Q4 2016 Earnings Call

Company Participants

- Robert L. LaPenta
- Thomas A. Kingsbury
- Marc D. Katz

Other Participants

- Ike Boruchow
- Matthew Robert Boss
- Brian Jay Tunick
- Lorraine Maikis Hutchinson
- Lindsay Drucker Mann
- David J. Glick
- John Dygert Morris
- John Kernan
- Christian Roland Buss

MANAGEMENT DISCUSSION SECTION

Operator

Greetings, and welcome to the Burlington Stores Incorporated Fourth Quarter Fiscal 2016 Earnings Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Mr. Bob LaPenta, Vice President and Treasurer for Burlington Stores. Thank you. You may begin.

Robert L. LaPenta

Thank you, operator, and good morning, everyone. We appreciate everyone's participation in today's conference call to discuss Burlington's fourth fiscal quarter and full-year 2016 operating results. Our presenters today are Tom Kingsbury, our Chairman and Chief Executive Officer; and Marc Katz, our Principal and Chief Financial Officer.

Before I turn the call over to Tom, I'd like to inform listeners that this call may not be transcribed, recorded or broadcast without our expressed permission. A replay of the call will be available till March 16, 2017. We take no responsibility for inaccuracies that may appear in transcripts of this call by third parties. Our remarks and the Q&A that follows are copyrighted today by Burlington Stores.

Remarks made on this call concerning future expectations, events, strategies, objectives, trends or projected financial results are subject to certain risks and uncertainties. Actual results may differ materially from those that are projected in such forward-looking statements. Such risks and uncertainties include those that are described in the company's 10-K for fiscal year 2015 and in other filings with the SEC, all of which are expressly incorporated herein by reference. Please note that the financial results and expectations we discuss today are on a continuing operations basis. Reconciliations of the non-GAAP measures we discuss today to GAAP measures are included in today's press release.

Now, here's Tom.

Thomas A. Kingsbury

Thank you, Bob. Good morning, everyone. We are very pleased to report better than expected fourth quarter results that included strong sales growth, positive comp sales, expansion in gross margin, and a 19% increase in adjusted diluted earnings per share. Our performance continued the strong momentum we have experienced throughout the year, driven by the successful execution and elevation of our off-price model. This is further demonstrated by our annual fiscal 2016 results that also included setting new records across all key operating metrics. For the year, we saw: net sales of $5.6 billion, increasing 9.2% from the prior year; a 4.5% increase in comparable store sales on top of 2015's 2.1% increase; and 80-basis-point expansion in gross margin; and a 100-basis-point increase in adjusted EBITDA margin.

We continued to generate strong cash flow, which enabled us to not only fund our growth, but return value to our shareholders through our share repurchase program. The combination of all these factors contributed to a 40% increase in fiscal 2016 adjusted net income per share. The sustained and consistent strength of our business not only highlights our ability to satisfy customers with highly desirable brands, terrific value and great customer service, but also the successful expansion of our product offerings. I want to thank our entire organization for contributing to our strong 2016 performance and we remain excited about our business prospects in fiscal 2017 and longer term.

Let me share with you some highlights of the fourth quarter. Total sales increased 9.4%, with comparable store sales rising 4.6%. The fourth quarter marked our 16th consecutive quarter of positive comp sales. Once again we saw positive traffic; including the fourth quarter, we've now delivered positive traffic in nine of the last ten quarters. Top performing businesses were home, beauty, men's and athletic shoes, and handbags. We're also very pleased with our gift businesses across the company, which continued to help us de-weather our business.

In the quarter, non-cold weather businesses comped up 6%, while cold weather categories comped down 3%. As a reminder, we define cold weather categories as coats, sweaters, cold weather accessories and boots. In terms of territories, the West, Northeast and Southeast were the best performing regions and the Midwest and Southwest underperformed the company average. We were pleased to see that 27 out of 29 regions experienced a positive comp for the quarter, demonstrating our broad reach across the country. Comparable store inventory decreased by 9% at quarter end.

Our merchandising and planning teams continued to manage receipts well. To this end, inventory aged 91 days and older, continued to improve versus the prior year, declining 29%, on top of a 13% decline at the end of 2015. Once again, we increased our penetration of better and best product. Pack and hold as a percent of our total inventory was 23% versus 25% a year ago. There continues to be an abundance of opportunities available in the marketplace and we remain liquid to take advantage of great deals.

We repurchased over 560,000 shares of common stock during the fourth quarter for $50 million and 2.8 million shares for $200 million during the year. As a reminder, in November, our board of directors authorized a new $200 million share repurchase program, which will continue to be executed through November of 2018 as we opportunistically aim to deliver increased value to our shareholders.

Let me now turn to speak to our long-term strategic priorities, which remain focused on driving comparable store sales growth, expanding our store fleet and increasing our operating margins. First, with regards to driving comparable store sales growth, as I've mentioned before, we will continue to enhance our off-price model by investing in both our merchant organization and supply chain infrastructure. We have been focused on driving performance through our improved assortments, and continue to see opportunities within specific categories of home, beauty and ladies apparel.

With regard to home, we ended the year with the category reaching 12.4% of sales, up from 11.2% last year. Our growth in home was broad-based with the most significant increases coming in home decor, housewares and textiles. We continue to set our sights on a 20% penetration rate, which is more in line with our peers and expect to move closer to this objective in 2017 through faster identification and delivery of key trends, elevated assortments and an increase in national brands. In addition, beauty, which includes bath and body, skincare, hair care, accessories, cosmetics and fragrances, remains a growth priority and we're very pleased with this category's fourth quarter performance.

Our gifting strategies were successful and we continued to benefit from our fourth quarter 2015 transition of fragrances to an owned business from a lease arrangement. In 2017, we will continue to develop our fragrance business to store cosmetics and broaden our resource base. Ladies apparel also remains a growth opportunity for us. We increased our sales penetration by 80 basis points, and ended the year at 24.4% penetration versus 23.6% a year ago. We're pleased with our performance in [ph] Missy's Sportswear and Intimate Apparel (09:50), which are both benefiting from expanded assortments and increased better and best penetration. As a reminder, our peer group operates at approximate 30% penetration level, which continues to be our go-forward goal.

The increase in these categories just mentioned combined with the expansion of our holiday gift presentation, has enabled us to reduce our cold weather dependency in effect de-weathering our sales. And while we expect to always be known for having a premier selection of coats, the added diversity in our offering not only positions us to meet more of our customer's shopping needs, it also mitigates our dependence on any one category for our growth. We ended this year with coats representing 5.5% of total sales versus last year's [ph] ending (10:47) penetration of 6.3%. Reducing our penetration of coats has been a consistent effort by our merchant team. To put it in perspective, when I started at the company, coats represented a double-digit sales penetration.

Our localization efforts also continued to focus on tailing our assortments and brands to the various needs of the markets we serve. We're pleased with our localization efforts in coats and cold weather products as well as gift giving as we further improve in tailing those assortments by store. Our marketing initiatives also support our sales growth priority with our marketing testimonial campaign continuing to resonate with our customers. We will continue with this campaign in 2017 with the dollar spend similar to 2016.

Our second growth initiative is the expansion of our store fleet. We ended the year with 592 stores, adding 25 net new stores averaging 51,000 square feet. We are very pleased with the performance of our new stores in our smaller formats. Stores less than 60,000 square feet achieved a sales productivity 17% above our comp base. In total, new and non-comp stores contributed an incremental $257 million to our 2016 net sales. We also completed 11 remodels and 25 refreshes. We will continue to remodel and refresh our store base as appropriate to provide the best possible shopping experience for our customers. In 2017, we continue to expect to open 30 net new stores with an average square footage of 45,000 square feet. This will consist of approximately 44 new stores, including approximately six relocations and eight pure closures.

All but one of the closings are stores that we decided to close as they are low EBIT contributors in declining locations where we are not earning an acceptable return on capital. Given the strong performance we've experienced in our new stores and the real estate opportunities that continue to be presented to us, we remain very confident in our ability to expand to 1,000 stores over the long-term. Our third priority is to continue to expand our operating margins. As we benefit from increased leverage of our fixed cost, as well as optimized markdowns, localize our assortments and remain disciplined with regards to inventory management, these efforts helped contribute to the 100-basis-point expansion in adjusted EBITDA margin we delivered in 2016. We will continue to apply these same strategies to further drive operating margin expansion in 2017 and beyond.

Now, I'd like to turn the call over to Marc to review our financial performance and outlook in more detail.

Marc D. Katz

Thanks, Tom, and good morning, everyone. Thank you for joining us today. As Tom mentioned, we are very pleased with our better than expected fourth quarter sales and earnings performance, which completed a strong year of growth and record setting accomplishments toward advancing the priorities we set at the start of the year. Specifically, the fourth quarter and full year saw positive momentum across key metrics including increased sales, expansion in gross margin and reduction in interest expense. This, combined with the lower share count from share repurchases, drove an increase in adjusted net income per share for the fourth quarter and 2016 of 19% and 40% respectively.

Turning to a review of the income statement. For the fourth quarter, total sales increased 9.4% and comparable store sales increased 4.6%. This marks our 16th consecutive quarter of positive comp store sales growth. In terms of comp metrics, our comparable store sales performance was driven by increases in traffic, conversion and units per transaction, while average unit retail was down versus the prior year. We are very pleased that our positive traffic momentum continued as we now have seen increases in traffic in nine out of the last ten quarters.

The gross margin rate was 41.8%, an increase of 80 basis points versus last year, driven primarily by improved shortage results. This more than offset a 25-basis-point increase in product sourcing costs, which include cost of processed goods through our supply chain and buying cost, both of which are included in selling, general and administrative expenses.

As you may recall, our physical inventories during the fourth quarter of 2015 resulted in a higher shortage rate than we had initially expected. Consequently, the full year negative impact fell into the fourth quarter. As we've mentioned in previous calls, we view this result as a call to action and implemented specific steps throughout the year to course correct. We were very pleased to see the positive results from our summer physical inventories carry forward to our January inventories as well. We had planned the full year shortage rate to come in better than last year and we ended up beating our plan.

SG&A exclusive of product sourcing cost and cost related to certain litigation decreased to 23.2% from 23.3% last year. This improvement was driven by leverage attained in advertising spend, store occupancy costs and store payroll costs. The overall improvement was partially offset by the impact of incentive compensation and insurance. Adjusted EBITDA increased 13% or $30 million to $255 million. Sales growth and gross margin expansion led to a 50-basis-point expansion in rate for the quarter. Depreciation and amortization expense exclusive of net favorable lease amortization increased $2 million to $41 million, and interest expense decreased $2 million to $13 million.

The adjusted effective tax rate which excludes the impact of the release of a valuation allowance on deferred tax assets was 37.2% versus 36% in the 2015 fourth quarter, primarily related to the timing of hiring related federal tax credits. Combined, this resulted in net income of $126 million, an increase of 27% compared to last year and adjusted net income of $126 million for the quarter, an increase of 15% compared to last year. We continue to return value to our shareholders through our share repurchase program. During the quarter, we repurchased over 560,000 shares of stock for $50 million. We have $200 million remaining on our share repurchase program, approved last November. This resulted in diluted net income per share of $1.77 versus $1.35 last year and diluted adjusted net income per share of $1.78 versus $1.49 last year.

For the full year of 2016, total sales rose 9.2% and included a comparable store sales increase of 4.5%, following a 2.1% comparable store sales gain in fiscal 2015. Gross margin was 40.8%, representing an increase of 80 basis points versus fiscal 2015 driven by improved merchandise margins. This improvement more than offset a 20-basis-point increase in product sourcing costs.

As a percentage of net sales, SG&A exclusive of product sourcing costs and cost related to certain litigation improved 50 basis points to 26.2%. This improvement was driven by increased leverage in store occupancy, store payroll cost and advertising expense, and was partially offset by an increase in incentive compensation. Adjusted EBITDA increased by 21% or $101 million to $585 million, representing a 100-basis-point increase as a percent of sales in 2016. Depreciation and amortization expense exclusive of net favorable lease amortization increased by $12 million to $160 million. Interest expense decreased $3 million to $56 million driven by the repricing activity completed in the second quarter of 2016.

The adjusted effective tax rate which excludes the impact of the release of a valuation allowance on deferred tax assets was 37%, flat to fiscal 2015. Combined, this resulted in net income of $216 million, an increase of 43% versus last year and adjusted net income of $232 million versus an adjusted net income of $175 million last year, up over 33%. Diluted net income per share was $3.01 versus $1.99 last year. Diluted adjusted net earnings per share were $3.24 versus $2.31 last year. And our fully diluted shares outstanding were 71.7 million shares versus 75.4 million last year.

Turning to our balance sheet, at quarter end, we had $82 million in cash, no outstanding borrowings on our ABL and had unused credit availability of approximately $428 million. We ended the period with total debt of $1.1 billion. We are very pleased to report that our debt leverage ratio at the end of 2016 was 1.9. Merchandise inventories were $702 million versus $784 million in the prior year. The decrease was primarily driven by a decline in comparable store inventory of 9%. Pack and hold inventory represented 23% of inventory at quarter end versus 25% last year. Cash flow provided by operations increased $275 million to $602 million, primarily related to our improved operating results and changes in working capital inclusive of the reduction in our inventories. Capital expenditures, net of landlord incentives, were $155 million for fiscal 2016. We ended 2016 with 592 stores, including 25 net new stores for the year.

Turning to our outlook, for the full year 2017, which includes a 53rd week, we expect: net sales growth in the range of 7.5% to 8.5%, 1.4% of which is related to the 53rd week in the fourth quarter and comparable store sales to increase 2% to 3% on top of a 4.5% increase in 2016; adjusted EBITDA margin expansion of 40 basis points to 50 basis points; interest expense to approximate $57 million; an adjusted tax rate of approximately 36%; we expect the new accounting rules related to share-based compensation to have a favorable impact of approximately 100 basis points on the effective tax rate in 2017; a share count of approximately 71.8 million diluted shares; net capital expenditures to be approximately $200 million. This is higher than prior year's and is due to the 44 total new store projects Tom mentioned earlier and an approximate $47 million spend in supply chain, which is $25 million over last year.

Depreciation and amortization, exclusive of favorable lease amortization to be approximately $176 million. This results in adjusted diluted net income per share guidance in the range of $3.77 to $3.87 versus 2016 actual adjusted diluted net income per share of $3.24. Please note the 53rd week is expected to have a $0.04 per diluted share positive impact in the fourth quarter of the year and the change in share-based compensation accounting is expected to have a $0.05 positive impact for the year.

I want to take a moment to review some expense headwinds that have been offset within our 2017 guidance. First, we are expecting the wage increases from both our stores and distribution centers will negatively impact our full year performance by about $0.13. We also anticipate increased stock compensation expense of about $0.10 as the company continues its transition to a post-IPO long-term equity-based incentive plan.

Consistent with what we've done in the past, due to our strong profit improvement culture across all sales support teams, we have been able to offset these headwinds in our 2017 guidance. For the first quarter of 2017, we expect net sales to increase in the range of 5% to 6% and comparable store sales to increase between 1% and 2% on top of last year's 4.3% increase. This reflects the impact of the significant delay in the processing of income tax refunds this year compared to last year. Diluted adjusted net income per share is expected to be in the range of $0.67 to $0.70 versus $0.57 per share last year, utilizing a fully diluted share count of approximately 71.7 million shares. This reflects a $0.02 benefit from the recent accounting change for share-based compensation.

Now, I would like to turn the call back over to Tom for concluding remarks.

Thomas A. Kingsbury

Thanks, Marc. In summary, 2016 marked another outstanding year of sales and earnings growth driven by the ongoing success in increasing customer preference for our off-price model. I remain confident in our ability to further evolve our off-price model to drive sales productivity and profitability growth for many years into the future.

With that, I'd like to turn the call over to the operator to begin the question-and-answer portion of the call. Operator?

Q&A

Operator

Thank you. The floor is now open for questions [Operator Instructions] Our first question today is coming from Ike Boruchow of Wells Fargo. Please proceed with your question.

<Q - Ike Boruchow>: Hey, good morning everyone and congrats on a really strong quarter in a tough environment. I guess, first for Marc. Marc, can you maybe provide more color on the Q4 gross margin? Sounds like shortage drove most of the improvements. So, just kind of curious if you expect more good news there going forward and maybe if you could talk to IMU and markdowns for the quarter as well and what's baked into 2017 guide. And maybe also just headwinds related to share-based comp going forward, you guys have been doing well, it's been increasing about $5 million to $6 million a year, just kind of curious if you can help us there.

<A - Marc D. Katz>: Sure, Ike, good morning. Let's start with the Q4 gross margin question. As we mentioned last year, we have and continue to have a lot of confidence in our Asset Protection team [ph] and knew (28:54) they would view 2015's shortage result as a major call to action. Our Asset Protection team and the stores organization implemented a number of specific actions throughout the year. We were very pleased to see our encouraging results from our summer inventories carry forward to our January inventories as well. So, we took about 400 physicals in January, we saw improvements across all four of our major territories in just about every merchandising area. Specifically shortage ended up being about 65 basis points of that 80-basis-point improvement in margin and given that that was better than what we had planned in 2016, we're really only planning a very minor improvement in shortage for 2017, a few basis points.

In terms of the other components of gross margin you ask about, as it has been all year, our IMU was higher than last year and it more than offset the increase that we had in our markdown rate. The net of those two, Ike, was the other 15 basis points. It was really important for us to be as clean as possible from an inventory point of view as we started the spring season.

As Tom mentioned in his prepared remarks, our comp store inventories were down 9% and our goods aged 91 days and older were $85 million versus $120 million the year before, a 29% reduction. So the flipside of reducing that 91-day and older bucket is that we increased the freshness of our inventory. So we pay a lot of attention to those goods aged zero days to 30 days, and we began this year 2017 with that zero to 30 bucket 300 basis points ahead of last year.

As you know, we think about gross margin on a full year basis and we think about it on a full year basis net of product sourcing cost, so for the year we delivered an 80 basis point increase and that was primarily driven by the stronger IMU. The shortage benefit for the full year was about 15 basis points. And obviously that more than offset the product sourcing increase of 20 basis points.

Your second question, Ike, was stock-based comp related. So we did call out in the script, there was an incremental $12 million of SG&A in 2017, or $0.10 per share in stock-based comp. As you know, we became a public company in October 2013, and since that time, we've been transitioning to a more competitive equity grant program.

Stock-based comp last couple of years, as you mentioned, is right about $5 million to $6 million of incremental headwinds. Based on the leadership changes that we announced in January, there were some one-time equity grants that drove the majority of that incremental amount that you see in 2017. As far as going forward, we do not expect to see that type of increase in 2018. We expect it to revert back more in that $6 million range.

And obviously I was just talking about stock-based comp expense that hits SG&A, I was not talking about the accounting change related to stock-based comp. We expect that to be a $0.05 benefit in the year that's going to come through on the tax line.

<Q - Ike Boruchow>: Got it. Thanks, Marc. And then if I can, just one follow up for Tom. So there is a later Easter this year. I think a few years ago when Easter shifted around, you guys had a few execution issues that popped up. Maybe, Tom, can you just talk about the guardrails that got put back on the business back then and how that may be protects you this year and how you're kind of thinking about the Easter shift this year and how it compares to what happened a few years ago. Thank you very much.

<A - Thomas A. Kingsbury>: Hi, Ike. I think you're referring to what happened in 2015. We had a lot of receipt issues in some of the key businesses for Easter, one of which was ladies dresses. It was more about trying to time the receipts and we had the West Coast port strike. There are other outside factors that contributed to that, but we're not concerned about receipts this year. We have the right things in place to ensure that the goods get on the floor at the right time. So we're in good shape there. That was a one-off. I don't think we've really talked about that anymore after that one-time deal. So we're in good shape.

<Q - Ike Boruchow>: Got it. Congrats, guys.

<A - Thomas A. Kingsbury>: Thank you.

<A - Marc D. Katz>: Thanks, Ike.

<A - Robert L. LaPenta>: Thanks, Ike.

Operator

Thank you. Our next question is coming from Matthew Boss of JPMorgan. Please proceed with your question.

<Q - Matthew Robert Boss>: Hey, nice quarter, guys.

<A - Marc D. Katz>: Thanks, Matt.

<A - Thomas A. Kingsbury>: Thanks, Matt.

<Q - Matthew Robert Boss>: So, 4% to 5% comps, up 6% ex-cold weather, it clearly points to market share gains. I guess can you just talk about the tone that you're getting from the buying organization. Are you fielding calls from new brands out there? Are you seeing better quality of the assortments that you're getting? I guess I'm just thinking about this in the larger context of all of the lateral brick and mortar disruption that's happening out there.

<A - Thomas A. Kingsbury>: Matt, I'll take it. Yeah, we feel really good about the relationships that we're building with the vendor community. We've been doing this over a long period of time and there's people that really want to do business with us. And they see the results that we're getting, and there's things that are coming available to us. Our buying organization is getting much more mature in terms of executing the off-price model. They're getting better and better every season and there is a lot of positive – obviously a lot of positives around what's happening here at Burlington.

<Q - Matthew Robert Boss>: That's great. And then just a follow-up, Marc, on the SG&A front, any change to 10 basis points to 20 basis points of leverage at a 2% to 3% comp and then the 15 basis points incremental expansion for each comp point above, just kind of thinking about this year and multi-year?

<A - Marc D. Katz>: Yeah. Let me take that. So for 2017, we talked about EBITDA expansion of 40 basis points to 50 basis points. So 40 basis points of that's going to come from reported margin less product sourcing cost. So our product sourcing cost just like we had in the last couple of years, we are expecting some deleverage there and we're expecting it to be more than offset with gains in reported margins. So that's 40 basis points. 40 basis points to 50 basis points is just the difference between the 2% and the 3%. So at a 2% comp, we're at the 40 basis points, at a 3% comp that's where we will see 10 basis points of leverage from SG&A, and that's what gets us to 50 basis points. And still the same thing beyond 3%. As we go 3% to 4%, we would expect another 15 basis points.

<Q - Matthew Robert Boss>: That's great. Thanks for the help.

<A - Marc D. Katz>: You got it.

Operator

Thank you. Our next question is coming from Brian Tunick of RBC. Please proceed with your question.

<Q - Brian Jay Tunick>: Thanks. Good morning. I'll add my congrats as well, guys.

<A - Thomas A. Kingsbury>: Thanks, Brian.

<A - Marc D. Katz>: Thanks, Brain.

<Q - Brian Jay Tunick>: So two quick ones. Obviously, a lot of angst around the warm weather trends we've been seeing. So was curious regarding the Q4 results, if there was any color you could share with us regarding the monthly sales cadence or was it pretty consistent throughout the quarter as you I guess are changing the mix a little?

And then sort of along the same question, on the real estate side, particularly on these smaller store formats you're opening now, I guess as outerwear comes down as a percentage of the mix, can you maybe talk about what you're doing inside the store? Which categories are gaining floor space? And how you're looking at sort of these new smaller stores with the opportunity as outerwear continues to shrink? Thanks very much.

<A - Thomas A. Kingsbury>: Okay. Hi, Brian.

<Q - Brian Jay Tunick>: Hi, Tom.

<A - Thomas A. Kingsbury>: Well, during the quarter, all the months in the fourth quarter were positive. December is a little bit higher just because there's extra two days between Thanksgiving and Christmas this year. But overall, it was pretty consistent.

As far as the new stores go, the smaller footprint, we're going to add more space to home, beauty, accessories, the areas that we feel we can grow. And as we reduced our outerwear penetration, as we de-weather our business, these are natural categories that will grow. We're going to continue to push throughout the year our gifting business, which was very successful in the fourth quarter. But just simply we're going to continue to reduce our overall square footage in our apparel areas and outerwear's part of that, as I've mentioned before in other calls, so that we can increase our penetration in home and beauty, as I mentioned.

<Q - Brian Jay Tunick>: I guess when you look at your competitors that have square footage closer to 35,000 square feet per box, are there specific categories that you think are so important to Burlington that you guys couldn't do that in that kind of box?

<A - Thomas A. Kingsbury>: Well, we have some categories that take up more square footage. The Baby Depot business that takes up more square footage and that's a business that's a differentiator for us overall. We're still big believers in the tailored clothing business in men's and the furnishings business that takes up additional square footage. Even though outerwear has down as a percent of total, it's still a pretty big penetration relative to other retailers, so that takes up space. Now we're very proud of our ladies dress business that takes up space. So the big drivers I would say would be the Baby Depot, the men's tailored clothing business, and [indiscernible] (39:05) business.

<Q - Brian Jay Tunick>: Super. Thanks very much. Good luck.

<A - Thomas A. Kingsbury>: Thank you.

<A - Marc D. Katz>: Thanks, Brian.

Operator

Thank you. Our next question is coming from Lorraine Hutchinson of Bank of America Please proceed with your question.

<Q - Lorraine Maikis Hutchinson>: Thank you. Good morning. I wanted to follow-up on Ike's gross margin question. It sounded like fourth quarter markdown rates were higher. How are you thinking about that going forward into 2017? And when you talk about the 40 basis points of increased reported margin, is that still driven by higher IMU and do you expect the markdown rate to continue to trend up? Thank you.

<A - Marc D. Katz>: Yeah. It's really driven by both. We think about gross margin over the course of the year and our reported margin's going to offset product sourcing to be a net of 40 basis points, Lorraine. But we think it could come from a combination of both IMU and markdowns.

Over the course of the year, as we continue to reduce our comp store inventories, as we continue to turn faster, I would expect to start to see more good news come from that markdown rate. Our IMUs were strong all quarter long during 2016, so that's going to be a piece of it as well. So I could see it potentially coming from both places over the course of the year in 2017.

<Q - Lorraine Maikis Hutchinson>: Okay. And what was the driver of the higher markdown rates in 4Q?

<A - Marc D. Katz>: Just our desire to be very clean from an inventory position point of view.

<Q - Lorraine Maikis Hutchinson>: Okay.

<A - Marc D. Katz>: As we mentioned...

<Q - Lorraine Maikis Hutchinson>: Great, thank you.

<A - Marc D. Katz>: Yeah.

Operator

Thank you. Our next question is coming from Lindsay Drucker Mann of Goldman Sachs. Please proceed with your question.

<Q - Lindsay Drucker Mann>: Thanks. Good morning, guys.

<A - Marc D. Katz>: Good morning.

<Q - Lindsay Drucker Mann>: I wanted to ask about your first quarter guidance and the more subdued outlook, and the discussion of really attributing it to delayed tax receipts. A lot of companies talked about it, but I'm just curious from your perspective what you're seeing on the ground that gives you confidence that the softer start really is a function of these delayed tax receipts?

<A - Thomas A. Kingsbury>: Well, last year the income tax refunds started in week two February and this year it was in week four February. So we could just see how it impacted our business when we're up against last year's income tax refunds, and we saw what happened once the income tax refunds got in the customers' hands in terms of our business. But fundamentally we still feel very, very good about our business and the way we're operating the business. And we have taken a conservative view on the first quarter from a comp perspective, but the tax refund thing it's all built into our guidance that we supplied and we really feel that comfortable with our 2% to 3% for the year.

<Q - Lindsay Drucker Mann>: So is that to say that between weeks two and four business really softened because of the comparison but...

<A - Thomas A. Kingsbury>: Yes.

<Q - Lindsay Drucker Mann>: ...as you sit now, businesses are strong as you had hoped it would be.

<A - Thomas A. Kingsbury>: It's come back once the income tax refunds got into the customers' hands.

<A - Marc D. Katz>: Yes, that's first statement.

<A - Thomas A. Kingsbury>: Yeah.

<Q - Lindsay Drucker Mann>: Okay, great. And then separately just on comp store inventory, I was hoping you could give a little bit more color on how you're thinking about how much you can reduce these numbers. How much comp store inventories can decline? You had significant reductions in calendar 2016. What you're thinking about for 2017? And what the real drivers are of the reduced inventory going forward?

<A - Thomas A. Kingsbury>: Well, we still feel we have more inventories than we would like to have. We feel that we can experience mid-to-high single-digit decreases in comp store inventory for the foreseeable future. We're getting better in terms of selecting product. Our turns are getting faster. And the real driver is really as we grow home, beauty, and the non-apparel areas, we can take our inventories down in apparel. And we're going to do what we have been doing. We're going to work on reducing the amount of inventory we have that's in the older buckets as we've talked about in the prepared remarks. We are down 29% in terms of 91 days and older, but that's it. We want to have faster turnovers and we really feel that we can continue to reduce our inventories.

<Q - Lindsay Drucker Mann>: Great. Thanks very much.

<A - Thomas A. Kingsbury>: Thank you.

Operator

Thank you. Our next question is coming from David Glick of Buckingham Research Group. Please proceed with your questions.

<Q - David J. Glick>: Thank you. Good morning. I add my congratulations to the team. Marc, I wanted to...

<A - Thomas A. Kingsbury>: Thanks, Dave.

<Q - David J. Glick>: ...follow-up on your new store performance. Obviously, as the size shrinks and locations improve, the productivity you said I think was up 17%. How does that translate to four-wall profits now that you have more of these smaller footprint stores? And how do we think about how that impacts your return on invested capital? And then I have a follow up on supply chain. Thanks.

<A - Marc D. Katz>: Yeah. With our smaller stores, David, especially given that they're more in the retail hubs, if you will, we're paying more EBIT, so it's less because from a size point of view, they're smaller, but it's more because we're in the more of the retail hub. So our occupancy is higher for these stores, but to your point, given the fact that the sales productivity is 17% higher, it's making sure that we achieve an EBIT that we're very comfortable with. So we've been very happy with our new stores, both from a sales point of view and an EBIT contribution point of view. As Tom mentioned, we're ratcheting it up from a net [ph] 25 to 30 (45:00) next year and we've been very comfortable with how they've been performing.

<Q - David J. Glick>: Thank you. And if I could follow-up on supply chain, I think you said you're investing another $25 million, could give us a little bit of color on what you're investing in, how that might help your product sourcing costs, and how that might drive some future returns or cost savings? Thanks.

<A - Thomas A. Kingsbury>: Yeah. The two areas that we continue to invest in for this model are our merchant organization and our supply chain. So, as we mentioned, about $47 million in capital will be spent in 2017, it's $25 million higher. The majority of that incremental amount is two things. One, it's storage for pack and hold, and two, it's incremental processing in our distribution centers, which is primarily conveyer, but it's just to move more units through the system, little bit more in the fragile side and putting in more lanes that require a little bit more than manual intervention, where we have to touch more.

<Q - David J. Glick>: Thank you. I have one more follow-up. And you mentioned storage on pack and hold. Now that Jennifer has been aboard for a while, coming from Ross where, they obviously have a higher pack and hold penetration. I'm just wondering of the impact she's had on the organization in terms of your approach to pack and hold and your effectiveness in buying that category?

<**A - Thomas A. Kingsbury**>: Jennifer has done a very nice job in terms of helping the buyers and the divisional merchandise managers, and the general merchandise managers understand how to operate more effectively in terms of selection of pack and hold. She sits down with each merchant and talks to them about, what type of product we should be packing and holding, what are the manufacturers we should be packing and holding. The other thing she's helped us with is in terms of timing of when we bring the pack and hold goods in.

Now we're using pack and hold to setup some of the seasons, we use it for, in the second and fourth quarter to deliver more value on to the selling floor. So she has really helped us to really look at pack and hold in a more sophisticated way than we did prior. So, yeah, our level is coming out a little bit lower, but the quality is better.

<**Q - David J. Glick**>: Thank you very much. Good luck.

<**A - Thomas A. Kingsbury**>: Thanks, David.

<**A - Marc D. Katz**>: Thank you.

Operator

Thank you. Our next question is coming from John Morris of BMO Capital Markets. Please proceed with your question.

<**Q - John Dygert Morris**>: Congrats to everybody as well.

<**A - Thomas A. Kingsbury**>: Thanks, John.

<**Q - John Dygert Morris**>: You bet. Couple of quick ones here. Thanks for giving us a little bit of the color on the tax refunds, [ph] facing (47:53) a little bit of that headwind in Q1 and you guys able to surmount that. I'm wondering with the Macy's closings, and thinking about the liquidation sales that would be happening, if you have any experience looking at the stores that are in the close proximity to those Macy's closings, what kind of an impact you have seen from that?

And then my follow-up really would be, given the regional performance, you called out some of the outperforming regions, was there anything that you saw from a regional perspective with the patterns that was a learning, why West outperformed as opposed to some of the other ones underperformed, kind of what was going on there? Thanks.

<**A - Thomas A. Kingsbury**>: Hi, John. I will take the first one. And then if Marc wants to weigh in on the second one. So in terms of the Macy's closures, it's really too early to talk about the 2017 closure, but I can talk to you about some of the findings related to the 2016 closings if that helps you.

<**Q - John Dygert Morris**>: Yes. Great.

<**A - Thomas A. Kingsbury**>: Yes. Okay. In terms of the short-term impact, we did notice a small drop in the first three weeks of the liquidation. After that, it really leveled off and over the course of the 12-week period, was really not material. So then after the post-liquidation impact, the Burlington Stores that were colocated with Macy's saw a drop in sales most likely due to the overall traffic drop in that area, but the Burlington Stores that were between 0.5 miles and 5 miles away, we saw a slight pickup, so assuming the 2017 stores we had similar to 2016, we wouldn't really see a material pickup overall. But with that said, there is going to be other closures too. So we feel that if we can execute the off-price model and deliver value, we're going to continue to experience market share gain.

<**Q - John Dygert Morris**>: Just right before we get to Marc; Tom, can I ask, I think there is so far been enumerated about 65 of the Macy's closures this year, I think our count [ph] doing stuff (50:14) at the top of my head was that there was about 40 Burlington Stores that were within about a, I think, a 5-mile radius. Does that sound about right, I mean, do you have those numbers handy so we can think about it?

<**A - Thomas A. Kingsbury**>: Yeah. I think for us, it's closer to 51, John.

<Q - John Dygert Morris>: Okay. Good. So you would expect a longer term once those liquidation sales wrap up within say a 5-mile radius, you would expect to see kind of a nice pickup in market share I take it on a net basis.

<A - Thomas A. Kingsbury>: Well, we experienced a slight pickup, really not material in 2016, but as I mentioned, it's more than Macy's. There is a lot of other brick-and-mortar closures, so again if we can execute off price model and deliver great value as we have been, we should experience some market share gains, but it's beyond just the Macy's closures.

<Q - John Dygert Morris>: Excellent, and Marc?

<A - Marc D. Katz>: Yeah, John. So, when you have a quarter where 27 out of 29 regions comp, you got to feel pretty good about that.

<Q - John Dygert Morris>: Yeah, exactly.

<A - Marc D. Katz>: And to be honest with you, one of the regions was minus zero. So, we just didn't call that comp. The other region was really impacted by Texas and I think there was some unique things going on in Texas. I don't think there is anything...

<A - Thomas A. Kingsbury>: Yeah. Texas, I think everyone knows, with the strength of the dollar and obviously the oil business and I think a lot of other retailers have been impacted by those factors.

<Q - John Dygert Morris>: Okay, great. Thanks, guys.

<A - Thomas A. Kingsbury>: You got it, John.

<A - Marc D. Katz>: Thank you.

Operator

Thank you. Our next question is coming from John Kernan of Cowen and Company. Please proceed with your question.

<Q - John Kernan>: Good morning, everyone. Congrats on a great quarter.

<A - Marc D. Katz>: Thanks, John.

<Q - John Kernan>: So, it sounds like IMU is moving in the right direction, it's helping to offset some of the markdowns. Can you talk about the drivers of higher IMU?

<A - Marc D. Katz>: Yeah, and it's really coming from at least you look at it across the year, it's really coming from all buy types. It's not just coming from pack and hold or upfront, it's literally across the board. So, I mean I would tell you that and I'll let Tom weigh in here if he disagrees, but I would tell you, it's just more maturity within the buying team and better negotiating across the board.

<Q - John Kernan>: Okay.

<A - Thomas A. Kingsbury>: Yeah, I think what you said Marc is really accurate. I think the better we get at executing off-price, the markup has improved.

<Q - John Kernan>: Okay. And then just some model questions. Is there any embedded share buyback this year, I know there's some moving pieces with the incentive compensation and Bob, is there any debt pay down this year?

<A - Robert L. LaPenta>: So, we don't project any of that, John. So, we'll continue to just report any share repurchase at the end of each quarter and update you on what the new share counts will be going forward. And we don't predict any additional debt pay down in any of our interest expense modeling. As you remember from the script, there's $200 million available on the latest authorization for share repurchase, but we'll look at it opportunistically every quarter.

<Q - John Kernan>: Okay. Thanks. Best of luck guys.

<A - Robert L. LaPenta>: Operator, we have time for one more question.

Operator

Thank you. Our next question is coming from Christian Buss of Credit Suisse. Please proceed with your question.

<Q - Christian Roland Buss>: Yeah. Hello and congratulations on the nice quarter. I was wondering if you could talk a little bit about availability of inventory from vendors. We've heard from some vendors that they're trying to dial back their availability of goods into the off-price channel. What are you seeing from an inventory standpoint and an availability standpoint?

<A - Thomas A. Kingsbury>: We've seen a lot of availability. I mean it's been pretty consistent. Throughout 2016, there was really lot of goods to choose from. So far in 2017, there hasn't been a lack of inventory. There are some manufacturers I've stated that they're going to cut back on off-price, but there's lot of other manufacturers that are going to aggressively go after off-price, just because obviously we're gaining market share and our performance was very good. But in general, there's plenty of product out there and we're not concerned about it whatsoever. We've been hearing over and over again that there's going to be less and less goods, but it doesn't really manifest with that. So we're comfortable with the supply that we're going to have for 2017.

<Q - Christian Roland Buss>: That's very helpful. Thank you so much. And best of luck.

<A - Thomas A. Kingsbury>: Thank you.

<A - Robert L. LaPenta>: Thank you.

Operator

Gentlemen, do you have any closing comments?

Robert L. LaPenta

Yes, I do. I just want to thank everyone for joining us today. We look forward to speaking with you when we report first quarter results in May. Thanks again.

Operator

Ladies and gentlemen, thank you for your participation. This concludes today's teleconference. You may disconnect your lines at this time. And have a wonderful day.