Company Name: Burlington Stores Inc
Company Ticker: BURL US
Date: 2017-11-21
Event Description: Q3 2017 Earnings Call

Market Cap: 7,161.93
Current PX: 104.94
YTD Change($): +20.19
YTD Change(%): +23.823

Bloomberg Estimates - EPS
Current Quarter: 2.106
Current Year: 4.267
Bloomberg Estimates - Sales
Current Quarter: 1905.250
Current Year: 6054.176

Q3 2017 Earnings Call

Company Participants

- David Glick
- Thomas A. Kingsbury
- Marc D. Katz

Other Participants

- Matthew Robert Boss
- Ike Boruchow
- Kimberly Conroy Greenberger
- Lorraine Corrine Hutchinson
- John Dygert Morris
- Bilun Boyner
- Lindsay Drucker Mann
- Krista Zuber
- Dana Lauren Telsey

MANAGEMENT DISCUSSION SECTION

Operator

Greetings and welcome to the Burlington Stores Third Quarter Fiscal 2017 Earnings Conference Call. At this time, all participants are in listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

I would now like to turn the conference over to David Glick, Vice President, Investor Relations. Please go ahead.

David Glick

Thank you, operator, and good morning, everyone. We appreciate everyone's participation in today's conference call to discuss Burlington's 2017 third fiscal quarter operating results. Our presenters today are Tom Kingsbury, our Chairman and Chief Executive Officer; and Marc Katz, Chief Financial Officer and Principal.

Before I turn the call over to Tom, I would like to inform listeners that this call may not be transcribed, recorded or broadcast without our express permission. A replay of the call will be available until December 5, 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 2016 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, David. Good morning, everyone. We are pleased to report strong third quarter results driven by a solid 3.1% comparable store sales increase, which was on top of a strong 3.7% increase in fiscal 2016. Adjusted operating margin, or EBIT, expanded by 100 basis points, an outstanding result driven by increased merchandise margin which combined with our overall strong sales increase of 7.1% drove a 37% increase in adjusted earnings per share, significantly ahead of our guidance.

It is worth noting that the hurricanes that impacted Texas, Florida, and particularly Puerto Rico, resulted in 80 stores closed for at least one day. Our company policy is to remove those stores that are closed for seven or more days within a month during the quarter from our comparable store sales calculation. Accordingly, we removed one store for August, 19 for September, and 12 for October. As of the end of November, we'll still have eight stores closed that we believe will re-open in spring of 2018.

Turning to highlights of the third quarter, this was our 19th consecutive quarter of positive comp sales growth. Our comp sales growth was in part driven by an increase in traffic, our 11th quarterly traffic increase out of the last 13 quarters.

We delivered 100 basis point expansion in gross margin which drove 115 basis point increase in our adjusted EBITDA margin and a 100 basis point increase in our adjusted operating margin, and our adjusted earnings per share grew 37%.

Our new store performance was once again a highlight of our quarterly results. Our new and non-comp stores continued to outperform, contributing an incremental $60 million in sales in the third quarter. Note that this incremental sales contribution was negatively impacted by $17 million in lost sales from stores that were closed for seven or more days due to the hurricanes. Excluding that impact, new and non-comp stores contributed incremental $77 million over last year during the third quarter.

This result was driven by continuing strong performance of our new stores, underscoring our confidence in our site selection and underwriting process as we increase the number of net new store openings in our smaller store format.

Moving to category highlights, our top-performing businesses were all areas of home; beauty, driven by bath, cosmetics and fragrances; men's and women's sportswear, driven by better and active; young men's, and men's, kids and athletic shoes. In terms of weaker areas of the business, cold weather categories underperformed the chain average.

Regarding geographic performance, the Southeast, Southwest and West all performed above the chain average, while the Northeast underperformed. Moreover, 25 out of 27 regions had a flat or a positive comparable store sales trend.

Moving to inventory management, we are pleased once again with how our merchandising team managed our receipt flow and inventory as we ended the quarter with the comp store inventories down 2% while comp store turnover improved a strong 10%. Comparable store inventories were down mid- to high-single digits in both August and September.

Toward the end of October, we made a conscious decision to release gift giving product to ensure in-store presentation were set in all stores at the beginning of November. This resulted in comparable store inventories down only 2% at the end of October. This is merely a timing issue. We continue to expect to manage comparable store inventories down mid- to high-single digits for the foreseeable future.

We are pleased with our aged inventory levels, as inventory aged 91 days and older declined double-digits versus last year once again, as we focused on maintaining a fresh and exciting assortment for our customers.

In addition, we continue to see increases in our branded and better and best receipt unit penetration versus the prior year. Pack and hold as a percent of our total inventory was 15% versus 12% a year ago as we are able to capitalize on significant buying opportunities particularly in the better and best categories. Given the current disruption we are seeing throughout retail, the marketplace remains vibrant for our buying teams and we are thrilled with the great assortments and amazing values that we continue to deliver to our customers.

I'm also pleased with the value that we continue to bring to our shareholders as we repurchased over 800,000 shares of common stock during the third quarter for $70 million. At the end of the third quarter, we had $269 million remaining on the new $300 million share repurchase program authorized on August 16, 2017.

Now let me touch on our long-term strategic priorities which continue to be: focusing on driving comparable store sales growth; expanding, modernizing, and optimizing our store fleet; and increasing our operating margins.

First, with regard to driving comparable store sales growth, our underlying strategies remain: enhancing our assortments as we continue to improve our execution of the off-price model with particular focus on underpenetrated businesses; building on our marketing initiatives to ensure we are continuing to engage both new and existing customers; and improving the store experience for our customers.

Across our business, we continue to believe that we have significant opportunities to increase our penetration across several categories including home, beauty, and ladies apparel. Before we update our initiatives regarding these growth strategies, I wanted to spend a few minutes on the exciting gift opportunity we see in front of us for the fourth quarter.

We view the gift business as a key strategic year-round sales growth driver for the company as it is a business that should drive traffic and conversion as well as significantly help us de-weather our business particularly in the fourth quarter. We really began [ph] a foray (09:15) into gifts in the fourth quarter of 2014 and we have improved our execution each year since then.

After another strong gift initiative in last year's fourth quarter, we believe we can take the business to yet another level this fourth quarter covering more categories and improving our merchandising strategies and visual standards. Not only should this initiative drive growth in two of our key strategic growth businesses, home and beauty, but our assortments and gifts span the entire store across men's, women's, kids and accessories.

With regard to home, the investments we have made in expanding our merchandising team are paying off as, once again, the home business delivered another outstanding quarterly sales performance. We are making excellent progress in 2017, expanding the penetration of highly recognizable national brands in home in addition to sales performance of the key underdeveloped categories that we have targeted for growth in home, namely, housewares, home decor, and [ph] pet (10:17) were the fastest growing categories in home during the third quarter.

We ended 2015 with home sales at 11.2% of total sales, 2016 at approximately 12.4% of sales, and expect a meaningful increase in penetration once again in 2017 as we set our longer-term sights on a 20% penetration rate which is more in line with our peers.

Our beauty business had another very strong quarter and we expect this category to be a key growth opportunity for many years. We'll focus our efforts on beauty and expanding the number of brands in designer and prestige fragrances, expanding our assortments in beauty accessories, and chasing emerging trends in cosmetics. Beauty is a key element to our fourth quarter gift strategy and we believe we are well positioned for a strong fourth quarter in beauty.

Ladies apparel remains a significant opportunity as our penetration of 24.4% at the end of 2016 remains well below our peer group at approximately 30%. Once again, we had strong growth in the quarter in key Missy Sportswear areas such as better and active. We'll continue to develop these growth businesses, bolster our assortments in our heritage businesses such as dresses and suits, and capitalize on what we view as a significant plus-size opportunity.

On the marketing front, our holiday advertising strategy will build on the success of our testimonial campaign and feature our own customers shopping and finding great gifts in our stores. We continue to get positive feedback from customers regarding our campaign, and our research indicates very strong scores on both ad recall and brand recognition. In 2017, our dollar spend will be similar to last year.

Our store experience continues to be an important initiative for us. We're on a mission to get the majority of our stores to our brand standard over the next five years. Our customers have responded very positively to the improvements we have made to our store base, including our increase in the smaller-store footprint. This has manifested itself in our customer service scores, which have increased significantly since we began tracking in 2008.

Store remodels are an important component to modernizing our store fleet. In 2017, we completed 34 store remodels. We are committed to investing capital to continually improve our store portfolio and expect this will continue in the future.

The second growth initiative continues to be expanding our store fleet. We opened 31 net new stores during the quarter averaging 44,000 square feet. We are a national retailer that operates in 45 states and Puerto Rico and will only have 629 stores at year-end. There remains a sizable gap between our current store footprint in most, if not all, other national retailers.

Given the strong performance we've experienced in our new stores and the real estate opportunities that continue to be presented to us, we are confident we can continue to open net new stores in 2018 at a similar pace to the 37 net new stores we're opening in 2017. We remain confident in our ability to expand to 1,000 stores over the long term.

We also remain focused on our third growth priority, continuing to deliver operating margin expansion. From 2013 through 2016, we expanded our operating margin, or EBIT, by 280 basis points and today's updated guidance reflects another 80 to 90 basis points in our 2017 outlook. While we are very pleased with this progress, there's still significant opportunity versus our peer group.

Going forward, we will continue to execute the same game plan that we have deployed over the last four years, driving total sales increases, leverage fixed costs, optimizing markdowns, remaining disciplined with inventory management, and maintaining an active profit improvement culture across all SG&A areas.

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

Marc D. Katz

Thanks, Tom, and good morning, everyone. Thank you for joining us today. We ended the third quarter by recording our 19th consecutive quarter of positive comparable store sale. In addition, we achieved strong contribution from new stores and expansion in adjusted EBIT margin, which combined delivered a 37% increase in adjusted earnings per share.

Turning to a review of the income statement, for the third quarter, total sales increased 7.1% and comparable store sales increased 3.1% on top of last year's strong 3.7% increase. For the quarter, our comparable store sales performance was driven by increases in traffic, average unit retail, and units per transaction, while conversion was flat versus last year.

The gross margin rate was 42.2%, an increase of 100 basis points versus last year, driven once again primarily by lower markdowns although higher IMU was again a contributor. As a reminder, as it relates to inventory shortage, we recorded 65 basis points of good news related to shortage in the fourth quarter of last year as last year's result was significantly better than the prior year.

This year, we are planning our full year rate to be only slightly below last year. Given that we accrue based on last year's annual rate for the first three quarters, Q4 is not expected to be significantly different. As we stated on our Q2 call, we continue to expect a 20 basis point or $0.03 shortage headwind in Q4 of this year.

Product sourcing costs, which are included in SG&A and include the costs of processing goods through our supply chain and buying costs, were essentially flat to last year as a percentage of sales. While we are not planning for product sourcing cost leverage in the near-term, we are nevertheless very pleased with the continued productivity improvements in our supply chain and strive to minimize that deleverage going forward by focusing on additional productivity gains.

SG&A exclusive of product sourcing costs was 28.3%, 20 basis points lower than last year as a percentage of sales. These results were driven by savings in advertising, business insurance and incentive compensation, offsetting wage and stock compensation expense headwinds that we discussed in the last few calls.

Other income and other revenue was $7.8 million, 10 basis points lower as a percentage of sales versus last year. Adjusted EBITDA increased 22% or $24 million to $134 million. Sales growth and gross margin improvement led to a 115 basis point expansion in rate for the quarter.

Depreciation and amortization expense, exclusive of net favorable lease amortization, increased $4 million to $45 million, and interest expense increased $2 million to $15 million. As a reminder, we anniversaried the 2016 term loan B repricing at the end of this year's second quarter.

The effective tax rate improved 120 basis points to 33.8% driven primarily by the adoption of the new accounting for share-based compensation which lowered the effective tax rate by 430 basis points. Exclusive of the accounting change for share-based compensation, our effective tax rate was 38.1% compared with 35% during last year's third quarter.

This year's rate is higher due to a smaller benefit from federal hiring credit and an increase in state tax reserves within the quarter. Combined, this resulted in adjusted net income of $49 million, an increase of 34% compared to last year.

We continue to return value to our shareholders through our share repurchase program. During the quarter, we repurchased more than 800,000 shares of stock for $70 million. At the end of the third quarter, we had $269 million remaining on our $300 million share repurchase authorization that was approved this past August.

All of this resulted in earnings per share of $0.65 versus $0.45 last year and adjusted earnings per share of $0.70 versus $0.51 last year. The $0.70 per share represents a $0.09 beat versus our original top-end guidance. This beat was split between $0.06 of true operating outperformance and the remaining $0.03 beat was due to the adoption of the new share-based compensation accounting. As a reminder, we guided a $0.01 benefit for the adoption of the new share-based compensation accounting.

Turning to our balance sheet, at quarter end, we had $48 million in cash, $165 million in outstanding borrowings on our ABL, and had unused credit availability of approximately $381 million. We ended the period with total debt of $1.3 billion.

We are pleased to announce that on November 17, 2017, we closed on the repricing and extension of our $1.1 billion term loan B. Our new rate is LIBOR plus 250 basis points, with the maturity extended out to November 2024. Our previous pricing was LIBOR plus 275 basis points, with the term loan maturing in August 2021. This transaction not only moves out our term loan maturity date over three years to November 2024, but also results in approximately $2.8 million in interest savings per year for the next seven years.

Merchandise inventories were $904 million versus $822 million last year. This increase was driven primarily by an increase in pack and hold inventory, which was 15% of total inventory at the end of the third quarter of fiscal 2017 compared to 12% at the end of the third quarter of fiscal 2016, as well as inventory related to 39 net new stores opened since the end of the third quarter of fiscal 2016. These increases were partially offset by a 2% decline in comparable store inventory which contributed to a 10% improvement in comparable store inventory turnover.

As Tom mentioned in his prepared remarks, we made a conscious decision to release gift-giving product toward the end of October to ensure our in-store presentations were set across all stores in early November. Had we not released those goods, our comp store inventories would have been down mid-single digits.

Cash flow provided by operations decreased $77 million to $221 million primarily related to the changes in our inventory levels and income taxes payable. These decreases were partially offset by our improved operating results and changes in our accounts payable driven by the timing of our inventory receipts. Net capital expenditures were $156 million for the first nine months of the year.

During the quarter, we opened 31 net new stores ending the period with 631 stores. We still expect to open 37 net new stores for the year and end the year with 629 stores, with the opening of one additional store and three store closures occurring by the end of the fourth quarter.

As we indicated earlier in the call, due to weather-related damages, eight stores will likely remain closed for the entire fourth quarter of 2017. We anticipate reopening these stores, six of which are in Puerto Rico, during the spring of fiscal 2018.

In terms of our year-to-date performance, total sales was 6.9% and included comparable store sales increase of 2.4% following a 4.5% comparable store sales gain in the first nine months of last year. Gross margin was 41.3%, representing an increase of 100 basis points versus the first nine months of last year, primarily due to lower markdown rate and higher IMU. In addition, product sourcing cost improved by approximately five basis points versus last year. As a percentage of sales, SG&A exclusive of product sourcing cost improved 20 basis points to 27.3%. Expense leverage was driven mainly by reductions in business insurance and advertising spend, partially offset by increases in wages and stock-based compensation.

Adjusted EBITDA increased by 21% or $68 million to $398 million, representing a 110 basis points increase in rate for the first nine months of 2017. Depreciation and amortization expense, exclusive of net favorable lease amortization, increased by $11 million to $130 million, and interest expense was flat at $43 million.

The effective tax rate improved 660 basis points to 30.1%, driven primarily by the adoption of the new accounting for share-based compensation which contributed 730 basis points versus last year. Exclusive of the accounting change for share-based compensation, our effective tax rate was 37.4% versus 36.7% last year. The increase in effective tax rate was primarily the result of lower levels of federal hiring credits in the first nine months of fiscal 2017 versus last year.

Combined, this resulted in net income of $144 million, an increase of 60%. Adjusted net income was $157 million versus adjusted net income of $106 million last year, an increase of 48%.

Earnings per share were $2.04 versus $1.25 last year. Adjusted earnings per share were $2.22, inclusive of a $0.20 per share benefit related to the accounting change for share-based compensation versus $1.47 last year. Excluding the $0.20 benefit, adjusted EPS grew 37%. Our fully diluted shares outstanding were 70.6 million shares versus 72 million last year.

Turning to our outlook, for the 2017 fiscal year, which includes a 53rd week, we now expect total sales growth in the range of 8.1% to 8.4%, including 1.4% related to the 53rd week in the fourth quarter.

As a reminder, this guidance factors in lost sales of $17 million for the 19 stores closed seven or more days during the third quarter, as well as lost sales of $25 million for the eight stores expected to remain closed for the fourth quarter.

Comparable store sales increased in the range of 2% to 3% for the fourth quarter, resulting in a full year increase in the range of 2.3% to 2.6% on top of last year's 4.5% increase. Adjusted EBITDA margin expansion of 80 to 90 basis points, interest expense to approximate $58 million, and effective tax rate of approximately 33.1%. That tax rate factors in an expected favorable impact of approximately 390 basis points from the new accounting rules related to share-based compensation.

Capital expenditures net of landlord allowances are expected to be approximately $215 million. Depreciation and amortization, exclusive of favorable lease amortization, to be approximately $177 million. This results in adjusted earnings per share guidance in the range of $4.23 to $4.27, utilizing a fully diluted share count of approximately 70.3 million versus 2016 actual adjusted earnings per share of $3.24.

Please note the 53rd week is expected to have a $0.04 per share positive impact in the fourth quarter of the year and the change in share-based compensation accounting is expected to have a $0.20 positive impact for the year.

As a reminder, our initial 2017 annual guidance was $3.77 to $3.87, which we had increased at the end of the first, second, and now our third quarter call. We are passing through the $0.09 third quarter beat to our annual guidance. The fourth quarter EPS guidance will remain unchanged despite the negative impact of the closure of the previously mentioned eight weather-impacted stores.

For the fourth quarter of 2017, we expect total sales growth in the range of 11% to 12%, including 5% related to the 53rd week. As a reminder, this guidance factors in lost sales of $25 million for the eight stores expected to remain closed for the fourth quarter.

Comparable store sales to increase between 2% and 3% on top of last year's very strong 4.6% increase. Adjusted earnings per share is expected to be in the range of $2.02 to $2.06, utilizing a fully diluted share count of approximately 69.3 million versus $1.78 per share last year. This reflects no benefit from the recent accounting change for share-based compensation but does reflect a $0.04 benefit from the 53rd week.

With that, I will turn it over to Tom for closing remarks.

Thomas A. Kingsbury

Thanks, Marc. In summary, we believe our results this quarter demonstrate the agility of our business model. We drove operating results well above our expectations and we remain confident in our growth initiatives and store expansion plans. We are confident in our outlook and believe in our focus on evolving our off-price model and our ability to capitalize on the rapidly changing retail landscape. This positions us well to bring more great brands, styles, and value to our customers and increase value for our shareholders. Again, I'd like to thank the stores, supply chain, and corporate teams for their contributions to our strong year-to-date results.

Before I turn the call back to the operator, I'd like to take the opportunity to express our concern and appreciation for our associates and customers in Texas, Florida and Puerto Rico, whose lives were disrupted by the devastating series of hurricanes that severely impacted these regions.

I'm still appreciative of the resilience and generosity of our associates in these impacted areas who have helped get our stores and their communities back on their feet. I am proud of the recovery effort contributions not only provided by the company, but also from our associates and customers across the country who have given so generously to the Red Cross, the Salvation Army and other charitable organizations.

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. [Operator Instructions] In the interest of time, we ask that you limit yourself to one single-part question and one follow-up, and then re-queue for any follow-up questions. One moment please while we poll for questions. Thank you. Our first question is from the line of Matthew Boss with JPMorgan. Please proceed with your question.

<Q - Matthew Robert Boss>: Great. Congrats on a nice quarter, guys.

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

<Q - Matthew Robert Boss>: So, Tom, can you speak to product availability? I guess, more so, what's the best way [ph] to foot (32:39) commentary from some national brands speaking to cutting back on off-price? And, I mean, how should we think about leaner department store inventories and some sales shifting online? Just any way to size up the off-price business model. Do any of these have an impact multi-year?

<A - Thomas A. Kingsbury>: Hi, Matt. I've been asked that question now for almost nine years, and I know there's always this concern about product availability, so I'm glad you asked that question. So, while a few brands might moderate in terms of supply from time to time, overall, our top brands remain good partners. We continue to grow our business and we don't see any issues.

In terms of product availability, supply has never been better. Really interesting, the shift to online that you mentioned is actually a benefit to us in terms of product availability. We are finding that brands would rather clear product by selling to us and let us invisibly sell their clearance through our stores rather than run clearance sales on their websites that might damage their brand integrity.

As you heard in our prepared remarks, pack and hold was 15% of our inventory versus 12% last year, driven by a higher amount of better and best brands. I think that number speaks for us in terms of the current availability of brands at great values.

Matt, we're in the market every week working to open new vendors. We open them up every week and absolutely getting access to new brands. We continue to upgrade our vendor base as we added 1,300 new vendors, eliminated a similar number in 2016, and we carry about 5,000 vendors and expect that number to increase.

So, in summary, really, there's a lot of product available, and we're encouraged by what we're seeing in terms of the quality of the product that we're getting.

<Q - Matthew Robert Boss>: Great. And then just a follow-up. I think a clear point on the call seemed to be your enthusiasm around the gifting opportunity. I guess, can you just elaborate on steps that you've taken and how best to size up the overall opportunity this year in the fourth quarter with gifting just versus the strategy and investment that you made a year ago?

<A - Thomas A. Kingsbury>: Okay. As I said in the prepared remarks, we have a lot – we've made a lot of progress on our gifting strategy and indeed weathering our business. We haven't really shared the sales opportunity in gifts, but we do see it as a difference maker in the fourth quarter.

Something we did a little differently this year is deliver more receipts in October in order to set up gifts in all doors in the beginning of November. We just felt we needed more supply as we went into the fourth quarter, building products earlier than we did last year. And we really feel that overall, this will benefit us for the fourth quarter.

You'll see gifts included in our holiday TV campaign as we seek to be a holiday gift destination for existing as well as potentially new customers. What's really encouraging is I went to about close to 25 stores last week, and our in-store execution, the quality of the merchandise that our buyers are bringing in, really was exciting to see. Very – tons of consistency from store-to-store, and we invite all of you to go out and look at our great gift presentations that we have in the stores currently.

<Q - Matthew Robert Boss>: Great. Best of luck.

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

Operator

Our next question is from the line of Ike Boruchow with Wells Fargo. Please go ahead with your question.

<Q - Ike Boruchow>: Hey. Good morning, everyone. Thanks for taking my question. First question is for, I guess, for Marc. So, Marc, I think you said hurricane impact lost sales $17 million in Q3, $25 million in Q4. Just making sure I have that right. And then are there any additional P&L impacts that we should keep in mind that go along with those lost sales?

<A - Marc D. Katz>: Hey. Good morning, Irwin. Thanks for joining us this morning.

<Q - Ike Boruchow>: Oh, man.

<A - Marc D. Katz>: Let's just take a step back. I want to talk about weather-related events in general. So typically when we experience a few days where stores close, what we oftentimes see in the weeks following the event is call it a bounce back, call it replenishment activity, but we tend to get more business than what we really lost during the closure. And we believe that was the case for the majority of the 80 stores that were closed due to these weather-related events. Unfortunately, this hurricane season had a more devastating impact and as we said resulted in the 19 stores closed for seven or more days in September and then 12 of those 19 stayed closed through October. So we believe those more extended closures do result in lost sales and that's what equated to the $17 million in Q3 and those were the stores that we removed from comps. So yeah, you had that right.

In terms of additional P&L impact, we did incur about $1.1 million of weather-related expenses that were not offset in the third quarter because we did not meet our insurance deductibles. There's about another $1.1 million on top of the flow-through from the 2017.

So as I shift to Q4 now, at the end of the Q3 we mentioned we had 12 stores that remained closed. To be honest with you, Irwin, as of today, we still have 12 that are closed. We do think that four will reopen by the end of November so we expect to have eight stores closed for the entire fourth quarter, six of those are in Puerto Rico and then two additional. And that's the $25 million in lost sales for Q4.

As far as the P&L impact for Q4, we did not lower our Q4 guidance because we believe that we can offset the EBIT loss and the $25 million through reductions in SG&A and insurance recoveries. So that's why we kept our guidance the same for Q4 from an EPS point of view.

<Q - Ike Boruchow>: Got it. And then a follow-up, maybe some color about – I think last year on the Q3 call you gave us some out year color. Anything on 2018? There's a lot of moving parts that impacted this year, there's a 53rd week, stock-based comp, wage pressure et cetera. So is there any chance you can help us understand some of these factors into 2018 plans and bottom line growth?

<A - Marc D. Katz>: Sure. I got to start that one with the caveat that we have not finalized our financial plans for 2018, so things could change. Obviously, we'll discuss it in detail on our year-end call. But with that said, we have done a fair amount of work on 2018 so I'll share with you some color as it stands today.

In terms of the headwinds, we're going to continue to see wage pressure in both the stores and the DCs. As you know, we take a market-by-market approach, channelize our competitiveness and we've completed that review for 2018. And it looks like wage pressure is going to be similar in 2018 as it was in 2017, similar wage pressure.

The two other headwinds are stock-based comp expense and depreciation. Stock-based comp will continue to be a headwind but we expect that increase to moderate relative to the increase we saw this year in 2017. Depreciation on the other hand is going to work the other way. That's going to increase at a faster rate in 2018 than in 2017 and that's based on our higher capital spend this year. And by the way, 2018, the best proxy for 2018 capital is 2017.

With that said, with the headwinds, we continue to be impressed by all of our sales support teams who continue to embrace our profit improvement culture. We find ways to become more efficient really creative ways that – really helps with the offsets here.

And at the end of the day, we still view ourselves as a growth company. We believe we can deliver a double-digit increase in EPS despite these headwinds. But to your point, Irwin, just to keep in perspective with all the ins and outs that are happening this year, we would recommend you start with our all-in number for 2017, back out the 53rd week, back out the accounting change for stock-based comp, and right now those two together are about $0.24, and then that'll give you what we refer to as a base 2017 EPS. Then, to that, apply a mid-teens EPS increase from that 52 week number. And then the final step would be to add the same number as last year for the accounting change for stock-based comp, which is $0.20.

<Q - Ike Boruchow>: Got it. Super helpful. Thank you so much.

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

Operator

Our next question is from the line of Kimberly Greenberger with Morgan Stanley. Please proceed with your question.

<Q - Kimberly Conroy Greenberger>: Great. Thank you so much. Congratulations on a really fine third quarter. Marc, I wanted to follow-up with you on your comments regarding the closed stores for the fourth quarter. Can you quantify the negative impact of the $25 million in lost revenue on EBIT or EPS? It sounded like you said you'd be able to offset that loss impact on with SG&A savings and insurance proceeds. I just want to make sure I heard that correctly.

<A - Marc D. Katz>: You did hear it correctly, Kimberly. And, yes, it's $25 million in lost sales. I think you could figure out the EBIT flow-through on that, but you absolutely heard it right. We obviously knew these eight stores would be – or felt very strongly back in even September that they'd be closed for a while. So we kind of put some plans in place to make sure we can offset that EBIT loss. And we think between -we feel very confident between reductions in SG&A and then insurance recoveries come through to offset that EBIT loss.

<Q - Kimberly Conroy Greenberger>: Great. Thank you so much. And then, in terms of gross margin, you had a very nice lift, obviously, of gross margin here in the third quarter. Normally, we don't see that kind of a result on a 3% comp, so there's clearly something going on well internally to drive that level of improvement. I'm wondering if you can just comment on the improvement in merchandise margin, and I think you mentioned that IMU was also better. What's driving those two?

<A - Marc D. Katz>: Sure. I'd tell you, it was the third quarter in a row we really need to credit our merchandising team for how well they managed receipts. We mentioned our comp store inventories were down 2%. I think we explained that, and our comp store turnover increased 10%. One of the things as we started the quarter out, at the beginning with our goods aged 91 days and older kind of at record low levels, and then we ended Q3 really the same way; goods aged 91 days and older at record low levels.

So just the merchants doing a phenomenal job, turning faster, keeping aged inventory down, and the 100 basis point improvement that was by far the biggest piece of that was the lower markdown rate. We did get some help from a higher IMU, as you mentioned, and that higher IMU comes across all buy types. So, really, we think a function of just the maturity of our buying team and how well they're buying.

<A - Thomas A. Kingsbury>: Yeah. I just want to sort of piggyback on what Marc is saying. Our merchant team has come a long way in terms of understanding how to execute the off-price model. Obviously, Jennifer Vecchio has helped us a lot in that regard. And as we get better, we're able to, obviously, our selectivity of product gets better and our markdowns get lower, and we're able to take advantage of a little bit of more mark-on.

<Q - Kimberly Conroy Greenberger>: Terrific. Thank you.

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

Operator

Our next question is from the line of Lorraine Hutchinson with Bank of America. Please go ahead with your question.

<Q - Lorraine Corrine Hutchinson>: Thank you. Good morning. Marc, I just wanted to follow-up...

<A - Thomas A. Kingsbury>: Hi, Lorraine.

<Q - Lorraine Corrine Hutchinson>: I wanted to follow-up on the guidelines that you gave for 2018. At the end, you said add back $0.20 for the stock-based comp. Does that mean that you think the tax rate will look similar in 2018 as it did to 2017?

<A - Marc D. Katz>: Yeah. Yeah. That doesn't assume any changes in the tax rates. We think that'll be – you know it's really more of a function of where is your stock price going to be and how do we think our associates are going to execute on options that they have. So it's a tough thing to really try to pin down. The modeling that we've done right now tells us that the number that's available in terms of what's going to invest and options that can be exercised is very similar to last year and we make assumptions on what we think the stock price are going to be. And right now as we've laid it out, we do think that 2018 is going to be very close to 2017. If that changes at all, we tie the plans down and finalize those, we'll let you know. But for right now, our best proxy for 2018 is the 2017 number of $0.20.

<Q - Lorraine Corrine Hutchinson>: And then the mid-teens earnings growth rate, does that include any buyback or would that be incremental?

<A - Marc D. Katz>: That would be incremental.

<Q - Lorraine Corrine Hutchinson>: Thank you.

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

Operator

Our next question is from the line of John Morris with BMO Capital Markets. Please proceed with your question.

<Q - John Dygert Morris>: Thanks. My congrats as well to everybody.

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

<Q - John Dygert Morris>: Yeah. A quick question [ph] on the back-end (46:34) Marc. The improvement in traffic, was that actually positive traffic? I just want to get that clarification.

<A - Marc D. Katz>: Yes. Traffic's up 11 out of the last 13 quarters, John.

<Q - John Dygert Morris>: Okay. Good. That's significant. The remodel program, maybe a little bit more color there on what your learnings are so far? Maybe – I don't know if you all have store level ROI numbers or how that's tracking or you can give us a little bit of a feel for the success there with this smaller store format, whether it's remodel or some of the new openings. And maybe tell us with the remodels next year at least initially look similar to the numbers, you had very impressive numbers that we did this year, and what's the potential that we see across the chain?

<A - Marc D. Katz>: Okay. Yeah. As far as the number of remodels in 2018, I think your best proxy there is 2017, so the 34 is right. We are tracking the 34 remodels that we completed this year right now, so we'll be able to give you true color as to what lift we get from those, John, hopefully by the Q4 call or the Q1 call. What I will tell you just historically as we've done remodels, we do see a sales lift there and we do generate an IRR. It is not near, as high as what we get on a new store. As we've said, our new stores, our IRRs far exceed our cost of capital. And while again we do get a sales lift in our remodels, we typically generate an IRR that's a little shy of our cost of capital.

<Q - John Dygert Morris>: Okay. Great. Thanks for – I'm sorry, go ahead.

<A - Thomas A. Kingsbury>: If I could piggyback on the remodel comment. Obviously, we're on a mission to really over the next five years to have the majority of our stores at our brand standard. I mean, just – if you think about it, this year with 48 new stores, gross new stores, and 34 remodels, that's 82 stores that were changed or new, and we ended with 629.

So if you look at that, that's a pretty big percentage of our store base overall. But you'll see a continuous effort on our part to continue to improve our portfolio of stores. And when we do a remodel, we're taking the size of the store, we're rightsizing the store, and that will happen to adjust to our new model that we're operating in between a 40,000 and 50,000 square foot store.

<Q - John Dygert Morris>: They look great, Tom. Good luck for holiday. Thanks.

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

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

Operator

Our next question is from the line of Brian Tunick with RBC Capital Markets. Please proceed with your question.

<Q - Bilun Boyner>: Good morning. This is Bilun on for Brian. Thanks for taking the question. As you look at Q4, the holidays, I know you highlighted you're excited about gift giving opportunities including home and beauty. But for cold weather product buys, how are you planning those versus last year? And then in terms of market share gains, how do you expect the alignment to be with all the liquidation sales going on especially in the mid-tier department store space?

<A - Thomas A. Kingsbury>: Can you ask the question again about the product? What were you saying about what product? Couldn't hear you.

<Q - Bilun Boyner>: Cold weather, coats and sweaters.

<A - Thomas A. Kingsbury>: What about cold weather product?

<Q - Bilun Boyner>: How are you planning those compared to last year, maybe your expectations for the weather [indiscernible] (50:16).

<A - Thomas A. Kingsbury>: We always – so, okay. Thank you for clarifying that. I didn't – I couldn't hear you. Cold weather, we always plan conservatively, to be honest with you, just because of the fact that we're working hard on de-weathering our business. We really feel that gifts are really critical in that pursuit overall. Yeah, we just go in to every season looking at it conservatively. It's hard to predict what the weather is going to be and we would just – we just prefer to react to the business as it emerges or be a little short overall.

But in terms of market share, I mean, if you just look at our total sales, I mean, it appears that we are gaining market share and obviously we're guiding to a strong total sales number in the fourth quarter overall. So, we really feel that, based on our new stores and our comp performance, that, yeah, we will continue and we have gained market share quarter-by-quarter.

<Q - Bilun Boyner>: Great. Thanks very much.

Operator

Our next question is from the line of Lindsay Drucker Mann with Goldman Sachs. Please proceed with your question.

<Q - Lindsay Drucker Mann>: Thanks. Good afternoon, everyone. I had two questions. First on the Northeast, that's – over the last many quarters, it's been a standout positive market for you. So I was curious if the weakness you called out this quarter, you think it was just related to weather and whether cold weather product, which you said was an underperforming category across the chain, was especially an issue in this market?

My second issue is just on the pack and hold inventory. Those numbers had been coming down year-over-year for a number of quarters, up this year. Anything you can tell us just about the complexion or characterization of what's in pack and hold and where you saw specific opportunity? Thank you.

<A - Thomas A. Kingsbury>: As far as the Northeast goes, it was really simply just weather-related. It was obviously warmer than the prior year. There's nothing fundamentally wrong with our Northeast performance. And you're right, it's been doing very well. But like every other retailer, the cold weather products underperformed, and in the Northeast, we obviously had a tougher performance overall.

The level of pack and hold, I mean, we went from 12% to 15%, it's really because there was a lot of deals out there that we could take advantage of, especially in high-quality products and in better and best brands.

So, we're – again, we don't really target what level of pack and hold we want to have. It's really dictated based on the deals that are out there and what we can take advantage of. And we happened to see a lot of good deals, so we took advantage of it during the third quarter. But again, we're just not going to target – we're just not going to target the level of pack and hold, and we're just going to let the quality of the deals speak for themselves.

<Q - Lindsay Drucker Mann>: Great. Thank you so much.

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

Operator

Our next question is from the line of John Kernan with Cowen and Company. Please proceed with your question.

<**Q - Krista Zuber**>: Good morning. This is Krista Zuber on for John. Thank you for taking our questions. First, just if you could give us a little bit of insight as to how you feel about the merch margin opportunity in 2018, particularly since your gross margin seems to be at a multi-year high. Just wondering if you set any sort of target for sort of further expansion potential there?

<**A - Marc D. Katz**>: No. At this point, I wouldn't give any specifics on merch margin expansion in 2018 other than just to remind you, as we look at the 400 to 600 basis points of opportunity between us and our peers, it is split pretty evenly between gross margin and SG&A. So, in saying that, that would imply that we continue to expect healthy increases in our merch margins for the, you know, at least until we close that gap.

<**Q - Krista Zuber**>: Okay. Great. And then just one sort of housekeeping on sort of cash flow. Just any sense of what we should be thinking about for debt payment in 2018? Again, thank you for the guidance on the debt repricing and the lowered payment on interest expense there. Thank you.

<**A - Thomas A. Kingsbury**>: Sure. So we're very pleased with the repricing and extension that we did in November. As Marc mentioned earlier, we expect to see a $2.8 million cash save in interest expense annually going forward. In terms of debt repayment, we did reset the mandatory amortization payments which is 1% of the $1.117 billion, so we'll be paying back about $12 million a year going forward that's required now with the new amended extend.

Beyond that, we'll continue to evaluate what's more accretive, debt paydown or share repurchase. And we'll adjust accordingly when we think it's more appropriate to do either. And none of that's built into any of the future guidance we give you and we'll share with that each quarter as we go.

<**A - David Glick**>: Operator, we have time for one more question.

Operator

Yes, the question will be coming from the line of Dana Telsey of Telsey Advisory Group.

<**Q - Dana Lauren Telsey**>: Good morning, everyone. Thank you for getting me in, and congratulations on the very good results.

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

<**Q - Dana Lauren Telsey**>: One of the things we've been noticing is some creative new product additions you've been having like the pre-owned luxury vintage I think that you highlighted on your website earlier. As you think about these other categories, how is that doing? Is there opportunity for more – different types of product? And with the enhancement and expansion of beauty and what you're doing with home, how do you see that merchandise margin opportunity playing out? Do new categories give you further merchandise margin opportunity? Thank you.

<**A - Thomas A. Kingsbury**>: We're always look for other categories to do business. That's obviously important part of our overall model. We really haven't given out specifics in terms of things that – specific things on the e-commerce site overall. So, but we're always in the hunt, we're always in the hunt for things that we can do to accelerate our business overall. Not really going to talk about anything that's on the horizon in terms of what we're doing, obviously for reasons you probably could expect. I mean, we're not going to talk about our long-term strategies or overall strategies, but all I can tell you is we're going to continue to look for ways to do more business and look for categories that can help us build our business.

As far as the margin opportunities in the new categories such as beauty, most of them are really in line with our overall margins, in terms of the rate that we have right now. I don't know, Marc, if you want to talk to that at all?

<A - Marc D. Katz>: No, I think you said it well. Dana, our merchandise margins as we look across categories other than baby depot, baby depot clearly is our lowest merchandise margin category, other than that they really don't run that different. So as we drive beauty, as we drive home, everything seems to work for us in what we're trying to do here. Very consistent gross margins other than baby.

<Q - Dana Lauren Telsey>: Thank you.

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

Operator

Thank you. I will now turn the floor back to Tom Kingsbury for closing remarks.

Thomas A. Kingsbury

Well thanks, everyone, for joining us today. Happy Thanksgiving to all of you and your families. Enjoy the holidays and happy shopping. We look forward to speaking with you when we report our fourth quarter results in March. Thanks, again.

Operator

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