Ross Stores, Inc. (ROST) CEO Barbara Rentler on Q3 2019 Results - Earnings Call Transcript

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FQ3: 11-21-19 Earnings Summary

Press Release SEC *10-Q*

EPS of $1.03 beats by $0.05 | Revenue of $3.85B (8.44% Y/Y) beats by $75.82M

Earning Call Audio

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Ross Stores, Inc. (NASDAQ:ROST) Q3 2019 Earnings Conference Call November 21, 2019 4:15 PM ET

Company Participants

Barbara Rentler - CEO

Michael Hartshorn - Group President and COO

Travis Marquette - Group SVP and CFO

Connie Kao - VP, IR

Conference Call Participants

Matthew Boss - JP Morgan

Mark Altschwager - Robert W. Baird

Lorraine Hutchinson - Bank of America Merrill Lynch

Paul Lejuez - Citigroup

Kimberly Greenberger - Morgan Stanley

Alex Walvis - Goldman Sachs

Michael Binetti - Credit Suisse

Paul Trussell - Deutsche Bank

Kate Fitzsimons - RBC Capital Markets

Daniel Hofkin - William Blair

Adrienne Yih - Barclays Capital

Michael Baker - Nomura Securities

John Kernan - Cowen & Company

Dana Telsey - Telsey Advisory Group

Ike Boruchow - Wells Fargo

Marni Shapiro - Retail Tracker

Bob Drbul - Guggenheim Securities

Laura Champine - Loop Capital

Operator

Good afternoon, and welcome to the Ross Stores Third Quarter 2019 Earnings Release Conference Call. The call will begin with prepared comments by management, followed by question-and-answer session. [Operator Instructions]

Before we get started, on behalf of Ross Stores, I would like to note that the comments made on this call will contain forward-looking statements regarding expectations about future growth and financial results, including sales and earnings forecasts, new store openings, and other matters that are based on the company's current forecast of aspects of its future business. These forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from historical performance or current expectations. Risk factors are included in today's press release and the company's fiscal 2018 Form 10-K and fiscal 2019 Form 10-Q and 8-Ks on file with the SEC.

Now, I'd like to turn the call over to you, Barbara Rentler, Chief Executive Officer.

Barbara Rentler

Good afternoon. Joining me on our call today are Michael Hartshorn, Group President and Chief Operating Officer; Travis Marquette, Group Senior Vice President and Chief Financial Officer; and Connie Kao, Vice President, Investor Relations.

We'll begin our call today with a review of our third quarter performance, followed by our outlook for the remainder of the year. Afterwards, we'll be happy to respond to any questions you may have.

As noted in today's press release, we are pleased that our third quarter results were ahead of our expectations. Earnings per share for the period were $1.03, up from $0.91 last year. Net earnings grew to $371 million, from $338 million in the prior year. Total sales for the third quarter increased 8% to $3.8 billion, with comparable store sales up a strong 5% on top of last year's 3% gain.

For the third quarter, we saw broad based trends across both merchandise departments and geographic regions, with children's and the Midwest performing the best. We also continue to see improving sales trends in our Ladies apparel business. While this area becomes less important as we move into the fourth quarter, we believe the actions we are taking here will lead to ongoing improvement during the holiday selling season, and into 2020. Operating margin of 12.4% was above plan mainly due to better than expected sales and merchandise margins. For the first nine months of fiscal 2019, earnings per share were $3.32, up from $3.06 last year.

Net earnings were $1.2 billion, versus $1.1 billion in the first nine months of 2018. Sales year-to-date rose 7% to $11.6 billion, with comparable stores up 3% on top of a 3% gain last year. As we ended the third quarter, total consolidated inventories were up 10% over the prior year, while packaway was 39% of the total, compared to 41% last year. Average in-store inventories at the end of the period were up 3%. dd's DISCOUNTS continues to perform well, with robust above planned growth in both sales and operating profits.

Turning to our store expansion program, we opened 30 new Ross and 12 dd's DISCOUNT locations in the third quarter, completing our 2019 store opening program. We expect to end the year with 1,546 Ross and 259 dd's locations for a net increase of 89 for fiscal 2019.

Now, Travis Marquette will provide further color on our third quarter results and details on our guidance for the remainder of the year.

Travis Marquette

Thank you, Barbara. Let's start with our third quarter result. Our 5% comparable store sales gain was driven by higher traffic and an increase in the size of the average baskets. Third quarter operating margin of 12.4% was above plan and similar to last year. Cost of goods sold increased 10 basis points in the period. Merchandize margin grew by 20 basis points, while occupancy and buying levered by 10 and five, respectively. These favorable items were more than offset by distribution expenses that increased 45 basis points mainly due to the unfavorable timing of packaway relate costs and higher wages. Freight was flat for the quarter.

Selling and general administrative expenses for the period decreased 10 basis points. During the third quarter and first nine months of fiscal 2019, we repurchased 3.0 million and 9.6 million shares respectively of common stock for a total purchase price of $326 million and $966 million, respectively. We remain on track to buy back a total of $1.275 billion in stock for the year.

Let's turn now to our fourth quarter outlook. As noted in today's press release, we continue to project fourth quarter comparable store sales to increase 1% to 2%, versus a 4% gain last year. In addition, our guidance for fourth quarter earnings per share remains unchanged at $1.20 to $1.25, which now includes a one-time non-cash benefit of $0.02 per share primarily due to the favorable resolution of a tax matter offset by slightly higher pretax expenses. This forecasted guidance compares to $1.20 per share in the prior period, which also included a one-time per share benefit of $0.07 related to the favorable resolution of a tax matter. Excluding both of these one-time items and if comparable sales only perform in line with our guidance, earnings per share are forecasted to grow 4% to 9% over the last year.

The operating statement assumptions for the fourth quarter include the following. Total sales are projected to grow 5% to 6%. Operating margin is projected to be in the range of 13.0% to 13.2%, compared to last year's 13.2%. We expect net interest income of about $2.3 million. Our tax rate is expected to be approximately 22% to 23%, which includes the aforementioned one-time tax benefit. And weighted average diluted shares outstanding are projected to be about $357 million. Based on our year-to-date results and updated fourth quarter guidance, we now project earnings per share for the full-year to be in the range of $4.52 to $4.57, compared to $4.26 in fiscal 2018 which included the previously mentioned one-time per share benefit of $0.07.

Now, I'll turn the call back to Barbara for closing comments.

Barbara Rentler

Thank you, Travis. As we mentioned earlier, we are pleased with our solid sales and earnings performance in the third quarter. We believe these above plan results demonstrate that we are well positioned to compete effectively in today's volatile retail environment, giving consumers continued focus on value and convenience. However, as we look ahead, we expect another highly competitive fourth quarter. In addition, we are up against strong multiyear sales and earnings comparison, a shortened calendar between Thanksgiving and Christmas, and ongoing uncertainty in the macroeconomic and political landscape. Therefore, although we hope to do better, we believe it best to maintain a cautious posture heading into the holiday selling season.

At this point, we'd like to open up the call and respond to any questions you might have.

Question-and-Answer Session

Operator

[Operator Instructions] And our first question is from Matthew Boss with JP Morgan. Your line is open.

Matthew Boss

Great, thanks, and congrats on a really nice quarter. Barbara, on the top line, any areas of sequential improvement that you'd like to highlight by category, maybe how best to think about ladies apparel relative to the total comp going forward, and any particular areas of assortment opportunity that you think is worth noting into this year's holiday.

Barbara Rentler

Well, as we said in the comments, basically all merchandize areas it was very broad based the performance, so overall the company took a lift. As we look at Ladies, we really saw improved sales in the quarter, and it performed slightly above our expectation, and we're expecting to see ongoing progress in the quarter. So we're pleased with the pace of improvement, but at this point we wouldn't provide more detail in terms of that.

Matthew Boss

Great, and just a -- oh sorry, go ahad.

Barbara Rentler

Just say the second question again?

Matthew Boss

Just more into the holiday, any particular areas of assortment opportunity that you're excited about?

Barbara Rentler

Sure. Our main focus will be to build upon the success of our gift giving assortment. I mean we've built out gifts throughout the entire store, and we feel good about that, and we feel that we're offering gift items at really compelling values, because we really feel that value remains the most critical factor for her where she makes her shopping decisions, and we believe that we're really positioned to deliver on this.

Matthew Boss

Great. And then just to follow-up more on the margin side. So it sounds like freight has now moderated, and it's not the headwind for pretty much everybody out there. So I guess my question is if same-store sales are consistently in the 3% to 4% range and as we're thinking now going forward, is there any reason to think that the algorithm is any different historically than it was on the bottom line. Again, if you're at that 3% to 4% comp range just any margin headwinds or things to highlight that would be different than that historical 3% to 4% same-store sales double-digit earnings growth algorithm going forward.

Michael Hartshorn

Matt, it's Michael Hartshorn. So, our long-term earnings algorithm has not changed the combination of new store growth, comp growth, EBIT margin expansion at the high end, and then the buyback program. The one thing that I would throw in the mix with a lot of uncertainty around it is tariffs. So net of tariffs we haven't changed our long-term algorithm.

Matthew Boss

That's great, best of luck.

Operator

Your next question comes from Mark Altschwager with Baird. Your line is open.

Mark Altschwager

Great, good afternoon. Thanks for taking the question. Was hoping you could give a bit more color just on the distribution expenses in the quarter, I know that was a bit of a headwind. Do you expect that to normalize in Q4? And then just more broadly, hoping you could touch on the buying environment and how you'd characterize what you're seeing out there versus the earlier part of the year. Thanks.

Travis Marquette

Yes, sure. This is Travis. In terms of the distribution cost expenses, as we said, they were related to a couple of things. One, unfavorable timing of packaway, and then also wages. With respect to wages, there were a couple of things that have impacted that, as you all are aware. Last year, we raised our national minimum wage to $11 across the country. We did anniversary that after the second quarter of this year. Beyond that, there are ongoing state and municipal wage increases, particularly in California. California wages went up in January by a dollar and they'll continue to do so for the next couple of years. The wage increases do impact both stores and distribution centers, but as we managed the business this year more of cost mitigation efforts ended up in the SG&A line. In terms of guidance going forward, we feel comfortable with the guidance that we have. We do expect some continued pressure, and it's built in to the guidance that we gave.

Barbara Rentler

And as it pertains to the buying environment now versus the earlier part of the year, there's been plenty of availability in the marketplace pretty much all year. I'd say it's been consistent, whether it's vendors bringing goods in for tariff or just supply coming from sales falling off in the department store sector, there's been a lot of goods all along, and what we're really seeing is that the availability is broad-based across brands and categories. So it's really a good buying time.

Mark Altschwager

That's great, thank you. Best of luck over holiday.

Travis Marquette

Thank you.

Operator

Your next question is from Lorraine Hutchinson with Bank for America Merrill Lynch. Your line is open.

Lorraine Hutchinson

Thanks. Good afternoon. The packaway percentage is lower than it's been in quite a few years. And I was just hoping you could give us a little bit of insight into how the in-season buying is looking, and how you'll manage through holiday with a lower level of goods available in the packaway.

Michael Hartshorn

Sure, Lorraine. As we mentioned in our commentary, total inventory was actually up 10%. Packaway was 39% versus 41% last year, but on an absolute basis packaway was actually up year-over-year. The percentage was a function of higher inbound in transit, so that was higher for us. And we brought in product earlier to support the holiday selling season. I'd say overall, as Barbara mentioned, we continue to see plenty of availability, but our buyers are very strategic and ensure we have the best values. And I'd also add that we did [indiscernible] packaway to chase the -- ahead of plan sales in the quarter.

Lorraine Hutchinson

Thank you.

Operator

Your next question is from Paul Lejuez with Citigroup. Your line is open.

Paul Lejuez

Hey, thanks, guys. I'm wondering if you could give any more color on dd's comps versus Ross. Maybe talk about the magnitude of the traffic and ticket increases that you saw, maybe for each one. And then second, just to continue on the availability of product question, are you seeing, Barbara, any particular price strata more available just like the good, better, best as you think along those lines, are you seeing outsized availability in any particular price point? Thanks.

Michael Hartshorn

Paul, on dd's, we don't break that up separately. I'd just repeat what we said in the commentary. We're very happy with the results that performed well, and robust above planned growth in both sales and operating profits.

Travis Marquette

In terms of the components of sales, as we mentioned, the comp was driven by both higher traffic and an increase in the size of the average basket. The average basket was driven more by items per basket that was up, while AURs were down a little bit. In terms of traffic versus basket it was pretty evenly split.

Barbara Rentler

And then in terms of availability of product from a good, better, best point of view, the availability is truly broad based in all three, across all brands and categories. I mean there's really a large assortment of product to choose from. So I wouldn't say it's just focused on one, I'd say available in all.

Paul Lejuez

Got you. Thank you. And then just one follow-up, home versus apparel, any color you can provide there, and also, could you just remind us the percent of the business that home represents in 4Q versus the rest of the year? Thanks.

Michael Hartshorn

Yes, overall, apparel versus non-apparel results were pretty similar, and…

Travis Marquette

Home is a little bit more than a quarter of the business, and it's slightly higher in Q4.

Paul Lejuez

Thanks, guys. Good luck.

Operator

Your next question is from Kimberly Greenberger with Morgan Stanley. Your line is open.

Kimberly Greenberger

Okay, great. Thank you so much. Barbara, I wanted to just hear your sort of State of the Union on the ladies apparel business. Are you happy? It sounded like you like the trend, but are you satisfied with the performance across ladies at this point?

Travis, I just wanted to ask you a follow-up on the 45 basis points of distribution center headwinds. Was it unfavorable packaway and freight or unfavorable packaway and wages? I just wanted to get a clarification there. And then on the unfavorable packaway, could you just clarify, does that mean that sequentially from Q2 to Q3 packaway dollars would have declined sequentially, and so you would have more expenses flowing through the DC in the current period, is that right?

Travis Marquette

Yes, I guess, let me answer that question first. Packaway dollars were actually higher year-over-year and quarter-to-quarter. The unfavorability relates to sort of the magnitude of the increase compared to last year. So, they were up less than last year, but we typically see a benefit on the P&L from packaway this quarter. Your question on the 45 basis points, yes, it was packaway timing and wages was the answer.

Kimberly Greenberger

Okay, sounds great. And that just relates - sorry, Barbara. Go ahead. Sorry.

Barbara Rentler

No, go ahead, go ahead.

Kimberly Greenberger

I just wanted to make sure I understood the connection, and that was related to the wage rate increases in the state of California or have you not yet lapped wage increases in your distribution centers that were may be implemented later.

Travis Marquette

We lapped the $11 increase that we did sort of as a minimum across the company that was lapped after Q2, and so, these are primarily related to sort of state minimum increases, their state and local minimum wage.

Kimberly Greenberger

Right.

Barbara Rentler

And as it pertains to the ladies, as I said, the business performs slightly above our expectations, and we expect to see more ongoing progress. We were pleased with the pace of the improvement in the ladies business during the quarter. Obviously, I'm not going to go into more detail than that, but we expect to see ongoing progress in Q4 and beyond.

Kimberly Greenberger

Okay, great, Barbara. And just a quick follow-up question on tariffs, if I could, I'm wondering if you have -- what the tariff impact would potentially be incorporated into your Q4 guidance? Is there a way to quantify that? And do you have any visibility for the impact of tariffs -- your potential impact of tariffs beyond the fourth quarter at this point?

Travis Marquette

Sure, Kimberly, for Q4 right now we have $0.01 to $0.02 built into the impact, obviously they just went in place especially in apparel and shoes in the third quarter. It's too early to speak about the impact longer term. Obviously, the longer the tariffs remain in place, the more pressure it will put on the retail marketplace. So, the situation remains very fluid at this point. So, we wouldn't comment at this point beyond that.

Kimberly Greenberger

Okay, understood, thanks, and really nice quarter here. Good luck for holiday.

Travis Marquette

Thanks, Kimberly.

Barbara Rentler

Thank you.

Operator

Your next question is from Alex Walvis with Goldman Sachs. Your line is open.

Alex Walvis

Hey there, thanks so much for taking the question. I have a few questions on the category dynamics if I may. You mentioned children's being a particularly strong category for you. Can you talk about what's really working there? And then, second question is on men's that's been mentioned as a strong category for the last few quarters, can you talk about the progression of that business as well?

Barbara Rentler

Sure, the kids business really, really benefited from strong execution of the merchandise strategy. We have a very strong team. They put a strategy in place, and they really stick to their mantra, and then have done a really fine job. The business itself is pretty broad-based in terms of performance across total kids.

Our men's performance has been strong, and strong for a number of years, continues to be strong, it's performed pretty much in line with chain average, and we also feel like we have a solid strategy in there, and the business continues to move forward. I mean there is supply, there're some good opportunities in men's also.

Alex Walvis

Fantastic, thank you. And then maybe, if I may, a question on pricing trends in the market, recognizing of course that you guys -- price follows, any comments on what you're seeing out there? Any thoughts on what price could look like across that the categories in which you operate as you move into next year, and how you're likely to respond there?

Barbara Rentler

Sure. So far, we really haven't seen any material changes in pricing so far. I mean, the merchants are constantly competitive shopping and trying to stay on top of that, but to your point, we're not the lead, we're following pricing. So we'll have to wait and see how different retailers ultimately react to the higher cost and how they approach pricing, and then we'll go from there, but we're not the lead, we definitely follow, and again to-date we really haven't seen any material changes.

Alex Walvis

Marvelous, thanks so much.

Operator

[Operator Instructions] Your next question comes from Michael Binetti with Credit Suisse. Your line is open.

Michael Binetti

Hey, guys, so congrats on a great quarter, thanks for taking our questions here. Barbara, would you -- I think it's the second time you've been very, very direct with your expectation for an ultra-competitive promotional marketplace in the fourth quarter, I think excluding the one-time benefit, you moved the midpoint down a penny or two in the fourth quarter as far as what you expect now, could you just tell us what changed since many days ago, particularly since you're delivering it really well on the top line in the quarter? And I think, I guess, on the back of that, you did mention some higher pre-tax expenses that moved, and maybe you could just tell us a little bit about what some of those expenses were, so we can think about it for a model, please?

Travis Marquette

Yes. Just in terms of the expenses that we did have a couple of extra days of expenses in Q4 and those are really split across cost of goods and SG&A, so wouldn't be more specific really beyond that.

Michael Hartshorn

And Michael, on the guidance we didn't change the guidance coming out of Q3 and Q4. As we said, we guided with comp at 1% to 2%, and just to reiterate what we said in the commentary, we expect it to be highly competitive, and especially with the recent department store performance in Q3, and we're obviously up against a strong multi-year comparison. We have a shortened calendar between Thanksgiving and Christmas, and there continues to be uncertainty in both the macroeconomic and certainly the political landscape. I'd add, historically, the shorter calendar compressed the sales with minimum impact to the overall quarter. That said the shorter calendar had some uncertainty if there's a weather disruption, for instance, especially near the Christmas holidays, it's more difficult to overcome, but we believe it's the best way to manage our business with a cautious posture during the holiday season.

Michael Binetti

All right, that makes sense to me. I guess one follow-up, a little longer term question, as we look at some of the components, one thing that's fairly noticeable and impressive is that you've kept the merge margin expanding slightly, call it in around 20 basis points pretty consistently on a run rate basis for a while, talking years, not quarters, but you have been able to do that on pretty consistently lower AUR as well. I think it's been a few years since we heard the AUR up, is that a dynamic that's sustainable going forward on a multi-year basis is you know, you're thinking that you continue to prioritize value and to plan the AUR to be down slightly, but that the merged margins can continue to be up is there any reason that, that dynamic changes we look, lift our eyes to next year and beyond?

Michael Hartshorn

You know, what the key for us is to plan the business cautiously, and if we can beat the sales plan, one, we can turn faster, which helps on the markdown line, and then two, we chase the business with closed outs, which typically have better margins. So that's the secret sauce, if we can beat our sales plan, that's our opportunity.

Michael Binetti

Okay. Thank you very much.

Travis Marquette

And AUR is not something that we plan. We don't target a specific AURs, it's really an output of the process, not an input.

Michael Binetti

Okay. Thanks a lot, guys.

Operator

Your next question comes from Paul Trussell with Deutsche Bank. Your line is open.

Paul Trussell

Thank you. Good afternoon and good print. Just wanted to have you talk a bit more about new store performance, maybe discuss in what you're seeing in terms of some of the existing markets as you backfill and what you're seeing in new markets as well, and is there any reason why we shouldn't think that 100 doors a year is a good go forward number.

Travis Marquette

Sure, yes. Our new store performance has been pretty consistent for the last couple of years. As you might imagine, performance in our established existing markets tend to be a little bit higher, it's a little bit lower in our new market, but the average has worked out to around 60% to 65% over the last couple of years, and we're still seeing that. If we talk about sort of the opportunity for future growth, we're pretty comfortable with the 100 stores per year. We've been doing that 100 growth per year we are doing that for a little while now, and we think it sort of aligns with our ability to make sure we find the right side. We're not sort of forced to make decisions that we wouldn't -- sort of wouldn't be as beneficial to us, and we can open them in a way that, that sort of drives their success.

Michael Hartshorn

And I would just add that on the new store opening is our lineup site is really just a couple of years out. That's what we can see in the hopper from a real-estate standpoint. So we're comfortable with it.

Operator

Your next question is from Kate Fitzsimons with RBC Capital Markets. Your line is open.

Kate Fitzsimons

Yes, hi. Thanks so much. I'll add my congratulations as well. My question is on inventory receipts, you had slowed them earlier headed back to school, and it looks like that decision obviously really reap the rewards in the third quarter, maybe just how was it adjusting your views on inventory flows headed into holiday? Heard in-store inventories up 3%, I believe. So maybe just curious about the decision behind maybe adjusting some of those receipt timings headed into the fourth quarter. Thank you.

Travis Marquette

Yes, I mean, for us, it was really about the compressed calendar, and we thought we had some opportunities that we may have missed going into the quarter last year. So, it was in our plan at the beginning of the year, and we actually see it good.

Operator

Your next question is from Daniel Hofkin with William Blair. Your line is open.

Daniel Hofkin

Good afternoon. Just a quick question, I think you talked a little bit about home and I believe it was kids. Any other category commentary or kind of regional variances that you would care to comment on? That's my first question then I just had a quick follow-up.

Michael Hartshorn

Yes, sure. As we discussed, kids was the top performing category. Performance was pretty broad based to both cat --across both categories and geographic regions. Aside from kids, some of the shoes were also a strong category. Geographically, the southeast and southwest were also strong performers, but again, performance is pretty broad-based.

Daniel Hofkin

And any anything you can kind of as you're getting further into the kind of the improvement within ladies apparel, any more color you can share on kind of what the issues were, or have been that you're now correcting? And then, I guess, lastly on just online resellers, curious if there's any updated thinking about what you're seeing out there in the competitive landscape? Thank you.

Barbara Rentler

Sure. So, listen, back to the ladies scenario, what I would say about ladies is rather than rehashing is that we believe that we have the right initiatives underway to drive sales growth through the fourth quarter, and then into 2020. We continually see improvement, and although we're never fully satisfied with any part of our business, we're happy that it's moved in the right direction, and we feel like we have a strategy in place as we go throughout 2020.

Michael Hartshorn

On the retail competition, relative to the retail business model, we believe we have a differentiated value offering. We've obviously competed with many different retailers over the years, and our focus is making sure we continue to offer our customers the best branded values possible.

Operator

Your next question is from Adrienne Yih with Barclays. Your line is open.

Adrienne Yih

Good afternoon. Let me add my congratulations. Barbara, two longer term questions, and a quick one for Mike, what if anything would have to happen for you to contemplate the launch of a potential e-commerce business? And then, as you think about the expansion plans in the U.S., at what point in time, would you accelerate sort of a northeast regional expansion? And for Michael, you talked about some rent trends, what's happening with off small rents, and is it impacting at all sort of where your breakeven comp is on fixed expenses? Thank you very much.

Michael Hartshorn

Adrienne, I'll jump in there and take all three of those. So, on e-commerce, our view has not changed. We think that the moderate off price business, which is what we're in, would not work in an online environment. With a $10 to $11 AUR the economics with free shipping and returns are just not financially sustainable, and we don't see any way that business would be accretive to our profit. In terms of real estate growth over the next several years, our focus will continue to be building in the Midwest, about 10% to 15% of those stores, and continue to grow in existing markets and we will continue to do that over the next couple of years before we would enter into the rest of the country including the Northeast. And then, real estate trends, really not significant changes. We've not seen any significant changes in terms of rent or lease terms recently.

Operator

Your next question is from Michael Baker with Nomura. Your line is open.

Michael Baker

Thank you, guys. Two follow-ups, one, tariffs were supposed to be $0.03 in the back half, you said 1 to 2 in the fourth quarter, does that mean that they impacted by $0.01 to $0.02 in the third quarter? In other words, that we still looking for $0.03 in the back half, and then, a follow-up on the fourth quarter guidance and the slightly higher pre-tax expenses? Should we consider those to be one time as that $0.02 benefit that you mentioned, you specifically called out as one time or the slightly higher pre-tax expenses more just ongoing business expenses?

Michael Hartshorn

Mike, on tariffs our original guidance assumed $0.01 impact in Q3 and then the $0.01 to $0.02 in the fourth quarter. As I mentioned earlier, the tariffs just went into effect for the latest trench for a -- in September, so mid-quarter. I would also say that we had pre-tariff

Packaway inventory and pre-tariff purchase orders that enabled us to mitigate the impact in Q3 where you saw we had a 20 basis point improvement in merchandise margin.

Travis Marquette

And on that $0.02 additional expenses, those are just for -- we expect this just before Q4 only.

Operator

Your next question is from John Kernan from Cowen. Your line is open. John Kernan with Cowen, your line is open

John Kernan

Hey, guys, sorry about that, congrats on another nice quarter. Just want to go back to the inventory question. Your inventory turns improved consistently the last several years, it's obviously had great effects on the growth of free cash flow. Just wondering, how much faster you think you can turn how much more productive you think you can be with inventory and working capital. Thank you.

Michael Hartshorn

I think going forward it's been down. If you go back a decade, I mean, we brought down inventories over 40% in front of the customer. Given the way we plan the business, if we posture the plans at a lower level and we can beat those plans that's really like margin, that's our opportunity to turn faster.

Operator

Your next question is from Dana Telsey with Telsey Advisory Group. Your line is open.

Dana Telsey

Good afternoon, everyone, and congratulations on very nice results. Can you please talk a little bit about beauty and women's apparel? Are you still seeing the progressive improvement from Q1 and Q2 that was in the plan? And on the beauty side, how is that growing and as that becomes a larger piece of sales? Thank you.

Barbara Rentler

So, the beauty business has been one of our growth areas and continues to expand as we add additional classifications of products and boards and the assortments, and so we feel good about beauty, it's a growth business and it continues to grow, sequentially quarter-to-quarter. So ladies apparel business, you know, as we've gone through the year has progressively improved and as I said as we're looking forward you know, we expect to see ongoing progress

Operator

Your next question is from Ike Boruchow with Wells Fargo. Your line is open.

Ike Boruchow

Hey, good afternoon, everyone. Question for the team, just a high level question, nothing specific, but the company had a decade plus of margin expansion behind them, and this will be the second year in a row of operating margin was declining. I guess my question is the outlook for freight seems to be a little bit better, the outlook for wages, it doesn't seem like there's any broad-based wage inflation to begin next year. Can the business get back to potentially a period of margin growth, just kind of curious to put some takes again, just big picture looking out?

Michael Hartshorn

Yes, Ike, I think if we look ahead, certainly will start a year with a cautious outlook on sales and if we can drive ahead of the sales plan, that's where our margin opportunity is going to be. This year, I would point out even though we've been able to mitigate the tariff impact, the home accessories and cosmetics, tranches one through three have been in place all year, and we've spent a lot of time trying to mitigate those, and then here with transport. So, again, what different going into next year is tariffs, which are very uncertain at this point.

Operator

Your next question is from Marni Shapiro with Retail Tracker. Your line is open.

Marni Shapiro

Hey, everybody, congratulations, and I'd like to add it's a pleasure having such a boring conference call. I think you guys have missed it. That's a compliment. It's a great thing. Barbara, I have a big picture ladies question for you. There has been a lot of talk about ladies business. When the business got tough in the stores, did you see the shopper not buying, or was she shifting to other departments, whether that's anecdotal or you can tell by her receipts and credit card data, and if she was shifting to other departments, are you seeing that shifts back or is she just buying more, I'm curious just how the dynamics working in the store.

Barbara Rentler

I think when look -- I think when your ladies apparel business is tough, you know, our core customers are woman, so obviously it makes it makes the entire business more difficult, but when you think about the ladies customer, we don't think of her as just apparel, so we think of her more holistically, so we think of her as apparel and shoes and cosmetics, all the handbag, all the things that satisfy her. So, when this is all anecdotal, so this isn't going to be anything from -- any fact other than the other businesses that were healthy like beauty were healthy, stays healthy and continue to grow well ladies was difficult. And so, I don't necessarily -- I think she bought other products in the store. However, I think she probably would have bought those products, even if ladies apparel has been good or better I should say than what it was, because those businesses are growing exponentially and there're lots of products and things for her to choose. So I think in the end it all just becomes about the assortments that we deliver. If we deliver compelling bargains and compelling assortments, and we do that in ladies apparel, and we do it all the other things that satisfy her personally, all businesses and all ships arrive, but I think also when we don't do that in an area as big as ladies, there is potentially some total impact I think the total store, but I think that's very difficult to quantify, but if you think that these are core customer, it will be illogical.

Operator

Your next question is from Bob Drbul from Guggenheim Securities. Your line is open.

Bob Drbul

Hi, good afternoon. I was wondering if you could talk to did weather impact your business at all throughout the quarter, and was there any variation sort of month-to-month, and I guess the last piece you mentioned handbags, but you may be just talking about women handbags and accessories and how that as a category you've seen play out at this point? Thanks.

Travis Marquette

Yes. This is Travis, we don't specifically comment on results month-to-month. Generally speaking, there wasn't a lot of variation. In terms of weather, again, it wasn't a significant impact at all for the quarter. In terms of accessories and performance, again, it performed pretty close in line with the chain.

Operator

Our last question comes from Laura Champine with Loop Capital. Your line is open.

Laura Champine

Should be a quick one on the ladies business, was AUR down more in that category than it was for the company overall?

Travis Marquette

Yes, we don't generally talk about sort of AUR by specific line of business.

Laura Champine

I've got a Plan B. The Midwest region calms better than average. Can you give us a reason why you think it was strongest region in the quarter?

Travis Marquette

Yes, the Midwest has been one of our best performing regions ever since we entered the market many years ago. I think the customers responded well to sort of the values in the product that we offer them, and so we've been very pleased with the performance ever since we entered.

Laura Champine

Got it, thank you.

Travis Marquette

Sure.

Operator

Ladies and gentlemen, this does conclude the Q&A portion of the call. I will now turn things back over to management for any closing remarks.

Barbara Rentler

Thank you for joining us today and for your interest in Ross Stores. Have a great day.

Operator

Ladies and gentlemen, this does conclude today's conference call. Thank you for your participation and you may now disconnect.