you for taking my question. You had talked in the past about making opportunistic purchases that could benefit gross margin. Did you do any of that in the fourth quarter, and if so, which categories, how did it work out, and would you pursue that going forward?

Kevan Talbot:

Yes, we did have some opportunistic purchases there, many categories, as vendors were looking to move merchandise there. We continue to evaluate the opportunities as they are presented to us, and if it makes sense from a financial perspective, we will take advantage of that. I'm aware of one that we did just a few weeks ago, because it made financial sense. Other deals that have been presented to us, we have turned down. Again, we evaluate each deal on an individual basis to see where it makes sense from a financial perspective.

Ron Bookbinder:

Are they concentrated in any one category, or is it everything from heaters to kayaks?

Kevan Talbot:

It's across all categories. I don't know the specific classes or that, I'd have to get with my merchant to get down more into that detail, but it's across all categories.

Jon Barker:

One of the things I think is worth mentioning. The loyalty tests, and e-com commentary I made earlier about segmentation, has allowed our buyers across all categories to do purchases of much smaller quantities than we would historically for all of our stores, an example being if we can buy 20 or 30 of a high-consideration item at a great price, we now have an avenue to engage our loyalty customers on that special, and that's some of the tests we've been seeing with very great success. So, it's a slightly different way of thinking about special buys versus the large discounted special buy for a quarter. We are now opening up new channels to buy products that historically would have been too small of buys for the business.

Ron Bookbinder:

The firearms inventory in the industry channel, do you think it's at the proper level that, yes, we're going to see promotions basically come to a normalization at the end of this quarter, or is there still some excess merchandise, and would it more be on the long guns or on hand guns?

Jon Barker:

I think we've seen through the acquisitions that happened last year, and the promotions in Q4, it returned to a more normalized. I don't know that it's back to where it should be, but we saw a lot of that flow through in 2017, so I would expect we would be in a more normal position towards the back half of this year.

Ron Bookbinder:

Okay, and you guys are basically replacing—for every unit sold in firearms, you're replacing it with another unit, correct? You're not trying to reduce your firearms inventory (inaudible)?

Jon Barker:

No, we are not.

Ron Bookbinder:

Okay, and kayaks, have you guys expanded your selection of kayaks? It seemed like it was a large—I was in the store the other day and it seemed like a larger selection. Does that drive other categories, like the fishing category, which might bring a higher margin than a kayak?

Jon Barker:

Yes, no, I'm glad you were in the store, so we appreciate that. Certainly, going into spring, our entire paddle sports categories, you know, paddle boards, kayaks, canoes, small fishing boards, are all coming online and you're going to see more of those in the store. We also do a really nice business online, because the assortment is so broad there and we're shipping those to store. When the customer is getting into the store, it's an easy upsell, right? All of a sudden, you've got a kayak or you've got a canoe, you need oars, you need life jackets. Many of the kayaks we sell are fishing-related kayaks. So, it's a great opportunity to increase the upsell and to engage the customer in a broader assortment than just that single unit.

Ron Bookbinder:

Okay, great. Thank you very much and good luck in the new year.

Jon Barker:

Thank you.

Operator:

Our next question is with Danial Hofkin with William Blair & Company. Please proceed with your question.

Daniel Hofkin:

Hi, can you guys hear me okay?

Jon Barker:

Perfect.

Daniel Hofkin:

Okay, thanks. Just to quickly to follow up on an earlier question about the price increases expected in ammo later this year, can you just quickly discuss any past experience, you know, whether your comments about an expected reduction in unit demand as a result, whether that corresponds to what you've seen in the past when there have been maybe similar price increases? That's my first question and I have one follow-up?

Kevan Talbot:

Yes, no, we've seen both sides of it, as the price increases have gone on. A lot of it depends on other underlying demands, what's going on with respect to firearms and that attachment there. So, what we have based our guidance on is the historical that we've seen. As we indicated in our remarks, we do expect some headwinds because of that price increase, so that's how we've factored it in into what we expect this year. Could it be different? Yes, but that's how we've built it into our guidance.

Daniel Hofkin:

Okay, and again, you know, back to the sort of overall comp guidance, and I guess thinking about firearm demand year-over-year, later this year, I think you commented in a response that you would expect at some point later this year sort of a return to the normalized, you know, flat to up slightly growth environment. Can you help to square that with sort of the—you know, obviously, in the last dozen years or so, maybe, with the exception of last year, obviously, there was sort of a mid-single-digit or better average annual increase. Are we talking about kind of on the same basis you're now thinking that in this new environment going forward that you're thinking flat to up just slightly, or are we talking about two different things?

Kevan Talbot:

No, I think it's the latter. I think we're looking at it flat to up slightly. As we look at 2017, from a firearms perspective, while it was off significantly versus 2016, there were no significant spikes or events that caused increases in demand that we then have to anniversary this year. So, as we look to the remainder of 2018, anniversarying no significant event, we believe that will show us what is the longer term growth rate, which we believe is that flat to up slightly, as we've indicated in our guidance.

Daniel Hofkin:

So, that flat to up slightly is a moderation from what it was, let's say, over the last—the majority of the last dozen years or so, where it was, like, 5% to 8%; is that right?

Kevan Talbot:

That is correct. As I indicated, we're being cautious with our guidance for the back half of the year, but we do see a more normalized firearm environment happening this year.

Daniel Hofkin:

Okay, thanks very much.

Operator:

Ladies and gentlemen, we have reached the end of our question and answer session and I would like to turn the call back over to Management for closing remarks.

Jon Barker:

This is Jon, and I want to thank everyone for taking the time to join us today on our earnings call and for the questions received afterwards. We look forward to speaking to you more in greater detail in the future. Thank you and have a great afternoon.

Operator:

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