Company Name: Burlington Stores Inc
Company Ticker: BURL US
Date: 2017-05-25
Event Description: Q1 2017 Earnings Call

Market Cap: 6,885.81
Current PX: 98.62
YTD Change($): +13.87
YTD Change(%): +16.366

Bloomberg Estimates - EPS
Current Quarter: 0.498
Current Year: 3.926
Bloomberg Estimates - Sales
Current Quarter: 1349.688
Current Year: 6031.389

Q1 2017 Earnings Call

Company Participants

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

Other Participants

- Ike Boruchow
- Matthew Robert Boss
- Lorraine Maikis Hutchinson
- John Kernan
- Lindsay Drucker Mann
- Kimberly Conroy Greenberger
- Tracy Kogan
- John Dygert Morris
- Dana Telsey
- David N. Kwon
- Bilun Boyner
- Andrew Roberge
- Roxanne Meyer
- Adrienne Yih

MANAGEMENT DISCUSSION SECTION

Operator

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

I would now like to turn the conference over to your host, Mr. Bob LaPenta, Vice President and Treasurer for Burlington Stores. Thank you. You may begin.

Robert L. LaPenta, Jr.

Thank you, operator; good morning, everyone. We appreciate everyone's participation in today's conference call to discuss Burlington's 2017 first fiscal quarter operating results. Our presenters today are Tom Kingsbury, our Chairman and Chief Executive Officer; and Marc Katz, our 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 expressed permission. A replay of the call will be available till June 1. 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 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, Bob. Good morning, everyone. Our first quarter saw expansion in operating margin and a 39% increase in adjusted net income per share, which exceeded our guidance. As noted on our year-end call on March 2, first quarter sales got off to a slow start, driven by the later timing of tax refunds. While February sales were down high-single-digits, we were pleased to see momentum build as the quarter progressed, with the comp sales for combined March and April period, rising 4.5%. This gave us a 0.5% positive comp for the quarter on top of last year's 4.3% increase.

Total sales rose 5% on track with our expectations, driven by comp growth and an increasing contribution from new and non-comp stores. It is worth noting that May is off to a solid start. A few other notable highlights for the first quarter include: this was our 17th consecutive quarter of positive comp sales growth. We delivered an 80-basis-point expansion in gross margin, which helped to drive a 70-basis-point increase in adjusted EBITDA margin; and our adjusted net income per share growth of 39%. Our top-performing businesses were home, beauty, Missy Sportswear, men's shoes, athletic shoes and handbags.

In terms of the territories, the West, Southeast and Northeast were the best-performing regions and the Southwest and the Midwest underperformed the company average.

With regards to our inventory management this quarter, we are very pleased with how our merchandising team maintained a disciplined approach to managing our receipts, especially, given that we came in at the lower end of our total sales guidance.

In addition, we continued to see increases in our branded and better and best receipt unit penetrations versus the prior year. Comparable store inventory decreased by 7% at quarter end and we saw inventory aged 91 days and older decline versus the prior year as we focus on maintaining a fresh and exciting assortment for our customers.

Pack and hold, as percent of our total inventory, was 26% versus 28% a year ago. 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 add 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 515,000 shares of common stock during the first quarter for $49 million. We have a $151 million remaining on our share repurchase authorization.

Now, let me touch on our long-term strategic priorities, focusing on driving comparable store sales growth, expanding our store fleet, and increasing our operating margins. First, with regards to driving comparable store sales growth, our underlying strategies remain: one, enhancing our assortments as we continue to improve our execution of the off-price model, with particular focus on underpenetrated businesses; two, continuing to improve the store experience for our customers; and three, building on our marketing initiatives to make sure that we're continuing to engage both new and existing 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.

With regard to home, during the first quarter, we added our fifth DMM to the home category in support of our current and expected growth. In addition to building our penetration of highly recognizable national brands across many areas of the home, we'll look to grow housewares by increasing our investment in key entertaining categories, reshaping our cookware and bakeware assortments, and maximizing opportunities in kitchen storage and organization. In home decor, we look to elevate and expand our assortments in home accents, seasonal stationary and furniture.

Finally, we believe we can accelerate our growth in pet by maximizing impulse treat and toy categories. As we mentioned on our last call, we ended 2016 with a home penetration of 12.4%, and we continue to set our sights on a 20% penetration rate, which is more in line with our peers. Our beauty business continues to be a key merchandising opportunity for us. This area has consistently outperformed the company average. And in 2017, we will focus on increasing the breadth of designer and prestige fragrances, expanding our product offering in accessories and reacting more quickly to emerging trends in cosmetics.

As we've mentioned before, this area lends itself to gifting, which will be a key focus throughout the year. Ladies apparel continues to be another significant opportunity as we ended last year at a 24.4% penetration level, well below our peer group at approximately 30%. Our strategies in 2017 will be to grow Missy Sportswear by increasing the better and branded levels in outdoors, continuing to fund the strong active growth that we are experiencing, rebuilding our assortments in better and social dresses and suits and investing in the plus-size opportunity.

Our store experience continues to be an important initiative for us. We are pleased that our overall satisfaction scores have increased each year on a consistent basis since we began tracking in 2008. The underlying metrics have also shown strong growth, including friendliness, speed of checkout, cleanliness and ease of movement.

In an effort to provide the best possible shopping experience for our customers, we are planning to remodel 34 stores in 2017. We are committed to spending capital to improve our store portfolio and expect this will continue in the future. From a marketing point of view, we will continue to reach our customers through our testimonial campaign, featuring real customers in our stores. We consistently hear positive feedback from customers about the commercials and we are pleased with how they score relative to the percent of people who remember the ad and can name the brand. In 2017, our dollar spend will be similar to last year.

Now moving to our second growth initiative, expanding our store fleet. We ended the quarter with 596 stores, adding four net new stores, averaging 44,000 square feet. We continue to be pleased with our new stores and our smaller store formats. Stores less than 60,000 square feet continue to achieve sales productivity well above our comp base.

In total, new and non-comp stores contributed an incremental $65 million to our Q1 sales. For the year, 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 six relocations and eight pure closures.

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 confident in our ability to expand to 1,000 stores over the long term. Finally, we remain focused on our third growth priority to continue to deliver operating margin expansion. From 2013 through 2016, we expanded our EBIT margins by 280 basis points. While we are very pleased with the results, there is still significant opportunity versus our peer group.

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

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. We began the year by reporting our 17th consecutive quarter of positive comparable store sales. In addition, we achieved strong contribution from new stores, expansion in gross margin and strong SG&A control, which combined, delivered a 39% increase in adjusted net income per share.

Turning to a review of the income statement. For the first quarter, total sales increased 5% and comparable store sales increased 0.5% on top of last year's 4.3% increase. As Tom noted, the delay in the issuance of tax refunds impacted February comparable store sales. And while we were pleased to see combined March and April sales rebound to a 4.5% comp, it was not enough to fully offset the slow start to the quarter for many of our comp metrics.

We're comparing March and April together because of the three-week shift in Easter this year versus last year. For the quarter, our comparable store sales performance was driven by increases in units per transaction, while we experienced slight declines in traffic, conversion and average unit retail versus last year. For the combined March and April period, we did see an increase in traffic. It is worth noting that through the first three weeks of May, we have also seen an increase in traffic.

Gross margin rate was 40.9%, an increase of 80 basis points versus last year, driven primarily by increased merchandise margin. Product sourcing costs, which are included in SG&A and include the cost of processing goods through our supply chain and buying costs, improved 10 basis points from last year as a percentage of total sales. SG&A, exclusive of product sourcing costs, decreased to 26.6% from 26.7% last year.

This improvement was driven by a decrease in marketing expenses, business insurance cost, utilities and the timing of approximately $3 million of expenses that were planned in the first quarter, but will now be incurred in the second quarter of fiscal 2017. This allowed us to offset headwinds from increased wages and stock-based compensation costs that we discussed on the last call.

Other income decreased approximately 30 basis points, primarily driven by last year's sale of the company's (sic) Grow New Jersey tax credits of approximately $2.5 million during the first quarter. We had planned for a similar sale of tax credits in Q1 of this year, but that is now expected to occur in the second quarter of fiscal 2017.

Adjusted EBITDA increased 13% or $16 million to $137 million. Sales growth and margin expansion led to a 70-basis-point expansion in rate for the quarter. Depreciation and amortization expense, exclusive of net favorable lease amortization, increased $3 million to $42 million, and interest expense decreased $1 million to $14 million.

The effective tax rate on a GAAP basis improved 720 basis points to 30.4%, driven primarily by the adoption of the new accounting for share-based compensation, which contributed 660 basis points of the improvement. Exclusive of the accounting change for share-based compensation, our effective tax rate was 37% compared with 37.6% during last year's first quarter. The improvement was primarily driven by an increase in federal hiring credits.

Combined, this resulted in adjusted net income of $57 million, an increase of 36% compared to last year. We continue to return value to our shareholders through our share repurchase program. During the quarter, we repurchased over 515,000 shares of stock for $49 million. We now have $151 million remaining on our share repurchase authorization that was approved last year. This resulted in diluted net income per share of $0.73 versus $0.52 last year, and diluted adjusted net income per share of $0.79 versus $0.57 last year.

The $0.79 per share represents a $0.09 beat versus our top-end guidance. This beat was split between $0.04 of true operating performance, driven by our top line growth, margin expansion, and SG&A expense control. The remaining $0.05 beat was due to a $0.07 benefit from the adoption of the new share-based compensation accounting. As a reminder, we guided a $0.02 benefit for the adoption of the new share-based compensation accounting.

Turning to our balance sheet, at quarter end, we had $30 million in cash, $23 million in outstanding borrowings on our ABL, and had unused credit availability of approximately $514 million. We ended the period with total debt of $1.2 billion and a debt leverage ratio of 1.9 times. Merchandise inventories were $726 million versus $805 million last year. This decrease was due to a 7% decline in comparable store inventory, which contributed to a 7% improvement in comparable store inventory turnover, as well as a decrease in pack and hold inventory. Pack and hold inventory, as a percentage of total inventory, represent a 26% at the end of the first quarter of fiscal 2017 compared with 28% at the end of the first quarter last year.

Cash flow provided by operations decreased $5 million to $29 million, primarily related to a decrease in our accounts payable, partially offset by our improved operating results. Capital expenditures, net of landlord incentives, were $48 million for the first quarter. During the quarter, we opened seven new stores and closed three stores, ending the period with 596 stores. We continue to expect to open 30 net new stores for the 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 7.3% to 8.1%, inclusive of 1.4%, which is related to the 53rd week in the fourth quarter. Comparable store sales to increase in the range of 2% to 3% for the balance of the year, resulting in a full-year increase in the range to 1.6% to 2.4% on top of last year's 4.5% increase.

Adjusted EBITDA margin expansion of 50 basis points to 60 basis points. Interest expense to approximate $57 million and adjusted tax rate of approximately 34.8%. We expect the new accounting rules related to share-based compensation to have a favorable impact of approximately 220 basis points on the effective tax rate in 2017. Net capital expenditures to be approximately $200 million. As mentioned during our fourth quarter call, this is higher than in prior years and is due to the 44 total new store projects Tom mentioned earlier and an approximately and an approximate $47 million spend in supply chain, which is $25 million over the 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 $3.86 to $3.96, utilizing a fully diluted share count of approximately 7.13 million 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 $0.10 positive impact for the year.

As a reminder, our initial 2017 annual guidance was $3.77 to $3.87. For the second quarter of 2017, we expect total sales to increase in the range of 6.7% to 7.7% and comparable store sales to increase between 2% and 3% on top of last year's 5.4% increase. Diluted adjusted net income per share is expected to be in the range of $0.46 to $0.50, utilizing a fully diluted share count of approximately 71.2 million versus $0.39 per share last year. This reflects a $0.02 benefit from the recent accounting change for share-based compensation.

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

Thomas A. Kingsbury

Thanks, Marc. In summary, we believe our results this quarter demonstrate the agility of our business model. We drove total sales in line with our expectations and earnings above our expectations, despite the short-term impact on consumer spending from later tax refunds. We remain confident in our outlook and believe our focus on evolving our off-price model and the ability to capitalize on the rapidly changing retail landscape positions us well to bring more great brands, styles, and value to our customers and increase value for our shareholders.

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. At this time, we'll be conducting a question-and-answer session. [Operator Instructions] Our first question comes from the line of Ike Boruchow with Wells Fargo. Please proceed with your question.

<Q - Ike Boruchow>: Hey. Good morning, everyone. Thanks for taking my question. So I have a question for Tom, and then I just have a follow-up for Marc. I guess, Tom, as we think about the business not making up the difference from the February drop-off, are there areas of the store that you can talk about that maybe you were disappointed in, and then, I guess, to that point, is it fair to assume that these areas are trending better throughout the quarter and then into May?

<A - Thomas A. Kingsbury>: Hi, Ike. As I mentioned in prepared remarks, we were really pleased with home, beauty, Missy Sportswear, men's and athletic shoes, and handbags; they outperformed the chain average. But, candidly, we were disappointed in our apparel business; that underperformed in the first quarter. And we had like the perfect storm; it was warm in February and cool in March versus the prior year. But the good news is that when the weather improved in April, and so far in May, we've seen improvement across all apparel zones, including ladies, men's, and youth.

<Q - Ike Boruchow>: Great. And then, Marc, just a follow-up. Can you maybe provide some more color on the 80 bps improvement in the gross margin relative to the 10 bps decrease in the product sourcing cost? I think it's been a while since we've seen leverage there. And then, as we get into the back half of the year, should we start to see a little bit of favorability on the SG&A line as you lap, I think, $10 wages? Thanks.

<A - Marc D. Katz>: Okay. Ike, let's start with the 80 basis points of gross margin improvement. That beat was a combination of a lower markdown rate and improved IMU with the markdown rate being a little heavier weighted there. The improved IMU is not new; we talked about that throughout last year. The markdown rate, we ended 2016 very clean from an aging point of view. So we were expecting good news in our gross margin rate.

And even though we came in at the lower end of our sales guidance, it's really a credit to our merchandising team for how well they manage receipts throughout the quarter. It's one of the great things about our model in really having liquidity is where the receipt dollars can be spent to chase trends, when the trends are there or not spent depending on the business need. So all in, Tom mentioned that comp store inventories down 7%, ageing down; felt really good about margin in total.

As it relates to product sourcing cost, yeah, you're right, a 10-basis point reduction. I don't think we saw that last year. We may have seen it in one quarter in 2015. But certainly, some of this is atypical. It was driven by two factors like the first was labor savings in our DCs due to fewer units moving in and out of our storage locations within our DCs. As you know, we store pack and hold goods and we store what we call short-stay inventory. That's the inventory we use, when we have multiple allocations of the same style to prevent too much item depth in our stores. That less movement in and out of the storage locations that we experienced in Q1, right now we do not have a plan for that same thing to happen in Q2, Q3 or Q4.

The other factor that really drove it was profit improvements that were put in place by our supply chain team. We build some of those into our plan, primarily more in the back half throughout the course of the year. And the team just did a fantastic job right out of the gate implementing some initiatives to pay dividends in the quarter. We talked about product sourcing costs a number of times. We're going to continue to invest in our merchant organization, continue to invest in our supply chain. Both are critical to our model. We're certainly encouraged by these two factors that we saw within the quarter. But one quarter doesn't make a trend, so we'll continue to watch this closely. In terms of product sourcing cost in the rest of the year and our annual guide, we still have deleverage in product sourcing costs baked in.

And I think your final question, just the overall SG&A in either expansions. So over the course of the year, we said 50 basis points to 60 basis points improvements in EBITDA rate. 50 basis points of that's going to come from the net of reported margin less product sourcing. And then at the high end of our sales range will pick up 10 basis points in SG&A and that's what gets us to 60 basis points.

<Q - Ike Boruchow>: Great. Thank you so much, guys.

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

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

Operator

Thank you. Our next question comes from the line of Matthew Boss with JPMorgan. Please proceed with your questions.

<Q - Matthew Robert Boss>: Thanks. So on your new store growth, what percent of your fleet is in the smaller format today? And can you just walk through the cash returns you're seeing, payback period and what level of comps do you see out of the gates versus your older legacy stores?

<A - Marc D. Katz>: Okay. So our stores less than 60,000 square feet are still performing, Matt, well above the chain average. I think at the end of the year, we gave that stat at 17%. Fair to assume that that hasn't changed at all. Here is a stat I can you give you on new stores, as we watch these, as we continue to get smaller in size; they're more productive. And also, just to add on that certainly, the occupancy rates are higher in these stores because we're more the retail hub.

Let's specifically talk about our 2013 and 2014 new store cohort, because I think you're trying to get how are they comping versus the chain. So in 2016, our 2013 and 2014 new store cohorts, they out-comped the chain by 260 basis points and their EBIT rates increased a 100 basis points over what the chain increased. So we are starting to see the gap between our overall EBITs come closer to the chain average, the 2013s and the 2014s as I said out-comped, and they had better improvements in their EBIT increase.

<Q - Matthew Robert Boss>: That's great. And then, just a follow-up. Tom, I guess if you dig further in the same-store sales and the traffic that you've seen basically for the last two-and-a-half months, March, April and May so far. Larger picture, is there anything different in the performance versus what you were seeing pre-February, meaning, is there any hangover effect whatsoever to consider here? And just given what you've seen in the past two-and-a-half months, I guess, what's been your biggest learning? And as we think about the back half, what do you think the biggest opportunity is in the back half versus last year from a top line perspective?

<A - Thomas A. Kingsbury>: Okay. Hi, Matt. No, I don't think there's anything really structurally different than what we were experiencing prior to February. Again, as I mentioned, we're really in a deficit based on the – in February based on the tax refunds delay. But as we got into March and April and now in May, we're back to where we were before, as I mentioned in the prepared remarks. So we still think the biggest opportunities is what I have mentioned many times before in the back half is continuing to drive our home business, continue to grow our beauty business. We make up the differential we have in ladies apparel. So we're still focused on those initiatives and we really feel that those are going to really lead our business, not only this year, but for years to come.

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

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

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

Operator

Thank you. Our next question comes from the line of Lorraine Hutchinson with Bank of America. Please proceed with your question.

<Q - Lorraine Maikis Hutchinson>: Thank you. Good morning.

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

<A - Thomas A. Kingsbury>: Good morning.

<Q - Lorraine Maikis Hutchinson>: Can you talk a little bit about the AUR pressure that you experienced in the first quarter, and then how you see that metric trending for the remainder of the year?

<A - Marc D. Katz>: Sure, Lorraine. A decline in AUR for us obviously is not new. It's been happening for many quarters now. And it continues to be driven by two things. One is the mix shift just within our businesses with home and beauty becoming a bigger part of our mix. They both have AURs lower than the chain. And secondly, our desire to continue to pass on value to our customers is also putting a drain on AUR.

On the flipside, we have seen an increase in UPTs, which has been offsetting that lower AUR and increasing overall basket. So we're pleased with that. But in terms of going forward, I think that negative pressure is going to remain from a mix point of view. Tom talked about home and beauty. And they're only going to grow in penetration. And it's also going to remain from us passing on value to our customers. So we don't see that going away. I guess, somewhat of an offset will be as we continue to increase our better and best penetration. That should help offset it to some extent. But we're still expecting a slight decrease in AUR.

<**Q - Lorraine Maikis Hutchinson**>: Thank you.

Operator

Thank you. Our next question comes from the line of John Kernan with Cowen & Company. Please proceed with your question.

<**Q - John Kernan**>: Good morning, everyone. Thanks for taking my question.

<**A - Thomas A. Kingsbury**>: Good morning, John.

<**A - Marc D. Katz**>: Good morning, John.

<**Q - John Kernan**>: Around the theme of gross margin, just how will the benefits of IMU, I think you've been benefiting from that as we go back through last year, I just wonder how durable those benefits are and how much longer you think you can continue to get these IMUs to offset some of the markdowns within merchandise margin?

<**A - Marc D. Katz**>: Yeah. You faded out there at the end, John, but I heard your initial question, just about IMUs and how many legs does that have. It was strong all last year; it's strong this year, I think, and we're still seeing it across all buy types. So it's not limited just to certain buy type. I think it's a credit to the merchandising team. And I think each year as we get more mature, they just get better at buying. And that's a big piece of it. But I think it's two things that will continue to play into our gross margins going forward. It's that end. We still think that and we will plan our comp store inventories to be down mid to high single-digits. We're going to continue to turn faster. And that's going to reduce markdowns for us. So in terms of a longer-term play, we continue to see benefits coming from both areas, IMU and the lower markdown rate.

<**Q - John Kernan**>: Okay. That's helpful. And then, just one quick follow-up. The expectations for merchandise margin as we go through the rest of the year and the back half of the year within your 50 basis points to 60 basis points of EBITDA margin expansion?

<**A - Marc D. Katz**>: Yeah. So what we said was the 50 basis points was the net between reported margin and product sourcing cost. And you can expect a little bit of deleverage in the product sourcing cost.

<**Q - John Kernan**>: Best of luck.

<**A - Marc D. Katz**>: Thanks.

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

Operator

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

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

<**A - Thomas A. Kingsbury**>: Good morning.

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

<Q - Lindsay Drucker Mann>: I was hoping you could describe the performance of your stores in close proximity or in the same malls as Macy's that have closed, whether the going out of business sales impacted your business, or whether you feel you've picked up market share or been negatively affected by weaker traffic in those areas?

<A - Marc D. Katz>: Yeah. Lindsay, we really studied that with last year's closings, to be honest with you, and as we're looking at the 2017 ones, it was following in a similar pattern. Long story short, after the course of the year and what happened in 2016, our stores that were co-located, so within 0.5 miles, so that was either right in the same mall, or within a 0.5 mile. Over the course of the year, they saw a slight drop, we think, just due to the overall traffic drop.

Our stores that were between 0.5 mile and 5 miles away from the Macy's store over the course of the year saw a slight pickup. So net-net, what we looked at in 2016 was a slight pickup; but to be honest with you, it really wasn't material overall. In terms of this year, we have 55 stores that are within 5 miles of their closing and 15 stores inside of 0.5 miles.

<Q - Lindsay Drucker Mann>: Great. Thank you. And, Tom, you talked about the disruption in retail today creating opportunities. I was hoping you could describe how your team sees availability today versus availability of buys today versus what you might typically see heading into this time of year?

<A - Thomas A. Kingsbury>: Well, I think, it's pretty typical in terms of what's available. We've always had a lot of merchandising opportunities to get the product. It really hasn't changed; it maybe accelerated a little bit more. But there's always a lot of goods that we can buy. And I've said this many times before, we turn down more deals every day than we accept. So as the disruption continues, I'm sure the flow of goods will be plentiful. But it's pretty much same as always. There's just a lot of goods available for us to purchase.

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

Operator

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

<Q - Kimberly Conroy Greenberger>: Great. Thank you. Good morning.

<A - Thomas A. Kingsbury>: Good Morning.

<Q - Kimberly Conroy Greenberger>: Marc, I just had a clarification for you and then a question for Tom on ladies apparel. In terms of the shifting of expenses out of Q1 into Q2, it sounded like there's $3 million of SG&A that was a benefit in Q1; that will be a deficit in Q2. I think you said a $2.5 million sale of a tax credit that was supposed to land in Q1, but that's getting pushed out to Q2. Do those effectively ordinarily net out in each of those two quarters? I just want to make sure I understand the impact correctly.

<A - Marc D. Katz>: Well said. Well done. Exactly.

<Q - Kimberly Conroy Greenberger>: Okay. Great. And then, on ladies apparel, Tom, it sounds like one of your key strategies to grow your ladies apparel penetration is increasing, I think, you said better and branded goods. I'm reading that to mean better and best, if you can tell me if I'm reading that correctly. And is that a reflection of the fact that you're seeing better availability in those nicer goods? Or do you think that that's simply just a more effective way to grow your market share in the category? Thanks.

<A - Thomas A. Kingsbury>: Really, it's really strategic. We really feel that we've gotten really good response in better and best products. And we want to continue to really skew our buys into that type of product overall. And there – the goods are available; but most importantly, it's really a successful strategy for us and we want to just continue to do that.

<Q - Kimberly Conroy Greenberger>: Thanks.

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

Operator

Thank you. Our next question comes from the line of Paul Lejuez with Citi. Please proceed with your question.

<**Q - Tracy Kogan**>: Thanks. It's Tracy Kogan filling in for Paul. I had two questions. The first is on that the eight stores you're closing. I was wondering is there any commonality in terms of geography or real estate types of these stores? And are they all larger format? And then, secondly, in the home category, you've got a competitor introducing a new home concept this year. And we are just wondering if this changes your strategy at all in the home category or the subcategories you'll be pursuing within home? Thanks.

<**A - Thomas A. Kingsbury**>: As far as the home, I'll answer the home question, then Marc can answer the closure question. Now, really, we're still focused on the things that which I talked about in the prepared remarks. We really feel that the strategy we have put in place is really the best strategy to really grow the business overall. So now, not really – we're not changing anything we're doing in terms of home. We just want to continue to bridge the gap that we have versus our competitors.

<**A - Marc D. Katz**>: And as far as the eight stores, Tracy, they are low EBIT contributors. Their leases were coming up; and, yes, they are predominantly bigger stores.

<**Q - Tracy Kogan**>: And no commonality in terms of geography or real estate...

<**A - Marc D. Katz**>: No.

<**A - Thomas A. Kingsbury**>: No.

<**A - Marc D. Katz**>: No.

<**A - Thomas A. Kingsbury**>: No.

<**Q - Tracy Kogan**>: ...any of those are mall based?

<**A - Marc D. Katz**>: I don't believe so. But I'd have to double-check that.

<**Q - Tracy Kogan**>: Okay. Great. Thanks, guys.

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

Operator

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

<**Q - John Dygert Morris**>: Thanks. Hey, good morning. And let me just say congratulations on great execution in a very challenging environment.

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

<**A - Marc D. Katz**>: Thanks.

<**Q - John Dygert Morris**>: Yeah. Marc, I think first question for you, it's kind of a variation on some of the earlier real estate questions. And I know we're emphasizing the productivity and better productivity of the smaller stores. But as you think about your opening cadence of 30 stores this year, anything changing in consideration of the store formats as the mall itself and those kind of mall type locations evolve, given the challenges at the department stores and what I would imagine to be available space coming over the years, some of that larger space. So I'm wondering the degree of

flexibility or how you think about that with respect of the footprint size?

<A - Marc D. Katz>: Sure...

<Q - John Dygert Morris>: Like would you take advantage of it, for example?

<A - Marc D. Katz>: Well, one thing to keep in mind as you think about all the store closings that are happening, and, John, you know them as well as I do. A lot of them are coming from either anchors or tenants in [ph] C and D malls. So...

<Q - John Dygert Morris>: Yeah.

<A - Marc D. Katz>: ... that's obviously – that's not where we want to be. That's not a real help to us. But, with that said, when you have a retailer like a Sports Authority, who goes out of business, somebody that was strip mall located that their store sizes were kind of lot more right in our wheelhouse. Those have been good opportunities for us. And, John, we'll probably end up with as we look at our pipeline right now. We'll probably look at obtaining over 20 Sports Authority locations by the time it's all said and done.

<Q - John Dygert Morris>: And do you ...

<A - Marc D. Katz>: But we...

<Q - John Dygert Morris>: Sorry, go ahead.

<A - Marc D. Katz>: I was just going to say, but we're saying primarily, but strip mall focused, the retail hubs, and strip malls, kind of where other people want to be, too.

<A - Thomas A. Kingsbury>: Yeah. And the store closures that are happening are really in the malls that are not productive. So it really doesn't lend itself to really for us as a big opportunity because obviously we want to be where there's a lot of traffic.

<Q - John Dygert Morris>: Okay. Good. And my follow-up is you guys do a great job with your new customer acquisition initiatives. Maybe if you can update us there and tell us a little bit about your approach in coming quarters and into the back half and your progress on new customer acquisition initiatives? Did that one stump you guys?

<A - Marc D. Katz>: No, no.

<A - Thomas A. Kingsbury>: I was waiting for Marc. Well, we have really done a nice job of really growing our customer base. We're very pleased. And our TV commercials, as I mentioned in the prepared remarks, they've been really resonating with consumers. And as I've mentioned previously, we're growing customers that make over $75,000 a year and actually last year....

<A - Marc D. Katz>: Yeah.

<A - Thomas A. Kingsbury>: ...growing customers that made over a $100,000 a year. And it's really – it's about what's happening inside the store. The customer experience continues to get better and better. And our customer service scores continue to improve. Obviously, that really helps. And it brings in more customers. The fact that we're continuously growing our better and best penetration in brands and our branded penetration in general. That is obviously helping us also in terms of getting a different customer.

And we're finding customers that the band – household income is $25,000 to $75,000. The customers that make less than $25,000 a year, they're leaving us; they're going someplace else. So we feel good about the fact that we're able to attract a higher income customer and it gives us a obviously a broader base of customers.

<Q - John Dygert Morris>: Good. Yeah, I was wondering if that trend was continuing. Okay. Thanks, guys.

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

Operator

Thank you. Our next question comes from the line of Dana Telsey with Telsey Advisory Group. Please proceed with your questions.

<**Q - Dana Telsey**>: Hi. Good morning, everyone.

<**A - Thomas A. Kingsbury**>: Good morning.

<**A - Marc D. Katz**>: Hi, Dana.

<**Q - Dana Telsey**>: Hi. I've been noticing that you have been getting some of the better goods, whether it's the Gucci's, the Burberry's, the Prada's in there. As you think of your mix in your assortment, where does it go? Are you seeing higher margins on that?

And given the store closures, are there categories or brand that you see an opportunity for that you didn't before? Thank you.

<**A - Thomas A. Kingsbury**>: Well, most of the names that you mentioned are really only in their e-commerce site, so. But, in general, we have more and more opportunities to bring in better goods. But it's really more related to what I said previously. It's more about the strategy that we're embarking on in terms of garnering more better and best product overall. It doesn't really have a whole lot to do with all the different store closures and stuff like that; it's more about the strategy that we're trying to accomplish.

<**Q - Dana Telsey**>: And then, as you think about the store closures that are happening out there, is there any boxes that you would want? Would you ever think of entering the mall landscape at all? Is that something, and with some of the rents and deals that may be offered, that would be an appeal to you?

<**A - Thomas A. Kingsbury**>: Well, first of all, we look at every deal. And if there is good economics, we may consider doing something in a mall. But, in general, we really want to be in strip centers. And that is what our strategy is overall. But we are opportunistic as we are buying products. And we would consider it; we would look at it. But we would prefer not to be in a mall.

<**Q - Dana Telsey**>: Thank you.

Operator

Thank you. Our next question comes from the line of Pamela Quintiliano with SunTrust Robinson Humphrey. Please proceed with your question.

<**Q - David N. Kwon**>: Hi. This is David for Pam. Thanks for taking our questions. Just a follow-up to the multiple real estate questions. Given the store closures across industry, how is that impacting your real estate opportunities in terms of lease renewals?

<**A - Thomas A. Kingsbury**>: I'm sorry. Could you repeat that question?

<**Q - David N. Kwon**>: Given the store closures, how is that impacting your real estate opportunities in terms of lease renewals as you go forward in terms of economics?

<**A - Thomas A. Kingsbury**>: Sure. Yeah, sure. So let's talk about just what's happening this year 2017. So we had roughly that 68 leases that were expiring. So I'll kind of give you a breakdown of them to give you a feel for what's happening. In 44 locations, we've exercised our options and extended term. We were able to get rent reductions in six of the locations. As we've talked about, we're relo and closing 14 locations. And two of them, we're able to give space back to our landlords. And then we're able to remodel and actually get some lease incentive money for the other two. So that kind of gives you the complexion of the leases that we dealt with in 2017, which would probably be the best go-forward proxy for future.

<Q - David N. Kwon>: Great. Thanks. And then, in terms of e-commerce, I know it hasn't been a major focus. But any updated thoughts on potentially expanding your presence?

<A - Thomas A. Kingsbury>: Well, e-commerce is less than 1% of our business. We'll see growth in e-commerce, but not a lot of growth. It's just really hard to replicate the off-price model online overall. And our main focus is growing our brick-and-mortar business. We feel we've done a very good job so far. And we want to continue to work on the customer experience as I mentioned before in our stores. So no, e-commerce is just not a huge focus for us overall, because it's a very small piece of our business.

<Q - David N. Kwon>: Okay. Thanks. And lastly, any updates on Baby Depot?

<A - Thomas A. Kingsbury>: Yeah. Baby Depot, obviously, it is a small business for us overall. But it's an important differentiator for us. We didn't do well in Baby Depot in the first quarter, underperformed the chain average overall. I still feel that our strategy is a good strategy and that we should see growth in Baby Depot in the second quarter in the back half of the year based on all the initiatives we've done. But in the first quarter, it's underperformed the chain.

<Q - David N. Kwon>: Okay. Thank you very much.

<A - Marc D. Katz>: Okay. Before we move on, operator, I just want to clarify one of the answers, we were asked about eight store closures this year. Four of our eight closures are going to be in malls. Thank you.

Operator

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

<Q - Bilun Boyner>: Hi. Good morning. This is Bilun on for Brian. Thanks for taking our question. I guess, first on SG&A, I think, you mentioned lower marketing expense in the quarter. Just wanted to see if that was a response as a response to the traffic trends in the quarter. Or are you getting more efficient with your marketing, maybe shifting the mix more towards digital and social media? And then, the shrink piece in gross margins, last year you were more prudent with shrink accruals through the year and that turned into a benefit in Q4. So just wanted to see how you're accruing for shrink this year maybe versus last year?

<A - Marc D. Katz>: Sure. As far as the marketing goes, yeah, I would say that it was predominantly more efficient marketing within the quarter. And then we did have some timing in marketing as well. So we had grand opening cost for four new stores that shifted from Q1 to Q2. So marketing actually played a role in both of those things.

As far as shrink goes, we're recording it with last year's final rate was for the first three quarters. So it is a slight good guide for the first three quarters. And then we expect a slight bad guide in Q4, based on what happened last year. But overall, on a full-year basis, the shrink accrual that's baked into our guidance is just a few basis points lower than last year.

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

<A - Marc D. Katz>: You bet.

Operator

Thank you. Our next question comes from the line of Bob Drbul with Guggenheim Securities. Please proceed with your question.

<Q - Andrew Roberge>: Hi. Good morning. This is Andrew Roberge on for Bob. Our question was just around the athletic space, could you just give us a little bit more on your performance there in both apparel and footwear? Thanks.

<A - Thomas A. Kingsbury>: Okay. As I mentioned in the prepared remarks, we had strong performance really across the board in all the activewear in terms of apparel. And our athletic shoe business was very strong, too. So we see that continuing in the second quarter in the back half of the year.

<Q - Andrew Roberge>: Okay. Great. Thank you.

Operator

Thank you. Our next question comes from the line of Roxanne Meyer with MKM Partners. Please proceed with your questions.

<Q - Roxanne Meyer>: Good morning. And thanks for taking my question. You talked about performance of your relatively newer stores over the past few years. I'm wondering if you can give us an update on the performance of both your renovated and relocated stores? And then, as a follow-up, you mentioned that traffic was up in May. I'm just wondering if it's fair to say the comps are in line with your guidance so far for the quarter? Thanks.

<A - Marc D. Katz>: Roxanne, we typically – for the remodels that we've done in the past, we have seen a nice lift in sales there. So stores that we've remodeled historically have out-comped the chain average. And then your second question was on?

<Q - Roxanne Meyer>: Was on whether it's fair to say that your comps so far are in line with your plan given that traffic is up?

<A - Thomas A. Kingsbury>: Yeah. 2% to 3% guidance is the typical guidance that we give in a quarter. We believe that it's prudent to plan conservatively because that's the expense base and receipts that we plan on that lower sales base. We really think that our merchants are very adept at chasing business when it's there. Our intent obviously is to beat the 2% and 3% guidance. But it incorporates everything where we are now, what we think is going to happen in the rest of the quarter.

<Q - Roxanne Meyer>: Okay. Great. Thanks a lot.

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

Operator

Thank you. Our final question for this morning will come from the line of Adrienne Yih with Wolfe Research. Please proceed with your question.

<Q - Adrienne Yih>: Thank you. Good morning. Let me add my congratulations. My first question ...

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

<Q - Adrienne Yih>: ...is on just to understand the inventory strategy, obviously, much more disciplined. When you take a look at the much smaller footprint store, the 45,000 square foot, 44,000 square foot versus the legacy stores. When we think about that, are you planning inventory per store or inventory per square foot, right, so is it in the absolute sense on a per store basis?

And then, secondarily, on the ladies apparel or the apparel business underperforming in the first quarter, has that continued into May? Or is it back to plan? And do you think it was a transitory sort of tax refund, weather issue, or is there something going on in apparel highly promotional, because obviously apparel's pretty weak across the board in general. Thank you very much.

<A - Marc D. Katz>: I'll take the inventory per store first, and then I'll kick it over to Tom. We've made, Adrienne, drastic reductions in our comp store inventories over time. Tom's taking out, I want to say, 60% of the inventory since he started here. So we just flat out don't need the 80,000 square foot boxes anymore. So going to the smaller stores gives us plenty of room to put in the inventory that we need. But the inventory is really more of a function of the sales that we think the store is going to do and that's how we merchandise it.

<**Q - Adrienne Yih**>: Thank you.

<**A - Thomas A. Kingsbury**>: As far as the ladies apparel go, we've seen improvement, as I mentioned in the prepared remarks, we've seen improvements actually starting in April and continuing in May once the weather normalized. But we really feel with a warmer February and a cooler March, it had a negative impact on apparel really across the company. But, no, as weather normalized, our performance improved.

<**Q - Adrienne Yih**>: Very good. Thank you very much. Best of luck.

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

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

<**A - Thomas A. Kingsbury**>: Well, thanks for joining us today – I'm sorry.

Operator

I'm sorry. Go ahead, sir.

Thomas A. Kingsbury

Thanks for joining us today. We look forward to speaking with you when we report second quarter results in August.

Marc D. Katz

Have a great weekend.

Thomas A. Kingsbury

Have a good day.

Operator

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

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