Tractor Supply Company (TSCO) CEO Gregory Sandfort on Q3 2019 Results- Earnings Call Transcript

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Q3: 10-24-19 Earnings Summary

Press Release *10-Q*

EPS of $1.04 beats by $0.01 | Revenue of $1.98B (5.45% Y/Y) misses by $-12.72M

Earning Call Audio

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Tractor Supply Company (NASDAQ:TSCO) Q3 2019 Earnings Conference Call October 24, 2019 10:00 AM ET

Company Participants

Mary Winn Pilkington - VP, IR and Public Relations

Gregory Sandfort - CEO

Kurt Barton - CFO

Seth Estep - SVP of Merchandising

Conference Call Participants

Zach Fadem - Wells Fargo

Brad Thomas - KeyBanc Capital Markets

Scot Ciccarelli - RBC Capital Markets

Peter Keith - Piper Jaffray

Simeon Gutman - Morgan Stanley

Peter Benedict - Baird

Matt McClintock - Raymond James

Steve Forbes - Guggenheim Securities

Chuck Grom - Gordon Haskett

Mark Carden - UBS

Seth Basham - Wedbush Securities

Chuck Cerankosky - Northcoast Research

Operator

Good morning, ladies and gentlemen, and welcome to Tractor Supply Company's Conference Call to discuss Third Quarter 2019 Results. [Operator Instructions] Please be advised that reproduction of this call in whole or in part is not permitted without written authorization of Tractor Supply Company. And as a reminder, this call is being recorded.

I would now like to introduce your host for today's call, Ms. Mary Winn Pilkington, Senior Vice President of Investor and Public Relations for Tractor Supply Company. Mary Winn, please go ahead.

Mary Winn Pilkington

Thank you, Vicki. Good morning, everyone. On the call today are Greg Sandfort, our CEO; and Kurt Barton, our CFO. After our prepared remarks, we will open the call up for your questions. Seth Estep, our SVP of Merchandising, will join us for the Q&A session.

Now let me reference the safe harbor provisions under the Private Securities Litigation Reform Act of 1995. This call may be - contain certain forward-looking statements that are subject to significant risks and uncertainties, including the future operating and financial performance of the company. In many cases, these risks and uncertainties are beyond our control.

Although the company believes the expectations reflected in its forward-looking statements are reasonable, it can give no assurance that such expectations or any of its forward-looking statements will prove to be correct, and actual results may differ materially from expectations. Important risk factors that could cause actual results to differ materially from those reflected in the forward-looking statements are included at the end of the press release issued today and in the company's filings with the Securities and Exchange Commission.

The information contained in this call is accurate only as of the date discussed. Investors should not assume that statements will remain operative at a later time. Tractor Supply undertakes no obligation to update any information discussed in this call. In discussing the results of operations, we will be providing adjusted net income and diluted earnings per share amounts that excludes the impact of an executive transition agreement. You can find additional information regarding these non-GAAP financial measures in our earnings release, which is available in the Newsroom section of our website.

Given the time constraints and the number of people who want to participate, we ask that you please limit your questions to one with a quick related follow-up. I appreciate your cooperation. We will be available after the call for follow-up.

Now, it's my pleasure to turn the call over to Greg.

Gregory Sandfort

Thank you, Mary Winn, and good morning, everyone. And thank you for joining us to hear more about our third quarter results.

The Tractor Supply team delivered a strong quarter that was in line with our expectations. I'm very pleased with the way the team balanced sales growth and operating profit margin expansion.

Today, given the investments we have made in technology and tools to grow our business, we are better positioned to capitalize on the trends of our business. Our comp store sales results were driven by broad-based growth across our geographic regions. We drove solid comp sales performance in regions where we had normal or improved moisture to last year.

This was partially offset by comp sales trends that were modestly below the chain average performance in the regions where there was below normal moisture, or in some even drought conditions.

We continue to experience increases in both comparable average ticket and traffic, and we saw strength across our merchandising categories with the strongest sales growth in our spring and summer assortments, accompanied with solid sales growth in our core year round categories.

At Tractor Supply, every quarter can play out differently from the year before as weather patterns, moisture levels, temperatures and even hurricanes will vary across our markets. These conditions will alter demand for products that we sell.

This quarter was no exception, whether it be store operations, supply chain, merchandising or marketing, our teams made the necessary adjustments to serve our customers.

Our supply chain teams did an excellent job managing to the demand of the business. Our ability to capitalize on geographic seasonal trends is a core competency and a strength of Tractor Supply. Overall, I'm encouraged by the underlying health of our customer and our business.

So now let me comment on a few highlights for the third quarter as compared to the third quarter last year. Net sales increased 5.4% to $1.98 billion for the quarter. Comparable stores increased 2.9% in the third quarter, with $0.10 also comping positive. Our comp average ticket increased 2.3%, and transactions grew at 0.6% in the quarter.

Our average ticket growth of 2.3% was positively impacted by our overall retail price management. And our team was nimble and well prepared with a great lineup of merchandise for our customers, both in our stores as well as online.

Gross margin improved 28 basis points to 34.99% despite tariff headwinds. Operating profit margin improved by 2 basis points and on an adjusted basis, improved by 17 basis points. Diluted EPS was a $1.02, and adjusted EPS increased 9.5% to $1.04.

Based upon our performance year-to-date, we have updated our guidance. Our forecast for fiscal year 2019 EPS is now $4.66 to $4.70. And on an adjusted basis, we are maintaining the midpoint of our full-year guidance, while narrowing the range to $4.68 to $4.72 per share.

Now, let's look at several of the operational highlights for the quarter. We opened 25 new Tractor Supply stores and one Petsense location. This quarter included the celebration of our 1,800 Tractor supply store, which is located in Berkshire Township, Ohio. Our selling metrics continue to perform well through our focus on GURA and providing legendary service to our customers.

For the third quarter, our customer experience GURA scores were at an all-time high. This quarter marks our 29th consecutive quarter of strong double-digit sales growth in our e-commerce business, and we continue to experience exceptional growth with our Buy Online Pickup in Store program. This too encourage customers to come into the store to pick up online orders, resulting in about 20% of our customers making an incremental purchase.

Between the combination of our Buy Online Pickup in Store and direct delivery to stores, greater than 70% of our e-commerce orders continue to be fulfilled at our stores. This illustrates the importance of our store assets and their key role in the fulfillment of our e-commerce business. Importantly, this is a cost effective way to serve our customers with greater speed, convenience and efficiency. So when reviewed, we are very pleased with our performance in the third quarter.

And before I turn the call over to Kurt, I would like to update you on the progress of the Board's CEO search. Succession planning is a top priority for our Board of Directors. And as the search is ongoing, we are committed to taking the time we need to select the right leader for the future of Tractor Supply.

In the meantime, I continue to be highly engaged in the business, along with the rest of the leadership team. And when the time comes, I will be here to assist the new leader in whatever way the Board believes will make for the smoothest transitions. This talented team knows retail and specifically knows farm and ranch retail and is committed to winning. I am confident that we will achieve our goal of adding new leadership, while still delivering on our commitments to drive long-term shareholder value.

And with that, I'll now turn the call over to Kurt.

Kurt Barton

Thank you, Greg, and good morning, everyone.

As Greg has taken us through key highlights of the quarter, let me walk you through some of the important financial details, along with our outlook for the remainder of the year.

For the third quarter of 2019, we had solid comp store sales growth of 2.9%. All periods of the quarter were positive, with July and September having the best performance. We started out strong, as the team capitalized on the ideal summer seasonal trends.

As we move through the quarter, hot and dry weather, along with lapping our hurricane benefit of 40 basis points in the prior year, which did not reoccur to the same extent, both impacted our performance.

We exited the quarter with September's performance in line with our expectations from the beginning of the year. We experienced strength in product lines such as animal feed, pet supplies, lawn and garden, riding lawn mowers and hardware. At the same time, our comp store sales growth was offset by softness in UTVs and emergency response categories. These same categories are negatively impacted - negatively impacted our big ticket sales.

Although we had strength in mowers, safes, log splitters and 3-point equipment, our big ticket sales were flat for the quarter as we were lapping above chain average comps in the third quarter of 2018. As we anticipated, new store openings were weighted to the latter part of the quarter and this did have an impact on our overall sales performance.

For the third quarter, gross profit increased 6.3% to $694.2 million. Gross margin had a strong improvement of 28 basis points to 34.99%. The team was highly effective with our retail price management initiatives and global strategic sourcing to manage product cost increases including tariffs.

Our targeted promotions were relatively consistent year-over-year. In addition, we benefited from reduction in freight expense as a percentage of net sales from our supply chain profit improvement initiatives and lower industry rates.

Including depreciation and amortization, SG&A, as a percentage of net sales increased by 26 basis points to 26.8%. The 26 basis point increase was primarily attributable to incremental costs associated with our new distribution facility in Frankfurt, New York, an executive transition agreement, which accounted for about 15 basis points of the increase and to a lesser extent, investment in store team member wages.

These SG&A increases were partially offset by lower year-over-year incentive compensation as a percentage of net sales, as well as leverage in occupancy and other costs from the increase in comparable store sales. Excluding the impact of the executive transition agreement, adjusted SG&A increased by 11 basis points to 26.7%.

Importantly, as Greg mentioned, we had operating margin expansion in the third quarter of 2 basis points and 17 basis points on an adjusted basis. Our effective tax rate increased about 70 basis points year-over-year to 22.2% in the third quarter, as the prior year's rate was favorably impacted by a tax benefit from share-based compensation.

Now to our balance sheet cash flow, we have a strong balance sheet and we continue our track record of generating strong cash flows from operations. At quarter end, our merchandised inventories were $1.81 billion, an increase of about 2.7% on a per store basis from the 2018 third quarter. The increase is principally due to inflation, including the impact from tariffs, as well as growth in fast turning everyday merchandise to support the positive trends in the business.

We're very comfortable with the quality of our inventory. As we enter the fourth quarter, we're well positioned to take advantage of the change of the seasons. We remain committed to returning cash to our shareholders through our share repurchases and dividends, while maintaining a disciplined approach to capital allocation.

We are managing to a leverage ratio of approximately 2 times adjusted debt-to-EBITDAR. Year-to-date, through the third quarter, we have returned $611 million to shareholders through the repurchase of about 4.9 million shares of our common stock for $490 million and quarterly cash dividends totaling $121 million.

Since the inception of our share repurchase program in 2007, we repurchased over $2.95 billion of our common stock. Our remaining share repurchase authorization was approximately $1.5 billion as of the quarter end.

Let's turn now to our guidance. Given our performance year-to-date, we are updating our financial outlook for 2019. For the year, we now anticipate net sales of $8.4 billion to $8.42 billion, comparable store sales growth of 3.2% to 3.4%, operating margin rate of 8.9% to 9.0%, net income of $564 million to $569 million, and adjusted net income of $566 million to $571 million, and earnings per diluted share of $4.66 to $4.70 and on an adjusted basis, earnings per diluted share of $4.68 to $4.72.

Both the adjusted net income and adjusted EPS exclude the after-tax impact of executive transition agreement. We now expect share repurchases of about $525 million to $550 million for the year, compared to our prior guidance of $350 million to $450 million.

For modeling purposes, weighted average shares outstanding are forecasted to be about 121 million shares. We continue to forecast capital spending in the range of $225 million to $250 million for the year, and our effective tax rate is anticipated to be in the range of approximately 22.4% to 22.6%.

Our priorities for capital deployment have been very consistent over the last several years. Our first priority is reinvestments back into the business to support the long-term growth of opening new stores and our ONETractor initiatives.

We are on track to open approximately 80 new Tractor Supply stores and 10 new Petsense stores. And we remain committed to creating lasting value for our shareholders through anticipated quarterly dividends and continued share repurchases.

Now recall, as we enter the year, we had anticipated having our strongest comparable store sales performance in the first half of the year with operating profit margin improvement in the second half of the year. This continues to be our expectation, given our results year-to-date through the third quarter. Being a needs-based retailer, our customers live life out here and as such, seasonal trends could impact our comp store sales performance.

For the fourth quarter of 2019, please keep in mind that we are lapping model or ideal conditions in the prior year, including about a 40 basis point benefit from a hurricane that we do not anticipate to reoccur. Our comparable store sales forecast for the fourth quarter of 2019 anticipates that ticket will be the primary driver of the growth, with transactions being centered around flat, given that we are lapping transaction growth of 2.6% in the fourth quarter of 2018.

We entered this year with confidence about our ONETractor strategy and that we were making the right long-term investments in our business. I believe our results for the third quarter have supported this view, and we are looking forward to delivering a strong performance in 2019 and beyond.

Now, I'd like to turn the call back to Greg.

Gregory Sandfort

Well, thank you, Kurt.

Now let me turn to the progress we're making on our ONETractor strategy, and we remain focused on these four objectives; driving profitable growth; building customer-centric engagement; offering the most relevant products and services; and enhancing our core and foundational infrastructure capabilities.

We are pleased with the traction we're gaining with our key initiatives and specific examples include capabilities such as growth of our Neighbor's Club engagement. The chain-wide rollout of our Stockyard Kiosk and mobile point-of-sale, enhancing our Tractor Supply credit card offering and investments in our supply chain.

As part of our ONETractor strategy, we are actioning the rich customer data we are receiving from our Neighbor's Club loyalty program, and the health of our program continues to be very robust as measured by membership growth, increased penetration of sales, greater frequency and higher average ticket sales by these customers. In addition, our core farm and ranch customer segment continues to be strong in both retention rates and spending.

The Neighbor's Club data allows us to target specific groups based on their frequency in category specific spending. This personalized approach is allowing us to drive engagement and build share of wallet over time with our Neighbor's Club members. The strength of our loyalty program allows us to be agile, all while amplifying our message to customers.

For example, with our recent TSC days promotion, the goal upfront was to support the new Tractor Supply credit card reward program and build customer acquisition in our core year-round categories. With this promotion, we were able to drive significant excitement for our new 5% PLCC rewards offer, growing sign-ups for the card and reinforcing a sense of urgency on the limited time of this promotion. It was just five days.

We were successful in acquiring over 50,000 new cut customers during the event. 25,000 customers that appeared as new to our Tractor Supply file and 25,000 existing Tractor Supply customers that had previously not purchased pet in our stores.

In addition, these new campaigns have things of outreach such as replenishment reminders and post-purchase follow-up for our pet customers. These are just recent examples of things we've initiated across our loyalty program.

We are managing our customer data to not only target our current Tractor Supply customers but also finding new look-alike customers through social media channels. We message to these customers where they are most likely to purchase and the categories that we are targeting. And with our new technology and the use of artificial intelligence, we can optimize individual messages that resonate with each individual customer.

We now have the ability to create relevant and customized messages for our customers and that's transforming our marketing initiatives, and that will improve our overall effectiveness in spend. Our Neighbor's Club membership growth continues to be transformational, and a growing asset to drive brand loyalty.

With a strong one-year retention - with a strong one-year retention rates, our customer feedback continues to be overwhelmingly positive and the rollout of Stockyard kiosks allows us to provide customers with the long tail of product assortment as we have now nearly 130,000 SKUs on our website.

At the store level, the Stockyard kiosks are a proven tool for driving incremental sales. The rollout of these kiosks, along with the expansion of mobile point-of-sale has now been implemented in the majority of our store base.

The Tractor Supply credit card offering supports our ONETractor strategy by driving sales and building loyalty. We continue to see the use of our private-label credit card increase across-the-board, as we offer more compelling financing offers and our data supports the credit card customers that visit our stores more frequently and have a higher average spend.

We continue to invest in the private label credit card program and have enhanced our rewards program to our Tractor Supply credit card holders. Cardholders now are able to earn $5 in Neighbor's Club rewards for every $100 they spend on the card, essentially, a 5% reward. Over time, we anticipate that this will become a key tool to deepen the relationship with our customers, drive loyalty and most importantly, increase our share of wallet.

So now, let me briefly highlight a few merchandising initiatives. From a strategic perspective, exclusive brands are an important part of our overall merchandise offering. Our goal is to provide quality products at a value price across good, better and best segments of our business and to build loyalty with our customers. We have exciting plans for product line extensions, new categories and refreshed packaging across our exclusive brands.

For example, during the third quarter, we introduced a new Workwear exclusive brand labeled Ridgecut. We recognize that we had an opportunity to close the gap on our assortments in the Workwear category. Ridgecut product line is designed for exceptional quality and durability with an outstanding value proposition versus the national brand comparison.

While still early, the Ridgecut brand is exceeding our expectations and it is being well received by our customers who are finding the value and quality of Ridgecut unmatched.

Further exclusive brand initiatives include new SKUs and packaging in our 4health dog food brand, expansion of equine Feed & Treats and an exciting lineup of pet supplies from MuttNation in partnership with Country Music singer, Miranda Lambert. In addition to exclusive brands, we are also committed to offering leading national brands across product categories that are relevant to our customers.

Looking ahead, we are very excited about the national launch of select models of Toro products. They being the leader in the outdoor power equipment sector, this will include for us zero-turn mowers, walk-behind mowers and portable power equipment both in store and online, beginning in spring of 2020.

We are committed to continually growing and investing in our stores and product offerings to meet the everyday needs of this rural lifestyle customer. A similar philosophy drives the Toro Company with its commitment to developing innovative products that help customers increase efficiency and productivity on their land.

Given the shared commitment to customers and overall strategic alignment, this new partnership provides a meaningful opportunity for both companies to strengthen our positions as premier providers of outdoor products.

To wrap up our conversation this morning, with fall coming to an end and the winter season rapidly approaching, we are prepared in store and online with seasonally relevant product offerings to meet our customers' needs. I want to thank the more than 33,000 team members across the company in both Tractor Supply and Petsense for a solid Q3 performance and for the dedication and hard work as they meet the needs of our every day Out Here lifestyle customer.

And with that Mary Winn, we'd now like to open the lines for questions.

Mary Winn Pilkington

Okay. Vicki, you want to five the instructions on the polling for questions?

Question-and-Answer Session

Operator

[Operator Instructions] And we will take the first question from Zach Fadem with Wells Fargo. Please go ahead.

Zach Fadem

So, Greg, there's been a lot of noise out there around macro softness, particularly in some of your farming and manufacturing focus regions. I'm hoping you can clear the air here a little bit. Maybe talk about whether you've seen any disparity in these regions, or if you think any headlines out there around the trade war or other macro factors are having an impact on your business or the consumer in general?

Gregory Sandfort

Zach, I'm going to turn that question over to Kurt this morning, and let him give you some thoughts. And I may follow-up with a comment or two.

Kurt Barton

Zach, hi, this is Kurt. Just as a reminder on the ag economy question, as you've heard from us before, Tractor Supply doesn't serve the production farmers primary needs. For those ag production farmers, we serve their lifestyle needs just like we do with our typical those ag production farmers, we serve their lifestyle needs just like we do with our typical customer. And so as you've indicated, we've recognized and watch closely as well. Yes, we acknowledge, there is pressure on the ag economy overall and you would imagine, as there is less income in that local economy, it would appear to be negative.

As we look at our business today, we're just not seeing that with our customers and those markets. Our core customers continue to be strong. As one example, on the ag economy, in the Midwest region, where there is the heaviest presence of the ag economy for both the third quarter and year-to-date that Midwest region is performing strong and outperforming the average change.

So, we've got a lot to be excited about what we're doing to drive business and meet our customer needs in the ag economy. We'll watch it very carefully. It is important, but at this point for Tractor supply, we're not seeing a real change in the trends.

Zach Fadem

And then considering your margin improvement this quarter, especially on a sub three comp, could you update us on the leverage point heading into 2020? Maybe walk us through the opportunities now that you're cycling some of your investments and the profit improvement initiatives are starting to roll through?

Kurt Barton

Yes, I mean you've hit - Zach, you've hit the key items on there. We continue to believe, as we move towards our long-term targets, our target of growing comp sales at 3% plus over the long term. And with the profit improvement initiatives that we have, the investments that we made in the past are plateauing but yet driving traction in both top line and efficiencies.

We're going to continue with a real strong effort on efficiency and productivity. We believe there is opportunity in labor as well as transportation. And then, of course, the benefits we're getting from the top line, we anticipate with our long-term target of 3% plus that we can see a leverage point around that 3% comp sales.

Operator

We will now take a question from Brad Thomas with KeyBanc Capital Markets.

Brad Thomas

I want to ask about the performance in the big ticket items. Could you talk maybe a little bit about some of the trends from a product standpoint or if weather was an issue in this quarter? And stepping back, maybe you could add a little more color about how the new private label credit card has been performing as you're lapping its big rollout last year. Thanks.

Kurt Barton

Sure, Brad. This is Kurt. I'll take both those questions, big ticket and private label credit card. As far as big ticket, there is a lot about the big ticket category that we really liked during the quarter. The important theme is, it can vary based on seasonal demand shifts.

So specifically in the quarter, we saw strong performance in zero turn mowers, log splitters, safes and 3-point equipment. That was offset by categories such as UTVs and generators. And UTVs are one of the highest big ticket items, also an area that has an impact from tariffs.

Generators, as Greg and I mentioned, the emergency response compares were challenging on the generator side. So when you're lapping prior year's chain average performance of big-ticket, higher than the overall performance third quarter last year. When you look at the core of it, a big ticket was still pretty strong, private label credit card continues to give us more leverage in driving big ticket.

As far as private label credit card, as Greg mentioned, all metrics are showing strong performance, meaningful growth in applications, our open accounts and our tender up strong double-digit growth, and we're very excited to see a step-up in a lot of those metrics since the launch of our 5% reward.

So, we'll continue with this initiative. We've said, it's a multi-year initiative, and we're very excited about what it can do to drive integration with our Neighbor's Club and overall drive both loyalty and sales.

Operator

And the next question will come from Scot Ciccarelli with RBC Capital Markets.

Scot Ciccarelli

So, I know you had - hi. I know you guys had to cycle some pretty meaningful tailwinds from hurricanes, not just in 2018 but also 2017. How do you guys kind of - and again, there's always weather volatility, but do you kind of include that when you're thinking about what a more normalized comp would be, i.e., you would add back kind of the 160 basis points, 180 basis points of tailwind that you had over the last two years. ?

Kurt Barton

Yes. Scott, this is Kurt. Yes, we do. We consider both of those. In regards to the hurricane, I'll just frame-up the year-over-year comparison on hurricane. Dorian was less of an impact this year than Florence was. As you know, Dorian did not actually hit land and we saw some preparedness response with Dorian. But unlike last year, we didn't see the post follow-up that you get on impact. And we called out last year that Hurricane Florence was about a 40 basis point benefit to us.

Net year-over-year between the two, we look at it, is about a 10 basis point to 20 basis point headwind on the comp. But your point about the hurricanes over the last few years, it is important to look at that and we recognize that as well. Because when you look at a three-year stack and in 2017, we had two strong hurricanes in third quarter.

The challenge overall and comparison on it was greater than that. And we do take that in consideration, did in our guidance, and I think it's healthy to look at that when reflecting on the real core of the business.

Operator

We'll go to Peter Keith with Piper Jaffray.

Peter Keith

I wanted to dig into pet food category. So in early July, the FDA had announced that certain grain-free dog food could be linked to heart disease and there were 16 brands listed including 4health. We know that you didn't call out pet food as an outperforming category during the quarter. So, I'm curious if this announcement from the FDA had any impact on your pet business and maybe is there any risk of future trade down out of grain-free or even trade out from 4health?

Seth Estep

Peter, this is Seth. So, yes, when we look at the overall pet animal business, looking back on the quarter, we're actually really pleased with the overall performance. Specific to pet, post that announcement, we really saw a trend similar to some of the things that you're seeing in the industry overall.

What we were seeing a little bit of shift out of some of the holistic natural grain-free products and into more of the pet specialty science-based formulations. But what we were able to do and what we're seeing in our database is that we're able to capture that customer with the broad portfolio that we have within our box today.

And utilizing category management as well, we're able to really respond with our shelf presence quickly to make sure that we continue to grow - to grow market share there. Relative to 4health, you mentioned that was obviously mentioned in the FDA announcement as well. One note with 4health, our original 4health lineup, which continues to be the largest segment of 4health is the formulations with wholesome grains. We are seeing a little bit of shift out of our grain-free SKUs and into the original 4health lineup.

But one of the things that you will see is a response, because we have been monitoring trends over time. Actually, even in the course of the next couple of weeks, you'll continue to see new formulas of 4health being launched. You're going to see new pack sizes. Most of those tailored around that original lineup of 4health. And we really look at 4health as a key differentiator continuing going forward to really drive and protect our pet food business. So overall, happy with the performance.

Peter Keith

I did want to ask a related follow-up on pet food. So, you guys ran the Buy One Get One 50% Off promo at the end of the quarter. I guess, Tractor Supply is not known as a company that runs promos late in the quarter to get sales. Greg, you had talked about this being a great traffic driving event. So, my question is there is investor concern out there that maybe you guys pulled forward sales out of Q4 with pet food. But I guess is your rebuttal on that is it, you feel you've acquired a number of new pet customers that this promo was ultimately a good success?

Gregory Sandfort

Yes. Peter, it was designed to do two things. One was, it was a - an event that really comped an event from a week earlier. So, we really changed the constitution of the event and said, you know, last year's event was good, but how can you refresh it? So, we refreshed it. We also tied it into the launch of the 5% back or the $5 for every $100 with the cards. So, we felt like we had a much more compelling offer. So, we shifted both things to latter part of the quarter.

And as we ran that promotion, we tightened up the number of items that were going to be in the promotion as well. We went from an eight-page to a four-page. We really consolidated down and said, let's put more effort behind fewer things and see if we can drive footsteps and also increase our penetration on the card. And it worked out beautifully. It played out exactly the way we wanted and we were very happy with the results. So, it was not an additional event by any means. It was just a different way of repackaging an event that was a week earlier from last year.

Operator

Next to Simeon Gutman with Morgan Stanley.

Simeon Gutman

The question is on gross margin. In the press release, you mentioned price management, which I assume is, I think the same price optimization program you've been doing for a long time. But it was prominently called out this quarter as a gross margin driver. Can you quantify how much it's helping gross margin. And then to what extent, is it driving comp through higher prices?

Kurt Barton

Simeon, hi, this is Kurt. Let me just address gross margin and I think it will answer your question. For gross margin, I'd package it as this. There is really three key drivers that I want to point to and price management was the primary one.

As far as price management, team has done a great job balancing market share and margin. And we've really advanced in these tools over the last year or so. And what the team is able to do is with price management, balance between both merchant across merchandise categories, as well as geography to get the most optimal retail price for market share and margin. Then combining into that is the price intelligence tools that we've invested in, allowing us to monitor the competitive pricing as well as gauge elasticity.

So, our ability to leverage all of that today to make sure that we're capitalizing on sales and margin is really been a key factor. And so of the drivers for gross margin, first one, price management is probably the most significant. Second one would be the freight expense benefit that I referred to.

And then third on gross margin. We are seeing gross margin benefit from some of the investments we're making in supply chain. And we don't speak as often to that, but with the investments in supply chain, which are in our SG&A, being new mixing centers.

The new distribution centers and import transload centers gives us the ability to reduce stem miles and actually go after new strategic sourcing opportunities with lower pricing. And so there is a little bit of geography trade-off there. So, those are the three real things that the - the merchandising and supply chain did an excellent job to drive both top line and gross margin.

Simeon Gutman

And the related follow-up. I assume there isn't an end in sight for this price optimization or price management continues to be a bigger driver. And in that point you made earlier about leveraging around a 3% or 3% plus, is gross margin the bigger of the levers or is SG&A?

Kurt Barton

Yes. There's - first, I'd say on the pricing tools, it continues to evolve and we've got a lot of runway ahead of us. And I think every year can be different on - the answer on the operating margin. But one important thing to always remember is the investments we'll be making in our supply chain puts a little bit of a headwind on SG&A. We recognize, that drives initially some benefit in gross margin and that will be part of our investment over the next couple of years. So, you will see that.

Operator

We'll go to Peter Benedict with Baird. Please go ahead.

Peter Benedict

Greg, I guess a question for you, with Steve's departure, just can you speak to any areas of need you think you have within the leadership team at this point? And then as the Board is conducting the CEO search, any color on kind of what precisely they're looking for in terms of a new candidate? That's my first question.

Gregory Sandfort

Yes. Let me - Peter, let me address, first, your question about need. As you probably know, there were a number of things that I had passed on to Steve, probably a good 18 months or so before the decision was made that he was not the candidate.

And so that's really just - kind of send it back to me. I'm having a lot of fun with it, to be very honest with you. Even I've got a lot of direct reports. It's a lot of fun to be - to have both feedback into the business and such. And it's been a really good for me and good for the team, to be honest.

So, there is really no gaps. I've filled the gaps. I've also got Seth here and others, a bunch in this group. As you know, they're very talented merchants, very talented marketers, good team in general and we're moving forward. So, that's addressed that.

The second piece here is what's the Board really looking for? Yeah, there is a lot of emphasis out there today on how you're using data and using information differently to drive your business as a retailer.

And I think some of the things that we talked about as a Board, I'm being a part of that Board is, can we find someone that has some deep background there, that has spent some time maybe in that space, also is crossed in between physical retail and digital retail and can combine those two together to bring more to the table here at Tractor and help us accelerate that side of the business.

But as I said, this is the highest priority for the Board right now. We're not in any big rush. We are making sure that we're doing the due diligence to find the right leader for this company. We want this to be a very seamless transition. I am committed to stay here as long as I need to be to make sure that, that transition goes well. We have responsibilities to our shareholders, the investment community, the company at whole. And I'm going to make sure we do this right.

And as I said, it's really business as usual, maybe us pushing a little harder right now. It's tough kind of jump back into that, that component, but I'm feeling very good about the process and where we are.

Peter Benedict

And then maybe, Kurt, one for you. You did a nice job kind of speaking to some of the dynamics that drove last year's strong comp in 4Q. It sounds like most of that was kind of earlier in the quarter, I think about the storms, the timing of cold weather or whatnot. And is it safe to say that, that the toughest comparisons are early in the quarter and then ease up as you move through? That's my last question.

Kurt Barton

Yes, Peter, you framed it up well. Last year's strength in the comp was earlier in the quarter and it had early cold weather that drove solid performance. So the cadence of the back half could be a bit different. And so implied in our guidance is about a 2.0% to 2.5% range for fourth quarter.

And the cadence between weather and even thinking about when Thanksgiving lands and the amount of weeks between Thanksgiving and Christmas, Seth and Christi continued to optimize marketing. I would tell you that cadence could be very different year-over-year, but we feel confident about the guidance we've given to land a solid comp in the range of 2% to 2.5% in the fourth quarter.

Operator

We'll go to Matt McClintock with Raymond James.

Matt McClintock

This one is probably for Seth or maybe just Greg. I wanted to focus on merchandising for 2020. There is a lot of investors out there that just don't seem to have visibility into what merchandising levers you can pull in 2020 to sustain comps in the 3% plus range. And Greg, you talked about Toro and how it can be meaningful. Could it be meaningful in 2020 to total sales? And then lastly on Toro, is this the start of an acceleration of? Should we see more strategic partnerships with brands as we progress over the next couple of years? Thanks.

Seth Estep

Matt, this is Seth. So from the core merchandising philosophy perspective, as merchants, we are always out there looking for what leading brands and what partnerships can we go after, that can be extremely meaningful to our customer base and the lifestyle that we serve. So specific to Toro, going to your question there, we already felt that we had one of the leading, call it, outdoor power equipment lineups in the industry.

And being able to go out and partner with Toro, which is the leader when you think about the zero-turn and large acreage. We look at it as nothing but cementing us as, call it, the leader in the industry as we go here, that can have a comp impact specifically, as well as leader in the industry as we go here, that can have a comp impact specifically, as well as 2020 and beyond, as we continue to partner together.

The other thing we look at a partnership such as this that we will continue to go after, is finding ways to drive key differentiation, specifically against farm and ranch and other competitors that are out there. Other things we look out to 2020 in key comp drivers outside of just driving newness, exclusive brands, we'll continue to go after and continue to drive a lot of newness across the four walls and exclusive brands.

Greg mentioned Ridgecut earlier, but we also are doing a lot of things in our livestock feed, in our pet world, where we are going to be driving new portfolios and our do more line of goods as well as adding new product line up. So overall, I would say yes to the standpoint of we're always looking out there for new strategic partnerships, where they would be meaningful to us as an organization and be able to drive key differentiation.

Operator

We'll go to Steve Forbes with Guggenheim Securities.

Steve Forbes

I wanted to focus on the abnormally dry weather across the lower states, where I think you sort of mentioned it in the prepared remarks, moisture versus non-moisture. But we think about maybe the last month of the quarter or versus the quarter as a whole, can you provide some additional color on the 3Q comp performance in the drought-exposed states versus those that are not?

Kurt Barton

Yes, Steve, and this is Kurt. In those conditions, the key is being nimble and reacting to the change in the shift in demand. And in the month of September, the merchandising and operations team supply chain partnered well. The key there is to transition to what's needed. And what really sold was C.U.E. items like feed and forage, cooling being fans, anything that moves water. Those are the areas. To be in stock and dependable at the end of the season like that is key for us.

And it's another example coming in or out of seasons why Tractor Supply chain and merchandising strength is helping us capture sales when it might not be the most ideal. So, those conditions weren't perhaps as ideal as solid moisture, which was there last year, but we're able to capitalize and actually produce a comp sales right in line with our expectations by shifting and being nimble.

Steve Forbes

And then just a quick follow-up on that topic, right, you called out cycling the - I think it's a 40 basis point tailwind, hurricane-related tailwind in the fourth quarter, but is there any drought impact in the fourth quarter implied comp guide as well?

Kurt Barton

Not specific to drought. I mean, fourth quarter is really about fall, winter. And temperature might be the primary factor that you think about when you're planning for and reacting to the fourth quarter.

Operator

And we'll go to Chuck Grom with Gordon Haskett. Please go ahead.

Chuck Grom

Obviously, comp duration is pretty important. As we look ahead to 2020, I'm wondering if you guys could just sort of force rank for us all the drivers that you have in place, the Stockyard, the loyalty card, credit card, online and some of the new product categories. And then, in the past you've talked about doing some remodel activity. Just wondering if that's on the table for next year. Thanks.

Kurt Barton

Yes, Chuck. This is Kurt. I think I heard what are the - what are the comp drivers going forward beyond 2019. Is that correct?

Chuck Grom

Yes, that's right.

Kurt Barton

Okay. Well, I mean, the focus is really continues to be right now, the ONETractor strategy, early in a lot of the phases and a lot of runway in there. So, our ability to drive additional market share and spend with our customers, Neighbor's Club, private label credit card and what we're doing with our omnichannel business, those complement everything Seth and the team are doing to drive additional new products and brands and creating new theater and strong complement of both national brands and exclusive brands. Those are really the primary drivers that will continue to deliver additional strength and competitive advantage for Tractor Supply in 2020 and beyond.

Gregory Sandfort

Chuck, let me add one thing. It all starts with the product and our customers rely on us to have the things that they need in stock when they make use of the trip to us physically or when they shop with us online. So if you think back to the ONETractor strategy, it was all built around the - having - building the capabilities to be able to meet that customer's needs as Kurt said earlier, when they need the product and it is different by quarter. It's different by year.

But what we built into this company now is a supply chain that has that nimbleness and ability to move within the 49 states that we do business and address those customers' needs in a way that most of our competition can't.

So, it is really an incredible part of the business. It's the strength of ours and it really all starts with having the product when they need it, the price they expect and meeting their demands because they are going to be different year-to-year and that's not easy stuff. It's difficult to do, but we've been able to accomplish that.

Chuck Grom

And then just as a follow-up. I mean, a lot made today about potential recession and so I'm curious when you look and rewind back to 2018, just wondering what the early indicators were back then in your business. People talked about some trade-down in the private brands. Just wondering what happened for you back then. And I don't think we are seeing anything in the comps position of the basket or in trip frequency that's giving you any early signs that, that something could be on the comps? Thanks.

Gregory Sandfort

Chuck, let me give you a little insight as to what we look for. Back in the former recession, what we noticed early on, was a change in purchasing patterns. Customers not making as many trips to the store, number one. Number two, we saw them instead of buying a premium product and I'll call it national branded feeds. We saw them shifting back into our brands and feeds because they were a better value.

We're not seeing any of that right now. We're not seeing any change at all the. The actual customer count and our transaction count and average transaction was up almost $1 this quarter. So, we are very pleased with, call it, the core business of our company looks, and this core customer looks to be very much intact.

So, I don't - we're not seeing any indications at this point of any slowdown from that standpoint. And again, I think if there is something on the horizon, it will look a little different probably than last time, but we will see the indicators first and we will be the first to share them with you.

Operator

We'll go to Michael Lasser with UBS.

Mark Carden

It's actually Mark Carden on for Michael Lasser today. Thanks a lot for taking the questions. Can you guys speak to your store growth potential and if there's been any change in your mindset here? Thanks.

Kurt Barton

This is Kurt. Store growth potential continue to be consistent with what we've said. We evaluate this, monitor it routinely. We're targeting that domestically 2,500 stores and our cadence is - has been consistent. And at this point, we continue to plan to reinvest in new store growth at a consistent pace, along with investing in our existing stores to continue to drive value and sales out of the existing box .

Mark Carden

And then traffic growth slowed a bit on a two-year stack. Can you guys talk a bit about what's been driving that and how much of its weather related, and then any comments on the outlook for commodity inflation? Thanks.

Kurt Barton

Okay. So, I'll take those. On the traffic, the important factors, we're lapping strong traffic comps over the last couple years in the third quarter. And then hurricane, as I mentioned, which didn't reoccur at the same extent, hurricanes drive traffic and they drive it pre and post. And so when you think about the traffic patterns there, there is a headwind in there.

And so year-to-date, nine months in, we have a solid traffic growth of 1.1%. And there is, as I mentioned earlier on a question, every quarter could be a bit different and hurricane in some of the weather patterns had a bit of an impact on the level of traffic comp in Q3.

As far as commodities, looking ahead, I'll just mention for commodity base, year-to-date, and I would expect this to be very similar for fourth quarter. We're seeing net modest commodity inflation. And that's one of just several factors that play into the average ticket.

Addition to commodity-based impact, we're seeing broad-based cost increases in the product input costs. That's either manufacturing cost increases or pass-through of tariffs. So the ticket price reflects those three things; the commodity influx, the broad-based product costs, as well as retail price adjustments that we make for direct import tariffs that we're incurring.

Operator

We'll go to Seth Basham with Wedbush Securities.

Seth Basham

I have a follow up on the average ticket question. If you wouldn't mind giving us a little bit more color, Kurt, on the impact of tariffs on the comps this quarter and then followed by any impact on the margin rate.

Kurt Barton

Sure. So the level of cost increases, I just mentioned, last one is a balance of those three things. And the ticket is pretty well balanced in this quarter between product mix and cost increases, and tariffs are just a piece of that. So trying to split out the exact level of tariffs, I'd just say it's generally in line with our expectation and of the cost increases, it's one of about three factors. And as we've mentioned in the past, we have, 10% of our products are direct import.

Seth Basham

As it relates to direct import and exclusive brands, we saw second quarter of a tick down in the mix of products or sales in those categories. Are you intentionally shifting sourcing away from those areas or how should we interpret that?

Seth Estep

Yes, this is Seth. No - so we have an entire team, obviously, really focused and dedicated on exclusive brand sourcing. Some of the things that we are doing, I mean, we are fully dedicated to our strategic sourcing initiatives. But some of the things that we are doing based off the tariff environment, we have shifted some things back domestically as well to other countries where we find opportunities.

That first and foremost can meet our quality expectations and meet the standards of our exclusive branded product. Give you example of one product, an example even this past year you think about to your point Q2, historically, we have been 100% direct import on barn fans.

And this past year, we found a domestic source of supply in Texas that allowed us to have some land cost efficiencies and mitigate tariff impacts and actually let us be more responsive to the business throughout the quarter. So, we'll continue to work on a strategic sourcing initiatives. But we'll continue to drive our exclusive brand piece there as well.

Seth Basham

Thank you.

Mary Winn Pilkington

Vicki, I think we've got time - one more question, please.

Operator

And that will come from Chuck Cerankosky with Northcoast Research. Please go ahead.

Chuck Cerankosky

Greg, I want to talk a little bit about storing. Your mentioned you've got over 1,800 store in Ohio, where we already have a lot of stores. What kind of informs the store location decision? We already have a fairly dense footprint. And then, what are you doing with regard to store relocations as you manage the store base in the US?

Gregory Sandfort

Okay, Chuck. Let me break that out for you a little bit to say that. Number one, there is a model that we use for store location and it is very robust. That has about 60 inputs. It has been refined four time since I've been here at the company. And if you place a store, what the model tells you to place a store, it performs and it typically either achieves or overachieves its pro forma expectations.

So it's a very sophisticated model. It also has, like I said, many inputs, and that helps us look at not only putting a store, maybe in an area where there may be other stores, but possibly wanting to take a little bit of the pressure off of some higher-volume stores through some cannibalization that's intended to do just that.

Ironically, when we do those things, we find that over a period of several years, the stores that we intentionally cannibalized seem to reach back to a fairly normal level, maybe the prior level where they were. And now we've just taken and added another $3 million or $4 million worth of volume in that same market. We've grown the market. So, there is a lot of time and effort that's put into choosing a store location.

The second thing is, as far as relocations, we don't do as many of those year-to-year, as we probably are doing new stores now. But if you look at the retail market within a certain geographic space, we're replacing a store.

Sometimes in some of these small communities, the retail sector for the retail path will shift from east to west or north to south in a small town. And one of the reasons we like to lease our locations versus purchase them is because it gives us the ability to be able to move that store when those types of things happen.

I'm not going to be sitting with basically a piece of real estate that has no value. So, we'll probably do less than 10 to 12 relocations a year. Most of those are those types of movements. Sometimes it may be one town over from where we were, but generally right now, we're still putting in new store base, still adding as I said, the use of the model and very pleased with the continued performance of the new stores.

Chuck Cerankosky

And thank you for that. And lastly, Kurt called out reduced transportation costs. Is that a function in some part of the new distribution center in New York State? Or is that facility still a bit of a drag on the margin?

Kurt Barton

Chuck, this is Kurt. When it comes to transportation, freight costs, the team is hitting on all three metrics that they focused on this year. They are reducing stem miles and the new distribution helps with that, reducing domestic carrier rates and increasing the inventory value per load. Those are the three primary reasons and drivers of reduced freight expense. Yes, the new distribution center costs has a bit of an impact on SG&A. But freight expense, they're hitting on all metrics.

Mary Winn Pilkington

Thanks a lot. So that wraps up our call. Thank you for joining us today. We look forward to having you join us on our next quarterly earnings call in January of 2020. I will be around for Q&A. And we thank you for your interest in Tractor Supply.

Operator

Thank you very much. That does conclude our conference for today. I'd like to thank everyone for your participation and you may now disconnect.