VIAVID
communications simplified.

Sportsman's Warehouse Holdings, Inc.

Second Quarter 2015 Earnings Conference Call

August 27, 2015

CORPORATE PARTICIPANTS

John Schaefer, *President and Chief Executive Officer*

Kevan Talbot, *Chief Financial Officer and Secretary*

Rachel Schacter, *Senior Vice President, ICR*

CONFERENCE CALL PARTICIPANTS

Stephen Tanal, *Goldman Sachs*

Seth Sigman, *Credit Suisse*

Matt Nemer, *Wells Fargo*

Mark Miller, *William Blair*

Michael Gunther, *Sterne Agee CRT*

Andrew Burns, *S.A. Davidson*

Peter Keith, *Piper Jaffray*

Patrick McKeever, *MKM Partners*

PRESENTATION

Operator:

Greetings and welcome to the Sportsman's Warehouse Second 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 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 of ICR. 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 include statements regarding our expectations about our future results of operations, demand for our products and growth of our industry. Actual future results may differ materially from those suggested in such statements due to a number of risks and uncertainties, including those described in the Company's most recent 10-K filed with the SEC on 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 Schaefer:

Thank you, Rachel. Good afternoon, everyone, and thank you for joining us today. I will begin by discussing the highlights of our second quarter and comment on industry dynamics and 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 second quarter results, which came in above our guidance. While the second quarter is seasonally not a high-volume quarter in our business, it does provide a directional indication of the strength of the industry and our customer mindset going into the fall hunting season.

A few highlights of the quarter:

We opened four new stores during the second quarter, with strong initial results: Heber City, Utah; Show Low, Arizona; Williston, North Dakota; and Fresno, California.

As with the previous several quarters, we met each of our financial performance objectives, despite the continued impact of competition in many of our markets, and the somewhat surprising continuation of the promotional stance from some national and mom-and-pop competitors. We are particularly proud that in the second quarter, our low-cost, high-service format has allowed us to not only exceed our sales projections, but do so while maintaining margin and sticking to our historical promotional calendar.

Firearms, on a same-store basis, while still somewhat choppy, have turned positive and continue to show signs of normalization. Our two stores opened in April and May of this year in Klamath Falls, Oregon, and Heber City, Utah, represent a new and exciting growth vehicle for us going forward, which I will elaborate on shortly.

Net sales for the quarter increased 8.5% to $173 million. Same-store sales increased 0.5% versus the second quarter of the prior year, again showing sequential improvement, and our first positive same-store sales performance in six quarters. Excluding the 10 stores that were impacted by new competition, our same-store sales were up 2.7% in total, with the majority of our stores without competition generating positive comps, confirming our expectation that the normalization of the industry would begin in the second half of this year.

Looking more closely at our store sales performance for the quarter, we believe that, both on a unit mix and price level firearms, sales are returning to historical trends and are moving with the overall growth in the industry. For all stores for the quarter, our firearm sales increased 12.2% over the prior year, and our unit sales increases were virtually the same as the quarterly adjusted NICS data for the states in which we operate, consistent with the correlation we have been seeing over time between our firearm sales and adjusted NICS unit data for our particular states.

While ammunition sales, on a same-store basis, were down slightly over the prior year, this was due mainly to a vendor promotion during our second quarter last year that was not repeated this year.

These facts, along with the growth in the number of our stores and the revenue they generate, as well as the growth in our non-hunting categories, show we are gaining market share, consistent with the trend that we believe is happening with the other national retailers. For us specifically, when looking at the states in which we operate retail stores, we have gained market share in each of the six quarters that we have been a public company, despite the increasing competition in many of our markets, which we believe speaks to the customer appeal of our model and the unique attributes that distinguish us from other national retailers.

Traffic, on a same-store basis, or more specifically customer frequency, remained negative, but both conversion and average order size improved year-over-year. While the warmer than normal weather pattern has continued, with record high temperatures in many of our markets that contributed to negative comps in clothing and footwear, we did see the continued positive growth in both camping and fishing, which are both use-driven categories, and which show us our customer is focused on enjoying their pastime despite the weather.

Now, on to profitability. Gross margin increased 40 basis points or 9.8% from the same period last year, through a combination of several factors, such as the continued strength in camping, higher margins on certain non-firearm hunting categories, offset partially by a mix shift to increased firearm sales and continued increases in our loyalty program versus the prior year.

From a product gross margin perspective, we are able to maintain and, in most cases, continue to improve gross margin at the individual product level, while adhering to our normal promotional calendar. This allowed us to achieve our traffic, conversion, market share and margin objectives, while sticking to our customary promotional discipline.

Adjusted operating income for the quarter was $12.8 million, with adjusted earnings per share of $0.14, above our guidance and an improvement over the earnings per share of $0.12 in the prior year period.

Looking at competition, in the second quarter, we saw the presence of new competition within the last 18 months in 10 stores or 16% of our store base. Stores facing competition once again performed better than planned during the quarter.

Our second quarter store openings once again illustrate our broad demographic appeal and ability to be successful in markets with varying population levels, from large MSAs, such as Fresno, California, with a population of just under one million people, to small MSAs, such as Show Low, Arizona, with a population of just over 100,000 people. We will continue to target small to large MSAs for either neighborhood stores or single-market destinations, each of which can generate our four-wall EBITDA objective of greater than 10% and a return on invested capital of 20% or more. This dual strategy allows us to effectively compete with our national competitors in large MSAs, while also being able to access markets that are not conducive to the typical prototype of the large national players. This makes the smaller MSAs particular attractive to us, given our flexible store format, our low-cost, high-service approach, our everyday low prices, convenient location and localized assortment, and, as I previously mentioned, we have outstanding customer service delivered by our passionate store associates.

Looking ahead, we remain focused on our strategic growth initiatives and key priorities:

First, we remain focused on capitalizing on the significant white space opportunity for new stores that we see within existing and new markets at an expected unit growth rate of greater than 10% annually for the next few years. With the opening of four stores in the second quarter, as well as Albany, Oregon, which opened two weeks ago in mid-August, and Flagstaff, Arizona, and Sheridan, Colorado, in the next four weeks, we will have achieved our store opening objectives for this year on time and prior to the start of the all-important hunting and holiday seasons.

Second, our improved fixturing strategy is now the standard going forward in our stores and continues to provide a major opportunity to focus on and achieve our return objectives in the smaller population MSAs, as well as open more neighborhood stores in those larger MSAs, as evidenced by our 2015 store class.

Third, another priority continues to be the enhancing of operating margins through increased sales of our private-label products, while simultaneously expanding our programs in clothing and footwear with major brands. For the second quarter of fiscal 2015, sales of private-label products increased 23.5% and represented over 2.7% of net sales, an increase of approximately 33 basis points, when compared to the second quarter of fiscal year 2014.

Number four, we are focused on maximizing the potential of our loyalty program and are implementing more effective marketing programs that better utilize the information we are capturing on the buying preferences of our loyalty program members. We are in the early stages of this initiative and expect to begin seeing the benefits of these programs in the back half of the year and into 2016.

Number five, we will continue to focus on associate training programs to maintain and further improve the great in-store customer experience we pride ourselves on delivering.

Sixth, and most important, over the past several months we have analyzed and tested a SKU rationalization program. The purpose of this program, along with our fixturing program, is to allow us to profitably serve those MSAs with a population under 75,000 people. This requires the ability to achieve our 20% ROIC and four-wall EBITDA margin targets of 10% at a sales level of $5 million, which is 40% lower than our current new store model sales benchmark, and substantially lower than any national competitor. These MSAs are dominated by mom-and-pops with a very limited offering, requiring people in those markets to either buy direct or travel significant distances to make their purchase. If we are to be successful in the smallest MSAs, we must be able to provide significantly more product than the mom-and-pops, but do it in a store size dramatically smaller than even our 30,000-square-foot model.

As we noted in our first quarter call, we opened stores in Klamath Falls, Oregon, in Heber City, Utah, in April and May of this year, months which, along with June and July, represent some of our lower volume months of the year. Both of these stores are in the 15,000- to 17,000-square-foot range and are built to achieve our required returns at the $5 million sales level. We believe the fact that both of these stores are currently trending above our pro forma in what is seasonally a slower period bodes well for the future performance of these stores, as well as the potential for this small-store concept which opens up potential store opportunities for us in more MSAs than previously envisioned, and in markets that our national competitors simply cannot justify.

With respect to the remainder of 2015, we continue to expect that, based on results, the overly aggressive promotional stance by some in the industry will subside and return to more historical levels as we move through the second half of the year. Given we are the everyday low-price provider already, our priorities will be to continue our normal promotional cadence and to generate profitable sales, while maintaining margin. As a result, our guidance continues to reflect our expectation that same-store sales trends should improve as we move through the year. We remain excited about our business in fiscal 2015, and the many opportunities that we have to expand the brand and grow the Company.

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

Kevan Talbot:

Thanks, John. Good afternoon, everyone. I'll begin my remarks with a review of our second quarter 2015 results and then discuss our outlook for the remainder of fiscal year 2015. My comments today will focus on the adjusted results for the second quarter of fiscal year 2015, which excludes the reversal of an accrual related to a previously announced litigation matter. We do not have any similar adjustments for the second quarter of 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 better than our expectation. Net sales increased in the second quarter by 8.5% to $173 million, from $159.5 million in the second quarter of last year. As John mentioned, not only did we have positive same-store sales of 0.5%, but we also saw better than expected results from our new store openings. From a category perspective, our same-store sales were led by strong results from our camping department, and specifically the firearms category within the hunting and shooting department.

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 markets. With the three additional stores that we have announced this afternoon, in South Jordan, Utah, Roseburg, Oregon, and Rohnert Park, California, we now have announced four locations for our 2016 class of stores. We have many locations in our pipeline and we'll be announcing additional 2016 locations soon.

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 second quarter, excluding the 10 stores in our comp base that were subject to new competitive openings, our same-store sales increased 2.7%, compared to the second quarter of last year. Our 26 base stores saw same-store sales increases of 2.1% in the second quarter, compared to the second quarter of last year. In addition, our 16 new stores saw a same-store sales increase of 4% in the second quarter, compared to the corresponding period of the prior year. Finally, our 10 stores that were subject to new competitive openings experienced a same-store sales decline of 7.9% in the second quarter of this year, compared to the second quarter of last year, again, ahead of our expectations.

While stores in markets that have exposure to the oil and gas industry underperformed versus the rest of our stores, the magnitude was minimal, an indicator that our product offering is an important ongoing purchase priority for our customers in those markets.

Gross profit in the quarter was $58 million, compared to $52.8 million in the second quarter of fiscal year 2014. During the second quarter of fiscal year 2015, gross profit as a percentage of net sales increased 40 basis points to 33.5%, from 33.1% in the corresponding period from last year. The increase in gross profit as a percentage of net sales was primarily driven by the strength of the camping department, as more camping-only customers become aware of our substantial product offering and expertise in this area, as well as increases in margin in several of our categories. This margin improvement was partially offset by a mix shift to increased firearm sales and continued increases in our loyalty program, as John mentioned.

During the second quarter, our loyalty patrons increased by more than 18% to approximately 650,000 members. We continue to expect growth in the program across our customer base, generating more frequent customer visits over time and higher average ticket, along with the benefits that come with these metrics.

Adjusted SG&A expenses for the quarter were $45.2 million, compared to SG&A expenses of $40.5 million in the second quarter of fiscal year 2014. As a percentage of net sales, adjusted SG&A expenses in the quarter increased to 26.1% from 25.4% in the corresponding fiscal quarter of 2014, primarily as a result of increased depreciation in the new store locations, combined with an increase in the legal and professional fees associated with the litigation matter.

Adjusted income from operations for the quarter was $12.8 million, as compared to income from operations of $12.3 million in the second quarter of fiscal year 2014. The year-over-year increase was driven by higher gross margins, offset by the changes in SG&A as a result of the factors I just described.

Our net interest expense in the second quarter of fiscal year 2015 was $3.4 million, compared to $4.1 million of interest expense in the second 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. Earlier this week, we amended our line of credit facility to lower our interest rate by 25 basis points, the impact of which will continue to lower our effective interest rate on our borrowings.

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 $5.7 million or adjusted earnings per share of $0.14 based on 42.2 million diluted weighted average shares outstanding, as compared to net income of $5.1 million or adjusted earnings per share of $0.12 based on 42 million adjusted diluted weighted average shares outstanding in the second quarter of fiscal year 2014.

Adjusted EBITDA for the second quarter of fiscal year 2015 was $17.3 million, compared to Adjusted EBITDA of $16 million in the prior year period.

Ending inventory was $235.4 million, as compared to $207.4 million in inventory as of the end of the second quarter of fiscal year 2014. On a per-store basis, inventory was flat with the prior year. As we enter the third quarter, we are very pleased with the quantity and quality of our inventory.

Turning to our outlook, we expect to continue to see sequential improvement in our business as our industry returns to a more normal level. As a result, our outlook includes third quarter revenue to be in the range of $198 million to $203 million; same-store sales of flat to positive 2%, compared to the third quarter of last year; and earnings per diluted share of $0.22 to $0.24 on a weighted average of approximately 42.3 million estimated common shares outstanding. Our third quarter guidance considers the increased pre-opening expenses for the three new stores that we are opening during the third quarter of fiscal year 2015, compared to the one store that we opened during the third quarter of the prior year.

For the full fiscal year 2015, we are reiterating our outlook initially provided with our 2014 year-end release. We continue to expect revenue of $720 million to $740 million; same-store sales of negative 1% to positive 2%; and earnings per diluted share of $0.56 to $0.63 on a weighted average of approximately 42.3 million estimated common shares outstanding.

We ended the quarter with $48.4 million in outstanding borrowings and $64 million in borrowing availability under our credit facility. During the first half of fiscal year 2015, we incurred approximately $19.4 million in capital expenditures. Not including any landlord incentives, we continue to expect to incur additional capital expenditures of approximately $10 million to $15 million during the remainder of fiscal year 2015, which will include our 2015 class of stores, as well as work on our 2016 new stores, and continued investments in IT infrastructure and our distribution center operation. 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 poll for questions.

Our first question comes from the line of comes from the line of Stephen Tanal at Goldman Sachs.

Stephen Tanal:

Good afternoon, guys, and thanks for the question. The first thing, the new small store, it sounds very interesting. In the past, I think not too long ago, you identified a whole lot of potential new markets, I think 627 was the number we counted. How does this format kind of fit into what you previously defined as the potential opportunity set? Is it above and beyond, or does it address some of those markets that you'd maybe been looking, but were potentially costly?

John Schaefer:

Well, when you look at 600 markets, you try to figure out what are the most opportune, and we are looking at somewhere in the neighborhood of 300 potential markets that made sense for our 30,000- to 40,000-square-foot store format, either as a standalone store in a smaller market or as a neighborhood store. As we developed the 15,000-square-foot model, that obviously makes a whole lot more of that remaining 327 markets available to us. So, while we don't specifically have a number, because this is still new, clearly, it represents numerous avenues of growth for us in an extensive number of markets, wherever we may choose to go.

Stephen Tanal:

Got it, and any sense for how small a market you could support at this point with the—or that could support a store of that size?

John Schaefer:

Well, we're looking at under 75,000. I mean, Klamath Falls, Oregon, is under that number and that store is doing extremely well. I think a lot depends on where the store is located. Clearly, there are number of stores in the West where you have relatively difficult drives to get to a major population center, and those, I think, provide significant opportunities. In the South and in the West, I think you have a number of small markets that have a very high proportion of the population that's a user base and those represent a lot of opportunities for us, so we'll be probably focusing on those first.

Stephen Tanal:

Got it, and then just lastly, I wanted to follow-up on the promotional environment. It sounds like it surprised you a bit in the quarter. Can you talk about a little what you're seeing, maybe by category or by player, or what you feel like is going on out there at this point?

John Schaefer:

Well, I'm not going to talk about the players, because there's just a ton of mom-and-pops who are doing it, you know, almost randomly. I think, as the environment improves, from a firearms and ammunition level, both on the demand and the sales level, we saw more promotions in what I would call, for us at least, non-drivers to the store, meaning clothing, footwear, certain accessories, and that was a little surprising because those categories normally, at least for us, don't drive people into our store. What drives people into our store are our optics and firearms and fishing and camping.

Stephen Tanal:

Okay. Thank you.

Operator:

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

Seth Sigman:

Okay, thank you. Nice progress, guys, in the quarter.

John Schaefer:

Thank you.

Seth Sigman:

I wanted to talk about the stores facing new competition, stores that are still within that 18-month window. The comp declines there have been better than expected for a few quarters now and I'm just wondering does that reflect less initial hit to those stores when new competition comes into the market, or are those stores actually just recovering better than you would have expected?

John Schaefer:

Seth, I think it's a number of factors. One, I think the aging of the stores in that 18-month is skewing from a number of them that are less than a year to now starting to get a number of them that are in the 12- to 18-month range, so we'll see the number in the competitive openings go down over time. I think that is one of the standards that helps the recovery.

Clearly, the stores we're opening in neighborhood markets, or stores that are opening on top of us in large MSAs, that forces them to become neighborhood store, show that the people that are within 20 minutes from us continue to want to shop at our store mainly because of convenience.

Then, the third factor is there's a couple of stores that are opened that aren't the normal size of some of our national competitors, and those stores have done significantly better than the average in terms of competition, competitive effect.

Seth Sigman:

Okay, that's helpful. Then, when you look at the economics of those smaller stores that you're talking about, you know, it seems like they can achieve similar sales per square foot to the rest of the chain today, but would you expect the operating cost to actually be a lot lower, potentially supporting better margins in those smaller stores?

John Schaefer:

No, no, what I would expect is—you know, you still have to have managers in those departments, you still have to have associates in the departments, you still need cashiers, et cetera. The fixed costs, we've managed to do a really good job keeping where we need to be, such that we can keep the variable costs in line. So, I would say, on a per-store level, these stores should perform at or slightly better on a per-square-foot basis, but on a four-wall EBITDA basis, I think they're going to perform pretty much the same as our other size stores. That's the way we have it pro forma-ed, and in the months we've had these stores open, that's kind of the way they've performed.

Seth Sigman:

Okay. Thank you.

Operator:

Our next question comes from the line of Matt Nemer at Wells Fargo. Please proceed with your question, Matt.

Matt Nemer:

Thank you. Good afternoon, everyone. I had a couple of follow-ups on the micro stores, as well. I'm curious if you have a timeline in mind that you want to watch these stores, in terms of when you'd be ready to potentially do a broader roll-out; and in terms of your pipeline right now, are any of those locations in this micro format?

John Schaefer:

I don't like the word micro. I'd probably choose not to call it a micro format.

Matt Nemer:

Medium.

John Schaefer:

There you go. We're looking at several markets for the 2016 class. We're very conservative when it comes to making 'go' decisions on things like this, I think, as you've probably realized. With the transition from the 40,000 to the 30,000-square-foot store format, we tested it, we opened a few, we watched, we watched, we watched some more, and then we said "this is working, let's go with it." We'll do the same with that. We've got two open. We've probably got a couple in the pipeline. I think, on an ongoing basis, the 30,000-square-foot is still going to be our standard, but we will supplement it with a few smaller format stores, as the market allows us to, and as conditions warrant, I would say. There's no numbers in mind yet. I think it'll be a nice mix between, but it will certainly still skew more heavily toward the 30,000-square-foot format.

Kevan Talbot:

Matt, none of the three stores that we announced today are of the smaller format, the 15,000-square-foot format. The stores that we announced today are all at the 30,000-square-foot format. So, none of these new ones are the smaller stores.

Matt Nemer:

Okay, that's helpful. Then, secondly, are you able to give us a sense for how big of a category MSRs are relative to the overall firearms category? Obviously, it looks like Wal-Mart is deciding to pull out of that and we're just trying to assess what the impact could be?

Kevan Talbot:

You know, Matt, MSRs are one of the many types of firearms that we do offer. They are a large portion—I shouldn't say a large portion—they're a portion of our firearm sales, but it is not a significant number of our sales. We've never released that number publicly. We continue to monitor developments in this arena, particularly with the announcement with Wal-Mart, but it is not—that is not something that really has been a material number for us historically.

John Schaefer:

You know, Matt, I'll tell you that people don't go to Wal-Mart to buy MSRs. People go to Wal-Mart to buy entry-level 22s and 12-gauge shotguns. Their explanation of getting out of the MSRs because it wasn't selling makes perfect sense to me.

Matt Nemer:

Understood. Thanks so much.

Operator:

Our next question comes from the line of Mark Miller of William Blair. Please proceed with your question, Mr. Miller.

Mark Miller:

Yes, hi, good afternoon, everyone. So, there was this vendor event last year which shifted—which I think penalized the comps in 2Q, is it by something like 0.5% or so. So, assuming that then benefits you this next period, it's looking like your comp outlook for 3Q is more or less similar to what you just had. It seems like it might be a little bit conservative, since the trend should be getting—it seemed to be picking up in the back half, and then if you could address that.

My second question is the range on EPS is quite wide, implying 5% to 28% EPS growth. Maybe you could talk about the factors that would push it out of the bottom versus opportunity to be at the high end. Thanks.

Kevan Talbot:

Mark, as we look at our earnings guidance, obviously, you know, there's a lot of factors to consider there that we have addressed, and we saw some positive movement in the firearms that we expect to continue. There are also some other items that have us concerned going forward. We're particularly concerned about the fires in the Pacific Northwest, the impact that that is going to have on the salmon fishery in the fall, access to camping in those markets. So, we do have some concerns, that we take all of that into consideration as we look at that guidance and as we set our guidance going forward. We looked specifically at the third quarter and we've reiterated, based upon these factors, our annual guidance, and just felt comfortable leaving the guidance where it was for the annual basis.

Mark Miller:

Okay. Given the industry-leading trends and good performance, can Management just address where you see the proper expansion rate for the Company? I mean, presumably, we're going to be looking at footage growth more so than the number of stores, but, I mean, opportunity to go faster, is it something being considered, do you have the personnel? I mean, what would be the constraints if you had an inclination for that?

John Schaefer:

Well, I think we certainly have the infrastructure and the personnel to move at a faster pace, if we so choose. The one benefit we have at the pace at which we're operating now is it allows us to achieve our growth objectives, both on a square foot and on a sales basis, and to be incredibly particular about what markets we choose to go to. We clearly want to go to markets where the risk is virtually none or very minimal, and we are able to do that at the current growth pattern. We can certainly jack that up without really increasing risk a whole lot.

The other objective that we always have is we want to find a good balance between store growth and debt pay-down. We consider being able to grow this Company on free cash flow an incredibly important factor for us, and to create enough free cash flow that we can not only grow the Company with free cash flow but also pay down our debt at a maybe slightly faster than necessary pace. So, we try to keep those two balanced.

Mark Miller:

Okay, responsible growth, I get it. Thanks.

Operator:

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

Michael Gunther:

Hi, this is Michael Gunther on for Lee. Thanks for taking my question. I was wondering if you guys could talk about how private label has been performing versus the branded assortment in apparel and overall, and how big that can get over time. I know it's a slow process, but maybe in the next five, ten years, how much can that make up of your total merchandise?

Kevan Talbot:

You know, we saw good results from our private label initiatives. These numbers that we provide, I don't have the specific numbers in front of me by category, so I'm going to speak to them in total, but we were up to 2.7% of our sales. Obviously, that's still a small number, but it was up over the same period of last year. So, we continue to see increases each period. We are looking at all categories, more than just our clothing and footwear. We are looking at some fishing items, we're looking at some gun cases, some camping items, so we're looking all across the store where it makes sense. As we have discussed our initiatives internally, we think that over time that number can approach 10%. We don't see it getting much higher than that given our focus on brands, but where it makes sense, we're looking for those opportunities and working that into our initiatives, and we're seeing results there, we're seeing an increase in the percentage of our sales, and we continue to expect that as we move forward.

Michael Gunther:

Thank you.

Operator:

Our next question comes from the line of Andrew Burns at D.A. Davidson. Please proceed with your question, Mr. Burns.

Please proceed with your question, Mr. Burns.

Andrew Burns:

Sorry, I was on mute there. Congratulations on the quarter. I have a couple of quick category follow-up questions here. Apparel and soft goods have been tough for two quarters. I think in both quarters weather was by far the largest driver of that, but didn't know if there was any other stories or anything else you can tell in terms of whether discounting from competitors was also a factor, or if there's areas to improve the assortment? Thanks.

John Schaefer:

I certainly think there's always room to improve the assortment, especially on the women's and kids' size. Very frankly, we didn't have as many—as high a degree of off-price clothing and footwear sales this year as we had last year because we bought better this year. Frankly, we ran out of women's and kids' clothing a month too early. So, we're taking learnings from that. Clothing and footwear with the store-within-a-store concept is still a relatively new concept for us and we want to have the product the customer needs, but we don't want to be liquidating at the end of the every quarter or end of every season to a high degree, and, frankly, this quarter we under-bought a little bit, and we'll learn from that.

Andrew Burns:

Okay, thanks, and on camping, you mentioned strength in your competitors in the quarter. Was there any merchandise changes that you made in particular or any new subcategories that were really driving that growth, or is it just overall participation and the healthy environment?

Kevan Talbot:

No, we didn't make any changes in the product mix, the merchandising mix. I think there are several factors that are causing camping to grow, not only for us but for other national players, and a couple of those are more people are getting into camping—there's certainly more product that makes camping less rugged and, frankly, more enjoyable to people, which I think spurs growth in that—and I think there's still that mom-and-pop kind of thing going on, not definitively, but as all the national players grow, they all have substantially better camping product offerings than people can either find locally or even, frankly, find online, and with those offerings comes increased opportunities to buy and increased desire to buy, and I think that's happening not only for us but for the other national guys as well, and I think it's going to continue.

Andrew Burns:

Great, thanks, and good luck on the balance of the year.

John Schaefer:

Thanks.

Operator:

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

Peter Keith:

Hi, good afternoon, and thanks for taking the question. I want to dig a little bit more into the firearms and make sure we're looking at the data right. So, I think you said your firearm sales were up 12.2% on a dollar basis. Based on NICS data on your states, we calculated up 10%. So, I guess, are you not seeing any ASP pressure anymore at this point and that's just clear evidence of a pure gain in firearms?

John Schaefer:

What we said was our unit growth was almost the same as the NICS data, so take that for what it's worth. We're seeing some movement upward in average selling price, and what we're seeing—I think the best way to say it is if you look over time and try to factor out the noise of the big spike and the noise of the oversupply, you'll see that the mix of firearms being sold and the price points at which they're being sold are kind of getting back to whatever it is you would define as normal, at least it is what we would define as normal for our business in our states, and therefore we expect to see, and we are seeing, both unit increases and slight price increases.

Peter Keith:

Okay, great. Your comp trend generally has been improving very nicely on a sequential basis, but on a monthly front, the NICS data has also been getting better. Would the general trends of NICS in the last couple of months be reflective of your comp trend, as well, with your general month-to-month improvement?

Kevan Talbot:

You know, we don't talk to month-to-month, because I don't think any player can correlate specifically with NICS on a month-by-month basis. We correlate very well on a quarter-by-quarter basis. That doesn't mean we correlate well on a month-by-month basis.

Peter Keith:

Okay, fair enough. I also wanted to—just to put it back that the competitive environment. So, you said it was maybe more competitive than you thought, but am I reading it correctly, that it didn't seem to have an impact on either your gross margin or your comp trend. Is that the best way to characterize it?

Kevan Talbot:

It's not the competitive impact. I guess what you are referring to is the promotional impact by both mom-and-pops and some national players. I think the types of items that were being promoted did not have an impact on our particular business. We're skewed a little more toward the hard goods than I think some of the other players, and the items that were being promoted were not necessarily those types of items.

Peter Keith:

Okay, I understand, thank you. I'd like to slip in one last question with regard to the weather. Understanding that you guys had a very warm winter in most of your geographies last year, how are you planning for the winter in the context this year's guidance? Are you thinking it's kind of the similar or maybe a more normal winter?

Kevan Talbot:

We've chosen to plan for more normal weather patterns, which obviously impacts our soft good sales. Things can always change and the weather is always changing, but we've felt that that was the best way for us to approach this, is to look at it on a more normal weather pattern.

Peter Keith:

Okay, very good. Keep up the good work. Thanks a lot.

Operator:

Our next question comes from the line of Patrick McKeever at MKM Partners. Please proceed with your question.

Patrick McKeever:

Okay, thanks. John, you mentioned traffic still being negative in the quarter. I'm just wondering if you've seen any change in the sequential trend, even subtle changes in the traffic patterns, or was the positive comp driven, you know, was that pretty much all average ticket?

John Schaefer:

No, we're seeing some improvement in traffic patterns. We're seeing sequential improvement in traffic patterns, as we would expect to see. I think, you know, traffic is negative but conversion is positive, and what that really tells us is it's more a factor of the flow of people in and out of the store in the prior year versus this year, and what I mean by that is last year you still had a—two years ago you had a number of people coming in, 10 people would want the one box of ammunition that was available, so you had terrible conversion, but you had huge traffic. Last year, you still had people coming in in the weekdays when the freight arrived, looking for certain products, and because those products were still in relatively high demand, there was more disappointment in the customers. This year, we're back to a more equal supply and demand. So, the math just works out that your conversion is going to be better and your traffic is going to be slightly down, but it's going to improve month-over-month and quarter-over-quarter, and that's exactly what we are seeing.

Patrick McKeever:

Okay, got it. Then, just looking into the fall hunting season, anything out there on the product side that's particularly new and innovative that might have a meaningful impact on the business, and if so, how are you positioned there?

John Schaefer:

Unfortunately, we haven't seen anything. That doesn't mean there won't be things coming up. I mean, there's a lot of vendor interaction at this time of year for the end of the hunting season and the holiday season, but, frankly, from the SHOT Show in January and throughout the year, there's been nothing that's—there has been no 'aha' moments or there's been no 'wow' products hitting the market this year, so we don't expect anything like that, to do anything special, I guess, in the second half of the year.

Patrick McKeever:

Okay, great. Thanks so much.

Operator:

At this time, I would now like to turn the conference over to Management for closing remarks.

John Schaefer:

Thanks. Thanks for all your questions. Thanks for joining us today and we look forward to speaking with you again when we report our next quarter's results. Thanks very much, everybody.

Operator:

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