Corrected Transcript

19-May-2016

Dick's Sporting Goods, Inc. (DKS)

Q1 2016 Earnings Call

CORPORATE PARTICIPANTS

Anne-Marie Megela
VP-Treasury Services & Investor Relations

Edward W. Stack
Chairman & Chief Executive Officer

Andrè J. Hawaux
Chief Operating Officer & Executive Vice President

Teri L. List-Stoll
Chief Financial Officer & Executive Vice President

OTHER PARTICIPANTS

Robert F. Ohmes
Bank of America Merrill Lynch

Seth I. Sigman
Credit Suisse Securities (USA) LLC (Broker)

Kate McShane
Citigroup Global Markets, Inc. (Broker)

Simeon Ari Gutman
Morgan Stanley & Co. LLC

Christopher Michael Horvers
JPMorgan Securities LLC

Stephen Tanal
Goldman Sachs & Co.

Michael Louis Lasser
UBS Securities LLC

Sam Poser
Sterne Agee CRT

Michael Baker
Deutsche Bank Securities, Inc.

Camilo Lyon
Canaccord Genuity, Inc.

Christopher Svezia
Susquehanna Financial Group LLLP

Patrick G. McKeever
MKM Partners LLC

Peter S. Benedict
Robert W. Baird & Co., Inc. (Broker)

Lowell Wayne Hood
BMO Capital Markets (United States)

Scot Ciccarelli
RBC Capital Markets LLC

Mitch Kummetz
B. Riley & Co. LLC

Paul Swinand
Morningstar, Inc. (Research)

Joseph Isaac Feldman
Telsey Advisory Group LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the DICK'S Sporting Goods First Quarter Earnings Conference Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note, this event is being recorded.

I would now like to turn the conference over to Anne-Marie Megela, Vice President-Treasury and Investor Relations. Please go ahead.

Anne-Marie Megela
VP-Treasury Services & Investor Relations

Thank you. Good morning, and thank you for joining us to discuss our first quarter 2016 financial results. On today's call will be Ed Stack, our Chairman and Chief Executive Officer; Andrè Hawaux, our Chief Operating Officer; and Teri List-Stoll, our Chief Financial Officer.

Please note that a rebroadcast of today's call will be archived on the Investor Relations portion of our website located at DICKS.com for approximately 30 days. In addition, as outlined in our press release, the dial-in replay will also be available for approximately 30 days.

During this call, we will be making forward-looking statements, predictions, projections, or other statements about future events. These statements are based on current expectations and assumptions that are subject to risks and uncertainties. Actual results could materially differ because of factors discussed in today's earnings press release and the comments made during this conference call and in the Risk Factors section of our Form 10-K, Form 10-Q and other reported filings with the Security and Exchange Commission. We do not undertake any duty to update any forward-looking statements.

We have also included some non-GAAP financial measures in our discussion today. Our presentation of the most directly comparable financial measures calculated in accordance with generally accepted accounting principles and related reconciliations can be found on the Investor Relations portion of our website at DICKS.com.

I will now turn the call over to Ed Stack.

Edward W. Stack
Chairman & Chief Executive Officer

Thank you, Anne-Marie. Good morning. For the first quarter of 2016, we are pleased to deliver EPS of $0.50 per share which is the high end of our guidance. Comp store sales were plus 0.5%, the midpoint of our range, and total sales increased 6.1%. Our eCommerce business grew to 9.2% of sales in Q1 from 8.5% in the same quarter last year and sales increased 15%.

We continue to be on schedule to relaunch DICKS.com on our own Web platform in January 2017. We launched Golf Galaxy on this platform in March of last year and Field & Stream this past October. We're quite pleased with these sites and their performance from both the technology and sales standpoint. To remind everyone, once we move DICKS.com to this platform in 2017, we expect our consolidated operating margins to increase approximately 30 basis points.

We continue to support initiatives to increase productivity in our stores. Two key areas of investment are footwear and our own product development. At the end of Q1, we had 52 new full service footwear decks in place. To-date, early sales are encouraging, and Andrè will provide an update on the buildout in a moment. We are also very focused on our product development. We have seen an increase in this business in Q1 of this year versus Q1 of last year. Our CALIA line of women's athletic apparel remains on track to be the number three women's athletic brand in our company by the end of the year, and it was number three in Q1 of this year. We continue to expand our proprietary products such as adidas Baseball, Field & Stream, Umbro Soccer, Top-Flite, Maxfli in our golf area along with Quest in the outdoor area.

We expect this to be a $1 billion business for us over the next few years with margin rates of 600 basis points to 800 basis points higher than the brands they replace. During the quarter, our golf business was positive with Golf Galaxy generating comps of 1.7% and the DICK'S business performing slightly better. The outdoor category was positive despite a decline in hunting. Our apparel business was below expectations and below last year.

Lastly, I'd like to talk about the marketplace. There's a lot of activity in the sporting goods landscape right now. The long-awaited consolidation is taking place. Over the past several months, City Sports in Boston has liquidated. Sport Chalet has announced the closing of all of their stores. The Sports Authority is in the midst of liquidating and closing their 400-plus stores, and others are evaluating strategic alternatives. Although it's a mess, it's a great opportunity for DICK'S Sporting Goods.

This environment will likely put short-term pressure on our business. There are over 200 stores within 5 miles of a DICK'S store that are closing and liquidating and over 350 stores within 10 miles of a DICK'S location. Once this consolidation works its way through the system, we are poised to pick up significant market share. We're in the process of executing plans to ensure a meaningful portion of this market share comes to DICK'S Sporting Goods. Although there will be some short-term pain during this process, we're pretty excited about the long-term future of our stores and our business online.

We also have a very strong balance sheet with no long-term debt to help us through the consolidation process. Last year, we generated over $640 million in cash from operations, produced approximately $730 million in EBITDA and returned over $420 million to our shareholders through share repurchases and dividends. We also have continued to invest both online and our store experience with increasing investments from our key vendor partners such as Nike, Under Armour, adidas and The North Face.

I'd like to thank our over 30,000 associates who have worked so hard to help ensure that DICK'S is not only a survivor of this consolidation but continues to lead this industry. Thank you to all of them.

I'd now like to turn the call over to Andrè.

Andrè J. Hawaux

Chief Operating Officer & Executive Vice President

Thank you, Ed. As we've previously discussed, one of our growth strategies is opening stores in new and underpenetrated markets. When opening in these new markets, we see our eCommerce sales typically double. Our new stores also deliver very attractive unit economics, on average generating an approximate 50% cash-on-cash return in year three.

In the first quarter, we opened three new DICK'S stores, with two of them in brand new markets. We also relocated three DICK'S Sporting Goods stores to more attractive retail nodes and opened two new Field & Stream stores. During the second quarter, we expect to open approximately five new DICK'S stores and relocate two DICK'S stores.

In total, for 2016, we expect to open up approximately 36 new DICK'S stores and relocate approximately nine DICK'S stores. We also expect to open approximately two new Golf Galaxy stores and nine new Field & Stream stores with all but one in the combo store format.

As Ed mentioned, one of the ways we are driving productivity is through our new premium full service footwear decks, and the early sales results are encouraging. The enhanced customer experience is being supported by investments in store payroll, associate training, and technology and importantly will include a broader assortment of brands and styles. At the end of the first quarter, we had 52 new premium full service footwear decks online. We expect to have approximately 124 in place by the end of Q2, in time for the critical back-to-school season.

The remaining 54 will be in place in time for holiday, bringing our total to approximately 180 premium full service footwear decks. Beginning in July, these stores will have a meaningfully broader assortment not readily available at DICK's Sporting Goods.

I'll now turn the call over to Teri to review our financial performance in greater detail.

Teri L. List-Stoll

Chief Financial Officer & Executive Vice President

Thanks, Andrè. Good morning, everyone. Beginning with our first quarter financial results, consolidated sales increased 6.1% to approximately $1.7 billion. Consolidated same store sales, which includes all banners both online and in-store, increased 0.5%, within our guidance of flat to up 1%. Within this, DICK'S Sporting Goods omni-channel same store sales increased 0.4%, driven by a 1% increase in sales per transaction and a decline in traffic of 0.6%. Golf Galaxy omni-channel same store sales increased 1.7% and our eCommerce business grew 15%.

Gross profit for the first quarter was $496 million or 29.86% of sales, down 10 basis points year-over-year. Within this, merchandise margins expanded. However, this improvement in merch margin was more than offset by occupancy and an increase in shipping expenses as a percentage of sales due to the growth of our eCommerce business.

SG&A expenses were $399 million for the quarter. This is 24% of sales, deleveraging 96 basis points from the first quarter of last year. This deleverage was primarily driven by higher store payroll costs, as we continued to invest to enhance the shopping experience within our stores, as well as higher administrative payroll and related benefit costs to support our planned future growth initiatives. We delivered earnings per diluted share of $0.50, which is at the high end of our guidance of between $0.48 and $0.50.

Now looking to our balance sheet. We ended the first quarter with approximately $92 million of cash and cash equivalents and $158 million in borrowings outstanding on our $1 billion revolving credit facility. This compares to $51 million outstanding at the end of the first quarter last year. The increase is a function of returning capital to our shareholders and our continued investments in our growth.

Total inventory increased 7.3% at the end of the first quarter of 2016 compared to the first quarter of 2015, slightly higher than the 6.1% sales growth in the quarter. This delta between inventory and sales growth is primarily made up of the cold weather merchandise that was packed away for the 2016 winter season.

Now turning to our first quarter capital allocation. Net capital expenditures were $73 million or $89 million on a gross basis. Additionally during the quarter, we paid dividends of $17.6 million. We also completed share repurchases of $50 million at an average price of $46.81. Since the beginning of 2013, we've repurchased approximately $863 million of common stock, and we have approximately $1.1 billion remaining on our authorizations.

Now, turning to our outlook for the remainder of 2016. As we've indicated, 2016 is an important investment year for us. First, we are continuing to invest in eCommerce as we transition to full operational control in January 2017. Second, we're partnering with the United States Olympic Committee and Team USA in a way that will have a far-reaching impact on our brand. And lastly, as Andrè described, we are elevating the footwear business in our stores. We estimate these strategic investments will have an approximate $50 million to $55 million impact on earnings before taxes in 2016.

Additionally, based on the expectation that TSA, Sports Authority, will liquidate all 400-plus stores and Sport Chalet will be closing and liquidating all of their 48 stores, together removing over 20 million of square feet from the market, our short-term results could vary widely. We believe TSA will be running a liquidation event through all of the second quarter and through the back-to-school portion of the third quarter. Importantly, as Ed described, we remain confident in our ability to capture the displaced market share and to strengthen our leadership position. This current market consolidation and the strategic investments we're making will benefit our business for many years to come.

Due to the liquidation pressure of Sports Authority and Sport Chalet in the near term, for 2016, we are lowering our full-year guidance and now expect earnings per diluted share of between $2.60 and $2.90. We expect consolidated same store sales to be in the range of negative 1% to positive 1%. Operating margin is expected to decrease year-over-year driven by SG&A deleverage, as we make strategic investments in our business. This will be partially offset by an expected increase in gross margin. Although painful in the short term, we see this industry consolidation as an opportunity over the long term.

Net capital expenditures for the full year of 2016 are expected to be approximately $230 million or about $420 million on a gross basis. 2015 net capital expenditures were $204 million or $370 million on a gross basis.

For the second quarter, we anticipate earnings per diluted share of between $0.62 and $0.72. Consolidated same store sales are expected to be in the range of negative 4% to negative 1%. Operating margin is expected to decrease, driven by SG&A deleverage and a slight decline in gross margin. Again, this guidance is heavily influenced by the liquidation activities taking place over the next quarter and a half or so.

This will conclude our prepared comments. We appreciate your interest in DICK'S Sporting Goods. Operator, please open the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. [Operator Instructions] And your first question will come from Robby Ohmes of Bank of America Merrill Lynch. Please go ahead.

Robert F. Ohmes
Bank of America Merrill Lynch

Q

Oh, thanks for taking my question. Ed, I actually had a broader question for you. I was hoping, given the outlook for The Sports Authority banner to go away and signs of pressure from other of your competitors, could you talk maybe more generally about how your key vendors are thinking about DICK'S Sporting Goods and where DICK'S Sporting Goods fits in for them over, say, the next 5 years to 10 years? And could you link into that your dot-com business versus your store growth potential over the long term? I know it's kind of open-ended, but there's a lot going on and I think it would be helpful to all of us. Thanks.

Edward W. Stack
Chairman & Chief Executive Officer

A

Sure. Thanks, Robby. How the vendors are thinking about us is, I don't think significantly different than they have been thinking about us, which they continue to make meaningful investments in our business. You can see the investment that we're making in the footwear platforms and what we're doing with Nike there. What we're doing with Nike, Under Armour, adidas and The North Face in our stores.

We continue to work with these brands very closely. I think that they really look at us as the future on the wholesale side of their business, which will continue to be very important. Although a number of brands have – they talked about what they're doing from a DTC standpoint, they also talked about a meaningful part of their growth is going to come from the wholesale side of their business, and we're an important part of that wholesale side of their business.

From a dot-com standpoint, we continue to think that there's great opportunities for us to continue to grow our dot-com business. As we move to the platform, our own platform, it will give us a lot more flexibility than we have right now, and based on what's going on in the marketplace that Teri indicated and that I've indicated, there will be some short-term pain but there's an awful lot of opportunity out there for us with this consolidation that everybody knew was going to come but just wasn't sure when. And it all seems to be coming at relatively the same time. So, it creates a big opportunity for us, and we continue to work with these brands and they continue to be very helpful and invest with us.

Robert F. Ohmes
Bank of America Merrill Lynch

Q

And Ed, should we – you aren't acquiring anything from Sports Authority we know of, so far, I mean, but should we assume that we shouldn't expect you to make regional acquisitions potentially in the future, or how – or does this environment make it easier for you to do some regional acquisitions?

Edward W. Stack
Chairman & Chief Executive Officer

A

Robby, I don't think – I mean it's been kind of well-chronicled that we've talked – we were at the auction for TSA, and we talked about a very small group of TSA's assets. And whether we end up doing this or not, it's hard to say. It's really inconsequential with what we're looking at from TSA. There's a small group of stores that we would love to get. But with all that's going on in retail today with other retailers, Penney's, Kohl's, Sears, Macy's, a few of them have announced store closings, there is going to be real estate out there and some of these trade areas we'll get into eventually. So, this is pretty inconsequential what we're doing with TSA right now.

And regional chains? I don't see us acquiring regional chains. I mean, we'll look at a couple of the Sport Chalet sites also, but the other regional chains, Robby, I don't see us being an acquirer of those. We'll grow organically with a big part of our growth coming from the dot.com business.

Robert F. Ohmes
Bank of America Merrill Lynch

Q

That's great. That's really helpful. Thanks, Ed.

Edward W. Stack
Chairman & Chief Executive Officer

A

Sure. Thanks, Robby.

Operator: The next question will be from Seth Sigman of Credit Suisse. Please go ahead.

Seth I. Sigman
Credit Suisse Securities (USA) LLC (Broker)

Q

Okay. Thanks a lot. Good morning, guys. Just on the short-term, I think last time you guys reported there were some uncertainty about TSA and the state of them at that point. Can you give us a sense of how the first quarter played out, what the impact from those first, I guess, 140 store liquidations were? And then what are you guys assuming in the second quarter guidance in terms of the impact from those liquidations? Thank you.

Edward W. Stack
Chairman & Chief Executive Officer

A

Well, Seth, the – we knew that – what was going to happen in the first quarter, but they were closing and liquidating about 140 stores, and these were really their – most of them, many of those were their worst-performing stores. These were the ones that they were going to jettison when there was talk about reorganizing the business. And we've had access to all of their store information – from a sales standpoint, what the – we got a lot of information about their stores through this process. And we have a sense of what the impact will be in the short-term and then what some of the opportunities we could have to gain market share there. So we're pretty confident in what we've laid out here. And as far as – the second part of your question again?

Seth I. Sigman
Credit Suisse Securities (USA) LLC (Broker)

Q

Just what would you be assuming in the second quarter for the impact. I don't know if there's a way to quantify what's in the comp guidance.

Edward W. Stack
Chairman & Chief Executive Officer

A

Yeah. Well, we talked about this and if we didn't have these issues, we'd probably be looking at somewhere between minus one and flat based on what's going on in the market place right now. So there's a big part of this has got to do with the short-term liquidation. And remember, there's over 200 Sports Authority stores that were within 5 miles of a DICK'S store, and a total of 350 stores that are within 10 miles. So this is going to have a short-term impact, but it does provide us a great opportunity going forward.

Seth I. Sigman
Credit Suisse Securities (USA) LLC (Broker)

Q

And just to follow up there, is there a thought that the impact is mostly isolated to the second quarter and third quarter or do you think that there is going to be some pull forward from these liquidations that also impact the fourth quarter?

Edward W. Stack
Chairman & Chief Executive Officer

A

Yeah, it's going to be primarily second quarter and the third quarter, really, primarily around the important back-to-school season. But we do believe that there will be some pull forward out of the fourth quarter into the – into right now through this liquidation process. And we really expect to see the – a bigger benefit to this beginning in 2017.

Seth I. Sigman
Credit Suisse Securities (USA) LLC (Broker)

Q

Okay. Thank you. And if I could just ask a follow-up question.

Edward W. Stack
Chairman & Chief Executive Officer

A

Sure.

Seth I. Sigman
Credit Suisse Securities (USA) LLC (Broker)

Q

I think Teri talked about the store payroll costs increasing in the quarter. Can you guys elaborate on the changes that you're making? What's one-time? What's recurring? And what's part of that $50 million to $55 million you've talked about? Because I know one of the opportunities here, you've talked about pretty clearly, is to improve the store experience over time. So just curious what may be changing. Thank you.

Teri L. List-Stoll
Chief Financial Officer & Executive Vice President

A

So of the $50 million to $55 million, if you remember, a big portion of it is Project Eagle, and then the remainder is split between full-service footwear and the marketing investments we're making in brand equity. And so, if you split out the part, obviously, the Project Eagle, we've been very public about how this plays out this year and next. And then of that remainder, particularly as it speaks to store payroll, some portion of the full-service footwear investment that's causing – we've kind of landed on $15 million to $16 million for that. Some portion of that is the current year impact of installing the footwear decks, et cetera, and then a portion of it is store labor. And I'll let Andrè talk a little bit about the store labor portion.

Andrè J. Hawaux
Chief Operating Officer & Executive Vice President

A

Yeah, so I think Teri articulated the pieces that are supporting the investments we're making in premium full-service footwear. The other things that we have out there, Seth, as well is we are enhancing our customer experience and also what we have in some marketplaces. As you know, there is a little bit of upward rate pressure that we're also feeling as a result of various state initiatives around minimum wage. So I would capture them all and then we're not going to carve out what each of those dollars are, but that's roughly what we're seeing in the investment in payroll.

Seth I. Sigman
Credit Suisse Securities (USA) LLC (Broker)

Q

Okay. Understood. Thanks very much.

Operator: Our next question will be from Kate McShane of Citi Research. Please go ahead.

Kate McShane
Citigroup Global Markets, Inc. (Broker)

Q

Hi. Thanks. Good morning, and thank you for taking my question. I just had a couple of questions, one on the impact from TSA. Ed, I think you had mentioned before that there is some opportunity for you to buy maybe some cheaper inventory from the vendors that – as a result of what's happening in the marketplace. Has that come to fruition? And how much has that been able to offset some of the margin pressure or the expected margin pressure from the liquidations?

Edward W. Stack
Chairman & Chief Executive Officer

A

Well, that process is really just starting to take place once TSA indicated that they were going to close their stores. So we've gotten calls from some vendors and provided us some opportunities to buy some product off price. I won't go into specifically what that is. But we do think that, that will help alleviate some of the margin rate pressure. But it's not significant.

Kate McShane
Citigroup Global Markets, Inc. (Broker)

Q

Okay. Thank you. And then I think you had mentioned in your prepared comments that apparel was below your expectations. Can you give us any detail on the breakdown between men's versus women's versus your expectations, and then how footwear trended versus your expectations during the quarter?

Edward W. Stack
Chairman & Chief Executive Officer

A

Yeah, so we're not going to get quite that granular for you, Kate, but the business was a bit more difficult. Some of the apparel miss came from cold weather merchandise that you still have a fair amount of that, you still have some of that in Q1, in February and March. We also have – and in the athletic piece of that, you've got some of the issues around that with fleece and all that. But men's was better than women's. I will – I'll get to that point. So the men's business was better than the women's business.

Kate McShane
Citigroup Global Markets, Inc. (Broker)

Q

Okay. Great. And just to sneak in one last question about inventory growth, I think in the press release, it had mentioned that it included some winter pack away.

Edward W. Stack
Chairman & Chief Executive Officer

A

Yeah.

Kate McShane
Citigroup Global Markets, Inc. (Broker)

Q

Are you able to tell us what the inventory growth would have been ex the pack away?

Teri L. List-Stoll
Chief Financial Officer & Executive Vice President

A

Substantially all of the difference between the sales growth and the inventory growth is related to that pack away.

Kate McShane
Citigroup Global Markets, Inc. (Broker)

Q

That's so helpful. Thank you.

Operator: The next question will be from Simeon Gutman of Morgan Stanley. Please go ahead.

Simeon Ari Gutman
Morgan Stanley & Co. LLC

Q

Thanks. Good morning. Just a follow-on to the TSA questions. And, Ed, it's probably early and may not have enough examples, but so, some of the 140 stores that have closed, they've liquidated and they've shut down. Are you seeing any lift or retention that, that's coming back into the DICK'S store? I know there's a lot of estimates out there of what transfer rates could eventually be, but curious if there's an early read on that.

Edward W. Stack
Chairman & Chief Executive Officer

A

There's not quite yet, and I'll tell you the reason why. Those were really their smaller stores, so they would have less of an impact. Also, we think that some – those liquidations just recently concluded. We think there was some pull forward of some purchases, so there hasn't been enough time yet for us to be able to give you an indication there.

Simeon Ari Gutman
Morgan Stanley & Co. LLC

Q

Okay. That's helpful. And I may have missed it in prepared remarks, did you or can you speak to any regionality in the business? I guess, we've heard a story that the Northeast has been tough. Does weather explain variability? I guess, weather and maybe TSA would explain variability among regions, but anything else to call out there?

Edward W. Stack
Chairman & Chief Executive Officer

A

So TSA, we think, is going to have an issue and we're not talking about the weather anymore. The weather can have an impact, but we're not going to hide behind the weather. We're actually really pretty pleased under the – with the environment of what we did in the first quarter, posting positive comps and hitting the high end of our expectations. So we were relatively – we were really quite pleased with what we accomplished in the first quarter in a difficult retail environment.

Simeon Ari Gutman
Morgan Stanley & Co. LLC

Q

And to that, the improvement in ticket, did that play out any differently than how it did in terms of the drivers of that ticket growth? Was that similar or different to how it played out in previous quarters?

Edward W. Stack
Chairman & Chief Executive Officer

A

Not a lot different. We've had some nice growth in the AUR around the golf business, which we've talked about that all of the inventory that had been tied up in the system, along with the suppliers and retailers, is pretty much gone. Our margin rates, again, in the first quarter, were up in the golf business. Our footwear business was really pretty good. So, nothing really meaningfully different than what you would have seen in previous quarters.

Simeon Ari Gutman
Morgan Stanley & Co. LLC

Q

Okay. Thanks a lot.

Edward W. Stack
Chairman & Chief Executive Officer

A

Sure.

Operator: And the next question will come from Christopher Horvers of JPMorgan. Please go ahead.

Christopher Michael Horvers
JPMorgan Securities LLC

Q

Thanks. Chris Horvers. Following up on the TSA locations, so, I guess, only looking at a narrow subset of stores, are the locations that bad? Or are the lease rates just too high? Or do you think there's just too much money that needs to be put into the stores and wait for the landlords to take it back and you can get a better deal on the back end of it? Because if you look at where their stores are, at least from a state perspective, versus where you'd like to grow, that seems to be a pretty good crossover there.

Edward W. Stack
Chairman & Chief Executive Officer

A

There are a couple of stores that we've looked at, but what you've got to do, you have to take the TSA lease as it is. You've got to pay the cure cost, which is really the rent that TSA may not have paid. And we've taken a look at some of this and we've got a very small number of stores that we're interested in. Some of the reports are relatively accurate for the number of stores we're looking at, but it's really inconsequential to our growth plan. And as I said, with all the retail consolidation going on and store closing across retail, we don't feel compelled that we have to take any particular deal, that there'll be other opportunities in those trade areas. So if we can make the deal that we're comfortable with, we'll make the deal, but we're not stretching by any stretch of the imagination to do a deal.

Christopher Michael Horvers
JPMorgan Securities LLC

Q

And so – understood. So, it's not that – the locations might be fine. So how does that make you think about the potential share capture given the close proximity and the growth of the overall online business in this category? Should we think about your overall market share as the right guide in terms of how much share you capture from TSA?

Edward W. Stack
Chairman & Chief Executive Officer

A

Well, we're taking a look at this. So, from market share standpoint, in markets where we are – like we said, they've got 200 stores that are within 5 miles of a DICK'S store. We'll pick up an awful lot of that market share. We've – there's 350 stores between TSA and Sport Chalet that are within 10 miles of a DICK'S store. We'll pick up a fair amount of market share there. Some of the stores that they're closing in markets where we don't have a store, in some of the five boroughs in New York City or Alaska, Hawaii, which we're really not interested in, obviously, we're not going to pick up any share. So I would look at – we're going to pick up share in markets that we do business with and we compete with them, and I think a significant amount. And our online business, we think, will grow also because of the share that we can pick up from TSA.

Christopher Michael Horvers
JPMorgan Securities LLC

Q

Understood. And then the last question is, as you think about the second quarter guidance in particular, I guess, how much gross margin headwind are you baking in for TSA? And is it potential markdown risk or is it more your need to step up voice as they announce all the liquidation sales loudly? Thank you.

Edward W. Stack
Chairman & Chief Executive Officer

A

Well, it's going to be – there's going to be some customers who are going to go shop – who might shop with us normally, that based on the liquidations, they're going to go take a look and see what Sports Authority has. So I think it's going to impact our sales, which you saw in our sales guidance. When that impacts our sales, it's going to make it – some of the expenses deleverage, as we talked about. But we are not going to go chase the markdown dollars with Sports Authority. So when they're running X amount of product at 25%, 30%, 40% off, it's going to be – we're not going to go chase that. We don't think that's the right thing for our brand to do long term, and we're really looking at this as some short-term pain which we're willing to endure for the long-term benefit of our company and our shareholders.

Christopher Michael Horvers
JPMorgan Securities LLC

Q

Understood. Thank you.

Edward W. Stack
Chairman & Chief Executive Officer

A

Sure.

Operator: The next question will come from Stephen Tanal of Goldman Sachs. Please go ahead.

Stephen Tanal
Goldman Sachs & Co.

Q

Thanks. Good morning, guys.

Edward W. Stack
Chairman & Chief Executive Officer

A

Good morning.

Stephen Tanal
Goldman Sachs & Co.
Q

Ed, could you maybe – it sounds like you guys have a very good sense for the TSA impacts, but I didn't think you sized the impact you thought you saw in 1Q on the comp. Are you able to share that level of color?

Edward W. Stack
Chairman & Chief Executive Officer
A

I'm sorry. I'm not really sure I understand the question.

Stephen Tanal
Goldman Sachs & Co.
Q

Just like if you said, okay, TSA did X basis points to the comp in 1Q, like we would have comped X otherwise, something like that to help us sort of think about the magnitude of the impact there.

Edward W. Stack
Chairman & Chief Executive Officer
A

Yeah, it's pretty tough to say. And again, these were pretty – relatively small stores, so we don't think it had a real big impact on our business in Q1. Probably a little bit, but again, from what we've seen, these are their smaller volume stores. These are stores that if they had reorganized, they wanted to jettison out of the fleet. So they weren't stores that were performing very well for them, and therefore, they didn't have a meaningful impact on us.

Stephen Tanal
Goldman Sachs & Co.
Q

Understood. And as we think about stores you may acquire, how long does it typically take you to retrofit a store, and more specifically, of course, a Sports Authority store to a DICK'S?

Edward W. Stack
Chairman & Chief Executive Officer
A

Yeah, so it depends on the level of retrofit that we would want to do. But we can have it done in a matter of four months or five months.

Stephen Tanal
Goldman Sachs & Co.
Q

Got it. Okay. And then just lastly, I mean, obviously, the auction's done. There's some information out there now. You didn't comment on kind of the outcome. Do you have a sense for when you may or is there something specific you're waiting, perhaps the sale hearings next week?

Edward W. Stack
Chairman & Chief Executive Officer
A

Yeah, we'll see how it goes. We have yet to reach agreement. We made – there were some things in the press that were relatively accurate of what we've been talking about, but we haven't reached an agreement and quite frankly, we may not. And as I said, these sites are interesting sites that we would take if we can get them at the right economics, but they're really inconsequential. They're not – it's not very significant to our growth plan. And as we've looked at this with all the other real estate that's coming online from some other retailers closing stores, we're confident we'll get sites in those trade areas eventually. And we think this is a time to be very patient out in the marketplace. So we're not in any rush.

Stephen Tanal
Goldman Sachs & Co.

Q

Understood. Okay. Thanks.

Operator: The next question will be from Michael Lasser of UBS. Please go ahead.

Michael Louis Lasser
UBS Securities LLC

Q

Good morning. Thanks a lot for taking my question. Ed, so it seems like you've baked in a significant impact from the TSA liquidations in the second quarter, but it seems like you also are not baking in virtually any impact of market share gains in the second half of the year to get to the midpoint of the guidance. You have to assume that your comps are flattish, maybe slightly positive, slightly negative in the second half. So what was the thought process behind only baking in the downside and none of the upside?

Edward W. Stack
Chairman & Chief Executive Officer

A

Well, there's a couple things. So we think that TSA, from what we understand, they will liquidate through June, July and August. It may go longer, we don't know, but even if it goes into August, that goes into an important part of the back-to-school selling season in the third quarter. And we feel that there will be business that'll be moved from the third quarter, fourth quarter into these other quarters, and people will do some buying upfront. And we just think that there's a possibility that the market could just be tired by the time we get into the – toward the end of the year. And we really feel that there'll be an upside to the – beginning in 2017. There may be some upside at the back half there, which we talked about on a previous quarter call, but we do think that the market could be a little weary of sporting goods promotions as TSA and Sport Chalet liquidate 20,000,000 square feet of sporting goods. That's a lot.

Michael Louis Lasser
UBS Securities LLC

Q

But it is fair to say that you really haven't baked any share gains from those liquidations, from that 20,000,000 square feet, into the second half of the year outlook? Is that right?

Edward W. Stack
Chairman & Chief Executive Officer

A

That would be accurate, yes.

Michael Louis Lasser
UBS Securities LLC

Q

And then secondly, Ed, obviously, the margin of the businesses has been volatile over the last years, and it seems like you're on the precipice of a lot of margin enhancing opportunities, whether it's the eCom business coming back in house, the share gains. How much are you going to let fall to the bottom line as we look towards next year? And how much are you just going to flow back into the business because that's the way you think is the right thing to do?

Edward W. Stack
Chairman & Chief Executive Officer

A

Yeah, as we get further into taking a look at what we're going to do for next year, we'll make those decisions. But we do think, as we said from an eCommerce standpoint, we think that will increase our margin rates 30 basis points as we move to our own platform. So we'll take a look at that. The big – the meaningful amount of investments that we need to make in our business are being made through 2016. And we expect that the Project Eagle or the eCommerce business will – that will slow going into 2017. We're making a very big bet on the footwear side of the business with construction costs and buildout costs here in 2016.

We don't expect that to accelerate. We're going to have approximately 175, 180 of these stores done by the end of this year. We'll read that and see where that goes, and if there's another group of stores we want to do in 2017, I suspect it'll probably be toward the back half of 2017 or beginning of 2018 if we do that. But the – a lot of the investments are being made. And we said upfront earlier this year and in 2015, we telegraphed that, that 2016 would be an investment year. And we expect those to slow in 2017.

Michael Louis Lasser
UBS Securities LLC

Q

Let me ask it this way.

Edward W. Stack
Chairman & Chief Executive Officer

A

Sure.

Michael Louis Lasser
UBS Securities LLC

Q

As recently as 2014, you had an 8% to 9% operating margin. Is it realistic to expect, as you move through this transition period where you're frontloading some investments, that once you get past it, you'll be able to get back to the 8% to 9% operating margin that you had as recently as two years ago?

Edward W. Stack
Chairman & Chief Executive Officer

A

Let us get through the balance of these next couple of quarters and let's see what happens with the TSA, what kind of market share we can pick up, and give us toward the end of the year to give you more guidance on that question. It's a fair question, we're just not ready to provide guidance for that right now.

Michael Louis Lasser
UBS Securities LLC

Q

Okay. Thank you so much.

Edward W. Stack
Chairman & Chief Executive Officer

A

Sure.

Operator: The next question will be from Sam Poser of CRT Capital. Please go ahead.

Sam Poser
Sterne Agee CRT

Q

Thank you for taking my question. There were some information out the other day regarding Sports Authority, and I'm not sure about Sport Chalet, but that – there really was – there – they have a lot of stores, but there wasn't that much inventory. There – it sounded like there's like only about $400 million worth of inventory. So, I mean, yes, there's a lot of stores, but it sounds like a lot of the retailer stopped – a lot of brands stopped shipping these retailers fairly recently. So this liquidation may not be a – I mean, what is your thought there? Are my numbers wrong based on what you know? Because this impact may not be quite as big as you're leading on to if those numbers are right.

Edward W. Stack
Chairman & Chief Executive Officer

A

Well, Sam, if you think about this, that's $400 million at cost, not at retail. So it's a much bigger number at retail. And I'm sure you know, as they go through these liquidations, the liquidators have the opportunity to augment that inventory...

Sam Poser
Sterne Agee CRT

Q

Yeah.

Edward W. Stack
Chairman & Chief Executive Officer

A

...with buys or things that they have from previous liquidations. So I think it's pretty significant. And it is $ 400 million at cost, whatever that number translates to at retail, in a very short period of time.

Sam Poser
Sterne Agee CRT

Q

Right. Right. And then – thank you. And then as far as both the geographies of where you might be interested, there's some locations in South Florida that, from what I've heard, were very good Sports Authority stores and then in Southern California, which is basically going to be vacated of sporting goods. Would – are those the general vicinities of where your, I guess, the 20 store to 30 stores you might be interested in are located?

Edward W. Stack
Chairman & Chief Executive Officer

A

Well, we think it's – we're not going to give you that level of granularity right now, but the stores that we've looked at, we would be pleased to take those if the economics are right. As we've done a survey of the areas, we know that with some of the other closings that have been announced or other closings that may come, we're not concerned. One thing we all know is there's plenty of real estate around for retailers. And we don't feel compelled or we don't feel any pressure to go and make these deals at the present time. If we can get them under the right economics, we'll do it; and if we don't, we're good walking way.

Sam Poser
Sterne Agee CRT

Q

Thank you. And then one last thing. Sports Authority, it's said to have – do about $2.5 billion worth of sales annually. Without really thinking about any store pickups, I mean – with the 350 stores within 10 miles, I mean, how much of that business do you think sort of will sort of naturally – with some, I guess, marketing from you – but over time, sort of go your way? I mean, when you think about it, let's say, over the next few years?

Edward W. Stack
Chairman & Chief Executive Officer

A

You know what, I'm not going to go out on a limb and put that number out there, right? I appreciate the question and nice try, but as we kind of go through this, we'll give you guys some sense, you'll see what our sales are. We think we have an opportunity to pick up meaningful market share, but we're not going to go out on public and say what we think that is right now. We don't think that would be appropriate.

Sam Poser
Sterne Agee CRT

Q

Do you think we'd know that by, let's say, the end of the third quarter once sort of the dust has settled with the liquidations and you've seen a little bit? Or do you think this is more of an end of the year situation...

Edward W. Stack
Chairman & Chief Executive Officer

A

I think this is more end of the year, and as I indicated, I think we'll start to see that more impact beginning in 2017. Sports Authority's liquidation is going to go through this Father's Day period. It's going to go through a very big – virtually all of the back-to-school selling period, and I think at that point, the market is going to be a little tired and some business is going to have been pulled forward. And I think we'll start to see the positive impact of this in 2017. Could there be some positive impact on the fourth quarter? Yes. And if there is, we'll let you know, but the way we're looking at this right now is it's going to be beginning in 2017.

Sam Poser
Sterne Agee CRT

Q

Sure. Thank you. Thank you very much.

Edward W. Stack
Chairman & Chief Executive Officer

A

Sure, sure.

Operator: The next question will be from Michael Baker of Deutsche Bank. Please go ahead.

Michael Baker
Deutsche Bank Securities, Inc.

Q

Thanks. A couple. One, you – how does The Sports Authority going away change your long-term store count plan? Have you gone back and re-assessed what you may have thought in terms of a real estate plan? As you said, there are markets where you don't exist and where they did. Do you now plan on putting more stores in those types of areas?

Edward W. Stack
Chairman & Chief Executive Officer

A

Yeah, I don't think that has really changed. I think we can do – if we were looking at putting a store in trade areas, because we always felt very comfortable competing with Sports Authority. So – and as many of you know, we've got a store within a couple of miles or right across the street from a Sports Authority, and those stores have always performed quite well. Our view would be that the stores that we would put in those trade areas will have a higher sales volume. We don't necessarily need more stores.

Michael Baker
Deutsche Bank Securities, Inc.
Q

Okay. Helpful. A couple more, if I could. You had said earlier in the call, you do have plans in place to drive your share during this time. I mean, are those plans above and beyond the footwear deck and the Olympic branding and other things like that?

Edward W. Stack
Chairman & Chief Executive Officer
A

Yeah, we'll take a look at some marketing, increasing some marketing in some local areas where we feel that we've got the opportunity to take some significant market share, and we're working through this, but it's all baked into the guidance that you've seen.

Michael Baker
Deutsche Bank Securities, Inc.
Q

Okay. That was the important point. Lastly, unrelated to Sports Authority, the apparel weakness, I know we're not talking about weather, so – but is it more indicative of the overall consumer environment? Or do you think there are any share issues? We know that Amazon is getting more aggressive in the apparel space. Just wondering if you could sort of help us with why apparel was weak, if not the weather.

Edward W. Stack
Chairman & Chief Executive Officer
A

Well, I think we're coming off some pretty good apparel numbers over the last several years. We've been really aggressive there. I don't think that it is a share issue. I think that, that business has been, really, has been very good for us. We're not going to hide behind the weather, but we continue to invest in our apparel business, and think it will continue to be an important part of our business and a very profitable part of our business.

Michael Baker
Deutsche Bank Securities, Inc.
Q

Okay. Understood. Thank you very much.

Operator: Your next question will be from Camilo Lyon of Canaccord Genuity. Please go ahead.

Camilo Lyon
Canaccord Genuity, Inc.
Q

Thanks. Ed, last quarter, you talked about investing in attracting TSA customers in those initial 140 store areas. Can you just talk about the success that you've had in attracting them to your stores? And have you begun marketing to them already in their remaining trade areas?

Edward W. Stack
Chairman & Chief Executive Officer
A

Well, we're starting to, and we looked at not only some of the – those markets. We are waiting to get through the liquidation process and then we would start that. And they've liquidated – they're pretty much done with those 140 stores. Again, they were the smaller-volume stores that didn't have as big of an impact on us. But, yeah, we're starting to market to those and we think that there will be a positive impact.

Camilo Lyon
Canaccord Genuity, Inc.

Q

Have you seen the uptick in the rewards member sign-ups? I think that's what you've been using to try and attract them to your stores.

Edward W. Stack
Chairman & Chief Executive Officer

A

Well, we don't have their customer list. We just continue to try to market and try to bring people to shop in our store, and try to sign them up when we get them here.

Camilo Lyon
Canaccord Genuity, Inc.

Q

Okay. Since you're one of the very few retailers left that will continue to open large stores, have you already begun to see the benefits of lower rent costs in your current discussions with landlords, irrespective of any stores you may take over the next few months from the TSA? So, are current rent discussions becoming more favorable?

Edward W. Stack
Chairman & Chief Executive Officer

A

I don't think it's gotten any better or any worse than it has been. And I think that as some other retailers close stores that they've announced that they're going to close, there's a number of those that we would have an interest in. And again, we don't feel this – we're not compelled to open stores or accelerate our store program, we're very comfortable with what we're doing. And our view is if we can get the right economy – we're very disciplined from a real estate standpoint. And if we can get the right economics, we'll do the deal. If we can't get the right economics, we walk away from the deal. And believe me, we've walked away from plenty of deals where we didn't feel the economics were right. And many times, you let it sit for a few months, sometimes six months, sometimes a year, you come back and you make your right deal. So we're very disciplined and we're very patient.

Camilo Lyon
Canaccord Genuity, Inc.

Q

Would you say that the economics have become more favorable in the last three-month period given that TSA is completely going away and before it was an option that they may have stuck around in a smaller form?

Edward W. Stack
Chairman & Chief Executive Officer

A

I don't think landlords are really thinking of Sports Authority. We're starting to build some stores from the ground up again. Some centers are being added on to or built, and I don't think anybody was looking at Sports Authority as a viable tenant. So they really weren't playing in the game. So they didn't have much to do with the real estate rental prices.

Camilo Lyon
Canaccord Genuity, Inc.

Q

Okay. And then just shifting gears on – you mentioned on the full-service footwear decks that you would be getting new product that you hadn't done before in the DICK'S stores. Can you just talk about what that product consists of? And then any sort of comments you might have on your Brand Jordan stores, how those are performing?

Edward W. Stack
Chairman & Chief Executive Officer

A

We continue – we'll be – I will tell you, we'll be investing in some additional Brand Jordan shops. We love those shops. And as far as what we're doing in footwear, we're relatively happy with what's going on there.

Camilo Lyon
Canaccord Genuity, Inc.

Q

But can you talk about the categories that you're getting more allocations from that you weren't before?

Edward W. Stack
Chairman & Chief Executive Officer

A

Well, we're beginning – again, at some of the better-selling shoes that you would've seen in the marketplace that we didn't have access to. So, if you walk into our store today, to the premium full-service footwear areas you see, you'll see some – you'll see Nike Roshe shoes. You'll see some of the key adidas shoes. You'll see Steph Curry. You'll see some shoes that you didn't find – that weren't as readily available in our store as in the past. You'll see those in these full-service footwear decks.

Camilo Lyon
Canaccord Genuity, Inc.

Q

Got it. All the best. Thanks.

Edward W. Stack
Chairman & Chief Executive Officer

A

Thank you.

Operator: The next question will be from Chris Svezia of Susquehanna Financial. Please go ahead.

Christopher Svezia
Susquehanna Financial Group LLLP

Q

Good morning, everyone. Thanks for taking my questions. I guess, Ed, for you just to go back on the footwear for a moment. Is it fair to say that footwear out-comped the corporate average of 0.5% in the quarter?

Edward W. Stack
Chairman & Chief Executive Officer

A

We're not going to give you that level, get too granular with that, but the answer would be yes.

Christopher Svezia
Susquehanna Financial Group LLLP

Q

Okay. All right. Thank you. And then I'm curious, when you step back and think about the market share opportunities within 200 stores, 5 mile radius, what are some of the, I guess, inhibitors from you obtaining significant market share, whether that consumer goes to another broad hardlines retailer or mass merchandiser or goes online? Just maybe how do you think about the ability to retain as much as possible of that market share that becomes available?

Edward W. Stack
Chairman & Chief Executive Officer

A

I think there are some things that we have to do from an execution standpoint. So we have to plan for that market share so that we have the products, so that we're in-stock in that product, which is going to require some – to make sure that we've got the right inventory there. We're going to need to make sure that – and Andrè's doing this with the store operations group, he and George Hill. We need to make sure that we provide the customer with terrific service, and we've got people on the floor to help them. We need to make sure that they have a great experience, which comes from having what they want, having it in the size that they want, and helping provide them to make an informed decision of the right product for them.

So there's a number of things that we need to do that we are in the process of doing. We also need to take a look and try to market to those people to come and shop with us because I believe where they shop next, if they were a Sports Authority shopper and they did $2.5 billion in sales roughly, so they had some shoppers, our firm belief is that where those shoppers shop next is going to be where they primarily shop for their products that we sell. So we're going to work very hard to market to them to have them come and shop with us.

Christopher Svezia
Susquehanna Financial Group LLLP

Q

And that's what you said, I think, earlier. That's factored into your thought process for 2016. Correct?

Edward W. Stack
Chairman & Chief Executive Officer

A

Yes.

Christopher Svezia
Susquehanna Financial Group LLLP

Q

Okay. And just on some category perspective, golf, I know you haven't touched on that just yet, but nice to see it comping. Any thoughts about sustainability? What's going on in the industry from a pricing and inventory management perspective? Just any additional color. It's nice to see at least a positive comp out of that.

Edward W. Stack
Chairman & Chief Executive Officer

A

Yeah, so it has been a positive comp. Some brands came out with some really great product that captured the imagination of the golfer: TaylorMade with the M1 and the M2, Callaway with the Great Big Bertha. There's been some new shoe designs out from FootJoy. They've done a really great job over the last several years. So there's been some good product out there. The golf apparel business, there is some great golf apparel out there that's been helpful. And the pipeline of inventory is in pretty good shape, and we've indicated that over the next couple of quarters, as – our margin rates are up. And we've started to see, somewhat influenced by the weather in a positive way, that rounds are actually up. So that's helpful to the golf business.

Christopher Svezia
Susquehanna Financial Group LLLP

Q

Okay. Okay. Thanks very much. Good to hear. All the best.

Edward W. Stack
Chairman & Chief Executive Officer

A

Thank you.

Operator: The next question will be from Patrick McKeever of MKM Partners. Please go ahead.

Patrick G. McKeever
MKM Partners LLC

Q

Thanks very much. Just also on the footwear, the new footwear decks, and I saw one of them recently. It looks fantastic. Just wondering if you could share any kind of numbers on the impact to same store sales in footwear, maybe the economics – I know it's early – but the economics. And then, what might the hurdle rate be from a return standpoint for you to go forward and move beyond the 175 to 180 stores that are planned for this year?

Edward W. Stack
Chairman & Chief Executive Officer

A

Well, so, as you can imagine, we're not going to get too granular on this for competitive reasons and for some other reasons, but I will tell you that they are – once we get through the construction process, they're performing better than the balance of the chain from a comp standpoint. So, they're having the desired effect of being positive to our footwear business. And from an IRR standpoint, we're not going to let you know what that is, but you can imagine if we continue to go forward with these that they are meeting the hurdle rate that we put in place.

Patrick G. McKeever
MKM Partners LLC

Q

Okay. Sounds good. And then, on the hunting business, maybe a little – you mentioned that it was soft in the quarter. Just wondering if you could give us a little additional color. Better or worse than fourth quarter? Just thoughts on the current environment.

Edward W. Stack
Chairman & Chief Executive Officer

A

Well, the hunt business has been difficult. And some of the things that are driving that business, we're not as invested in. The handgun business, some of that, we just don't – we sell those in some stores. We don't sell them in all stores. But we suspect the hunt business is going to continue to be challenged for a little bit here. We don't – we're not looking at that to get a whole lot better, although I will tell you that our hunt business in Q1 was a bit better than it was in Q4.

Patrick G. McKeever
MKM Partners LLC

Q

Good stuff. Okay. Thank you, Ed.

Edward W. Stack
Chairman & Chief Executive Officer

A

Sure.

Operator: Our next question will be from Peter Benedict of Robert Baird. Please go ahead.

Peter S. Benedict
Robert W. Baird & Co., Inc. (Broker)

Q

Hey, guys. Thanks for taking the question. Just the $0.10 to $0.15 cut on the earnings plan, can you give us a – it sounds like it's spread across the balance of the year, 2Q, 3Q, 4Q, obviously more in 2Q. Can you give us a sense of maybe how that buckets out across the quarters?

Edward W. Stack
Chairman & Chief Executive Officer

A

We've never really provided guidance outside of the quarter or the year that we've been in, so we're not going to get that granular with you on it. We do feel that, as we've said, this liquidation is going to have an impact on Q2. It will have an impact on Q3 because it will go through the all-important back-to-school timeframe of the third quarter, and we think there'll be some pull forward out of the fourth quarter into the second quarter or third quarter. And the market is just going to be tired from a sporting goods standpoint going in the fourth quarter. Now, we might have some upside from that. We haven't baked that in, and we think the benefit of this consolidation that the industry is going through, we'll see the benefit of that in 2017.

Peter S. Benedict
Robert W. Baird & Co., Inc. (Broker)

Q

Okay. Thanks. Sounds like a reasonable approach. Just the other would be just on this overtime rule change that's coming into effect, any early thoughts, considerations on that and how that might impact the way you guys manage payroll, et cetera? Thank you.

Andrè J. Hawaux
Chief Operating Officer & Executive Vice President

A

Yeah, as you know, those regs just came down the other day, and I think what we're doing right now is we're assessing the impact. We don't see it as a material impact in either 2016 or 2017 as we go forward. So, it is something we're going through. As I said, the regs just got published the other day, and we're going through that. But we don't see that as a meaningful cost increase year-over-year.

Peter S. Benedict
Robert W. Baird & Co., Inc. (Broker)

Q

Okay. Great. Thanks, guys.

Operator: The next question will be from Wayne Hood of BMO Capital. Please go ahead.

Lowell Wayne Hood
BMO Capital Markets (United States)

Q

Yeah, I just had two questions actually. Separately from looking at a small subset of TSA stores you might buy, why wouldn't you put forth a proposal to buy TSA's customer loyalty list that they developed since 2012? And then I had a follow-up.

Edward W. Stack
Chairman & Chief Executive Officer

A

We haven't given any granularity into what the offer is on the table. So, haven't said we've done that, haven't said we haven't done that.

Lowell Wayne Hood
BMO Capital Markets (United States)

Q

Do you think, putting aside whether you did or didn't, is that a list that you would view as something that you would want to get because, stating the obvious right, it's a list that you can deep dive into?

Edward W. Stack
Chairman & Chief Executive Officer

A

So could we? Sure. There's other ways to get lists like that also. So, lists of names is not – we're not that concerned about the list of names. If the real estate sites are good sites and we can get the economics, we'd be happy to do that. The list of names is interesting but we can get names very easily, and we're starting to target some of those customers through other lists that we buy. And we think we might be able to buy them cheaper than we can buy from TSA.

Lowell Wayne Hood
BMO Capital Markets (United States)

Q

Okay. My final question is, just when you look at the market share data by line of business at TSA, recognizing they don't index high anywhere, but would you say that, like, footwear would be the greatest opportunity for you? As you look at categories where they might be over indexing where the – you would say that's our biggest opportunity, where would that be? Thank you.

Edward W. Stack
Chairman & Chief Executive Officer

A

So, it would only be kind of our sense because the data that we got from them was not at that level of detail, by category of business. But we do think that they had a relatively good footwear business. And we think footwear is an opportunity for us to gain some market share, as is their apparel business and their Team Sports business. They had exited some of the other businesses or really scaled them back, such as the Hunt Fish Camp business and some of – some other hardlines, ancillary hardlines businesses. But I would say, footwear and apparel is the key areas that we're looking at that will be the biggest market share opportunity for us.

Lowell Wayne Hood
BMO Capital Markets (United States)

Q

All right. Thank you, Ed.

Edward W. Stack
Chairman & Chief Executive Officer

A

Sure.

Operator: The next question will come from Scot Ciccarelli of RBC Capital Markets. Please go ahead.

Scot Ciccarelli
RBC Capital Markets LLC

Q

Good morning, guys.

Edward W. Stack
Chairman & Chief Executive Officer

A

Good morning.

Scot Ciccarelli
RBC Capital Markets LLC

Q

Ed, I have a bigger question for you or a bigger picture question rather. But what do you think the biggest challenges are for your industry? You have TSA and Sport Chalet essentially going away, DICK'S Sporting Goods as the leader of the industry, essentially flat comps even without TSA if you kind of look at the first half. Do you think it's an over-stored market? Is it a combination of just various pockets of softness in different categories? Slower levels of innovation on the part of vendors? Channel cannibalization from eCommerce? Just what's your view in color on that?

Edward W. Stack
Chairman & Chief Executive Officer

A

I think there's a number of things. I think the industry has definitely been over stored. We're making some big strides with this right now with over 20 million square feet coming out of the marketplace. I think that some of these other brands – these other companies, didn't have the relationships with the vendors that we do. When you walk into the stores, you can see that with the investment that we've made in conjunction with Nike and Under Armour, TNF. So, that was a big part of this.

And then, I think, one of the smartest things that we did versus some others, is that we have no debt. And a number of these retailers had a significant amount of debt. And when business gets soft, it gets difficult. So, we know the debt that TSA had. We know that whatever [ph] Vertis (01:03:11) had, they had. But we're debt free. We can ride through these difficult times much easier than some of these other retailers did.

Scot Ciccarelli
RBC Capital Markets LLC

Q

That's very helpful. And then, how do you think about the increase in penetration rates we're seeing in your category from eCommerce?

Edward W. Stack
Chairman & Chief Executive Officer

A

Yeah, we really look at that as an opportunity. That's why we're making the investments that we're making in Project Eagle. You can see that our eCommerce business continues to grow at a pretty rapid rate. We're going to continue to make these investments, and we look at that as an opportunity. And you'll start to see more from us on the eCommerce side as we try build out not only the DICK'S eCommerce business but also what we're going to be doing with Golf Galaxy and with Field & Stream. So, a number of retailers and analysts look at this as a problem for retailers like us, we look at it as a real opportunity, and if – you'll see as we continue to make these investments, our business will continue to grow in this area.

Scot Ciccarelli
RBC Capital Markets LLC

Q

Very helpful. Thank you.

Edward W. Stack
Chairman & Chief Executive Officer

A

Sure.

Operator: The next question will be from Mitch Kummetz of B. Riley. Please go ahead.

Mitch Kummetz
B. Riley & Co. LLC

Q

Yeah, thanks. Two questions. One, could you talk a little bit about your pricing strategy relative to the TSA liquidations? To what extent are you guys going to do some price matching, so that you don't lose more volume? And how does that kind of flow through the gross margin line? And then, I have a follow-up.

Edward W. Stack
Chairman & Chief Executive Officer

A

Sure. We're not going to go chase the liquidation pricing, so they're going to take pricing at 20% to 30% off, then they're going to go 40% to 50% off, and we're not going to go chase that. If those liquidations get to be pretty aggressive, we're not going to go chase that. We'll bide our time. We'll be patient and we'll – we don't think it's the right thing to do for our brand. And we will be patient and let them get through this liquidation over the next quarter and a half. And then, beginning in 2017, I think we've got an opportunity to take significant market share when these guys – when this 20 million square feet of sporting goods retail is gone.

Mitch Kummetz
B. Riley & Co. LLC

Q

And then secondly, how do you holistically think about a market, a trade region like California where you guys were obviously underpenetrated? You talked about wanting to expand there. A lot of stores are going away between TSA and Sport Chalet, and I get it that you guys are very measured and deliberate in terms of how you open stores, but is there any sort of increased urgency to do something there to maybe preempt some of your vendors from exploring other distribution opportunities like maybe an Under Armour kind of exploring, selling to Kohl's or something like that as they think about how they make up for lost volume?

Edward W. Stack
Chairman & Chief Executive Officer

A

There's not. The one thing that we've always talked about here is you can't fix bad real estate, and we're very disciplined and we think a lot of this market share is going to come to us. So, our business with Under Armour, we expect to go up. Our business with Nike, we expect to go up. The same with North Face, adidas, TaylorMade. We expect to increase our business with these guys, and we will not take bad real estate. We will not take real estate at economics that don't fit our model because you will live with that for 10 years. You can't fix bad real estate. You can make a bad buy from a merchandising standpoint, and you can mark it down and you can do whatever you need to do with it to get it out of the system. Bad real estate, you got it for 10 years.

Mitch Kummetz
B. Riley & Co. LLC

Q

Got it. All right. Thanks. Good luck.

Edward W. Stack
Chairman & Chief Executive Officer

A

Thank you.

Operator: The next question will come from Paul Swinand of Morningstar. Please go ahead.

Paul Swinand
Morningstar, Inc. (Research)

Q

Good morning, and thanks for taking all the questions as always. Wanted to ask a question on the – you mentioned the other stores, TSA, some of the people who are in trouble don't have the relationships with the national brands, with the big vendors. Could you say how much more of a lead you had with the top 5 or 10 national brands? In other words, was it 20% of the business and they were dwindling from 10% to 5% of the business?

Edward W. Stack
Chairman & Chief Executive Officer

A

Yeah, I don't know what that is. All I know is that we really made a strategic initiative years ago to partner with these brands. You walk into our store and you see the significant Nike presence, the significant Under Armour presence, what we're doing with The North Face. And I think that really resonated with the consumer and help move market share to us. And it's pretty – it's clear that we're the winners in this race between us and Sports Authority and Sport Chalet. And we're very happy with the position we're in right now.

Paul Swinand
Morningstar, Inc. (Research)

Q

Okay. Let me maybe come at it a different way. There's still – there are many regional players out there. I know you don't put your national market share that high, low double digit, I think. Of the regional players or some of the other players in the outdoor space that are maybe national, are there significant weaknesses in those national brand representations? And I guess where I'm going is how much further consolidation do you see in the next 5 years or 10 years?

Edward W. Stack
Chairman & Chief Executive Officer

A

I think there'll be more consolidation. Do we see weaknesses in some of these other competitors? Sure. I don't think it would be appropriate for me to call it out here, but yeah, I think there is. And I think there will be more consolidation going forward.

Paul Swinand
Morningstar, Inc. (Research)

Q

Okay. Great. Thanks. And best of luck.

Edward W. Stack
Chairman & Chief Executive Officer

A

Thank you.

Operator: And your next question will be from Joe Feldman of Telsey Advisory Group. Please go ahead.

Joseph Isaac Feldman
Telsey Advisory Group LLC

Q

Yeah. Hey, guys. Thanks for taking the question. Most of mine have been answered, but I do want to follow up on something. Just sort of the blending between stores and eCommerce. And I understand your comments earlier makes a lot of sense to me. You open a store in a new market, it helps drive eCommerce sales. That being said, have you guys thought about what the right balance is over a longer-term basis? I know that you have the long-term store potential, but that has been done in the prior years. And have you guys given any new thoughts to what the right number of stores might be relative to eCommerce? I mean obviously eCommerce growing at a nice clip for you guys and increasing penetration quickly. So, I'll leave it there.

Edward W. Stack
Chairman & Chief Executive Officer

A

Well, we think about that all the time, and that's why we are so disciplined from a real estate standpoint. We really do believe that a balance between stores and eCommerce is the right balance. Where that balance is, we're like everybody else in this industry, trying to figure out where that is. But that's why we're going slowly. That's why we're very disciplined from a real estate standpoint, and that's why the reports that you saw – we didn't make an offer on a lot of TSA stores. And that's why you hear me talking – throughout this call when we've talked about TSA, that the stores that we're interested in are really inconsequential to our plan.

There's some good real estate that we would like to – that we would be happy to take if the economics are right. We don't feel any pressure or any hurry to get this deal done. We don't feel any pressure or any hurry to take this real estate from Sports Authority because what's going on in the marketplace, there will be other real estate available. So, we're exercising our patience. We're being very diligent in our real estate process. And as we go on, we'll understand where that balance is. And we feel right now we're in a pretty good spot. And remember, our leases are for the most part only 10 years in duration.

And I forget – I don't have it right off the top of my head, but we've got a number of stores that are coming up for renewal next year or the year after that, the year after that. So, over a period of three years to five years, we have the ability to not renew or renew at lower rates stores that we have right now. So, we've got a lot of flexibility in our business. And this is one of the things that I don't think the Street understands is how much flexibility we've got in our real estate and our real estate strategy.

Andrè J. Hawaux
Chief Operating Officer & Executive Vice President

A

So just for the audience, it's about a quarter of our DICK'S fleet comes up over the next couple years and about 50-plus percent of our Golf Galaxy fleet comes up in the next couple years. So to Ed's point, we have a lot of flexibility as these leases come up for renewal whether to stay in a market or to exit the market.

Joseph Isaac Feldman
Telsey Advisory Group LLC

Q

That's really helpful, guys. Thank you. And good luck with this quarter.

Edward W. Stack
Chairman & Chief Executive Officer

A

Great. Thank you.

Operator: And ladies and gentlemen, that will conclude our question-and-answer session. I would like to hand the conference back over to Ed Stack for his closing comments.

Edward W. Stack
Chairman & Chief Executive Officer

I'd like to thank everyone for joining us on our quarterly call, and we'll look forward to talking to everybody at the end of the next quarter. Thank you.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.