At Home Group Inc.

Fourth Quarter and Fiscal 2017 Earnings Conference Call

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PRESENTATION

Operator:

Greetings and welcome to the At Home Fourth Quarter and Fiscal 2017 Earnings Call. At this time, all participants are in a listen-only mode. A question and answer session will follow the formal presentation. If anyone should require Operator assistance during the conference, please press star, zero on your telephone keypad. As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Ms. Bethany Perkins, Director of Investor Relations for At Home. Thank you. You may begin.

Bethany Perkins:

Good morning, everyone, and thank you for joining us today for At Home's Fourth Quarter and Fiscal Quarter Fiscal 2017 Earnings Results Conference Call. Speaking today are Lee Bird, Chief Executive Officer and President, and Judd Nystrom, Chief Financial Officer. After Lee and Judd have made their formal remarks, we will open the call to questions.

Before we begin, I need to remind you that certain comments made during this call may constitute forward-looking statements and are made pursuant to and within the meaning of the Safe Harbor

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provisions of the Private Securities Litigation Reform Act of 1995. In particular, statements about our outlook and assumptions for financial performance for fiscal years 2018 and 2019, and our long-term growth targets, as well as statements about the markets in which we operate, expected new store openings, potential growth opportunities and future capital expenditures, are forward-looking statements. Such forward-looking statements are subject to both known and unknown risks and uncertainties that could cause actual results to differ materially from such statements. Those are referred to in At Home's press release issued today and in filings that At Home makes with the SEC. The forward-looking statements made today are as of the date of this call and At Home does not undertake any obligation to update any forward-looking statement.

Finally, the speakers may refer to certain adjusted or non-GAAP financial measures on this call, such as Adjusted EBITDA, adjusted operating income, adjusted and pro forma adjusted net income, and pro forma adjusted earnings per share. A reconciliation schedule showing the GAAP versus non-GAAP financial measures is available in At Home's press release issued today. If you do not have a copy of today's press release, you may obtain one by visiting the Investor Relations page of the website at investor.athome.com. In addition, from time to time, At Home expects to provide certain supplemental materials or presentations for Investor reference on the Investor Relations page of its website.

I will now turn the call over to Lee. Lee?

Lewis L. Bird, III:

Thank you, Bethany. Good morning, everyone. Thanks for joining us to discuss our fourth quarter and fiscal 2017 results.

As you saw in our earnings release earlier, issued earlier today, we delivered strong fourth quarter performance, exceeded our expectation, driven by very positive customer acceptance for holiday assortment and our investments in incremental inventory. The strength of our business continues to illustrate that value is what customers demand in today's retail environment, and our value proposition is resonating with home décor shoppers now more than ever. We have been, and will continue to be, focused on delivering a compelling and unparalleled assortment of home décor at affordable prices, and both our fourth quarter and fiscal 2017 fiscal results reflect the success of our unique value proposition.

In our fourth quarter, we delivered a 26% increase in sales, which is our 11th consecutive quarter of 20 plus percent sales growth, driven by a 23% increase in stores and a 7.1% increase in same store sales, representing our 12th consecutive quarter of positive same store sales increases. Our top performance, along with gross margin expansion and expense leverage, fueled a 62% increased in adjusted operating income and a 100% increase in pro forma adjusted EPS of $0.28.

Turning to fourth quarter comp store sales, our 7.1% increase outperformed against both our long-term target of low-single-digits and the outlook we shared with you in January, driven by two main factors.

The first is the journey we started on three years ago to carve out a position as the holiday decorating headquarters for customers who want great holiday style and unparalleled value. We began transforming our fourth quarter offerings from basic commodity products to a creative assortment that firmly establish us as the go-to destination for holiday decorating. We've seen the success of this transformation deliver a 6.4% comp in Q4 last year and a 6.1% comp in Q4 of fiscal 2015. In fiscal 2017, we continue to merchandise the seasonal assortment along our archetypes, but we also expanded those décor themes and improved our inventory planning, to ensure we had enough on hand to satisfy our customers and deliver a very strong three-year trend.

The second driver of our robust fourth quarter was with inventory we brought in during the back half of last year. As we discussed in our third quarter earnings call, we conducted a thorough analysis of our inventory in the second quarter and identified an opportunity, specifically on items below $10 and $25.

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We capitalized on this opportunity to gain in Q3, and our customers responded, resulting in a broad-based sales lift in our everyday assortment.

From both the top and bottom line perspective, the fourth quarter was an exciting end to a year during which we achieved many important milestones and made progress against all of our strategic priorities, which I will go over shortly. In fiscal 2017, we grew our store footprint by 23% and ended the year with 123 stores. Strong new store performance, along with a 3.7% same store sales increase, drove a 23% overall sales increase for the year. In combination with a 23-basis-point improvement in adjusted operating margin, we drove a 26% increase in adjusted operating income and a 44% increase in pro forma adjusted EPS for fiscal 2017.

As I discussed on last quarter's call, we're very disciplined in executing against our strategic priorities, that cover the following areas:

First is our customer. We want to know the home décor shopper; specifically, the At Home customer, very well. To this end, in fiscal 2017, we grew our email database by over 120% year-over-year. We also announced a partnership with Synchrony Financial to provide customer financing options and began laying the groundwork for the private label and co-branding credit card program that we plan to launch later this year. Progress was made in each of these initiatives and is an important foundation for designing more targeted personal ad marketing efforts in future years.

Second is our assortment. We want to provide the largest and freshest assortment of home décor at the best value in the industry. This includes ensuring we have the right amount of inventory in every store to meet the needs of our customers. This past year, we continued to focus on our category reinvention strategy, in which we revamp and elevate portions of our offerings, to highlight that there is always something fresh and exciting about our assortment. These reinventions not only create a reason a to buy for our customers, but also create additional opportunities to communicate with her throughout the year.

As I mentioned earlier, we also strengthened our value proposition by investing in more inventory at our lowest price points, which received customer response in the back half of the year.

Our next priority, and our biggest growth opportunity is our new store growth. We have substantial white space. At only 123 stores at year end, we believe we can grow our nationwide footprint almost five times, to at least 600 stores. We have discussed before customers respond quickly and enthusiastically to our concept, which enables us to open our stores with relatively high first-year sales volume, and generates payback on initial store investment in less than two years. In fiscal '17, we opened 24 stores, expanding our store base by 23%. The reception to At Home has been, and continues to be, consistently strong across a wide variety of markets, whether new or existing, large or small, urban or suburban, and our fiscal 2017 new stores were the strongest performing At Home class to date.

For instance, opening in new markets for Minneapolis, Minnesota, Jackson, Mississippi, Albany, New York, significantly outperformed our initial expectations and highlighted the geographic diversity and affordability of our store base. By the same token, we saw encouraging outperformance when we open new stores in existing markets, such as our fourth location in Salt Lake City, and a very successful relocation in our home market of Plano, Texas.

Overall, the success of our fiscal 2017 stores gives us even more confidence in our long-term unit growth prospects.

Our fourth strategic focus is our in-store experience. We want to ensure that when our customers come to At Home they find our self-help shopping experience easy and enjoyable. In fiscal 2017, we concentrated on making sure our customer understood the value they were getting when they walk through our door. For example, we implemented a one-week-only special called *Flash Finds*, showcased by typically 50% off our everyday low prices. We also increased signage and value messaging throughout the store, and involved our end-caps feature tables. We were very pleased with the response

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that these value communication initiatives. We will continue to assess them and refine them in fiscal 2018.

Onto our fifth priority, operating efficiency. This means making the necessary investments in systems and infrastructure to ensure we're operating efficiently and effectively, while simultaneously solidifying our foundation to support the financial growth that lies ahead. For several years, At Home has operated a best-in-class, super-lean, self-help labor model. This year, we continue to find efficiencies and improve processes at the stores and our distribution centers, ultimately contributing to gross margin improvements through a reduction in non-product costs, like shrink, damages and breakage. Other fiscal 2017 investments were dedicated to improving product acquisition and distribution. In the second quarter, we brought in new expertise in our transportation company, by outsourcing it to a best-in-class supply team. We implemented a merchandise planning tool, which, is combined with the inventory allocation tool we implemented in fiscal 2016, will further support our objective of ensuring the right inventory at the right store at the right time. In the fourth quarter, we also completed the expansion of our distribution center in Plano, Texas, resulting in capacity to support up to approximately 220 stores.

Sixth is our brand. We are focusing on thoughtfully and aggressively expanding the At Home brand. In fiscal 2017, we expanded our marketing spend to 2.6% of sales, from a little of 2% in fiscal 2016. This incremental investment is largely dedicated to driving long-term brand awareness through our partnership with HGTV, that showcases a wide variety of indoor/outdoor everyday and seasonal home décor at value-oriented prices. This year, we also concentrated on our customer acquisition, a critical touch point, by successfully testing and rolling out new-mover program, intensifying Back to campus efforts, as well as adding direct mail to our marketing playbook for new store openings. In each of these initiatives, we saw customer response rates significantly above industry averages. We expanded our online presence, as well, enabling customers to browse almost 50,000 items on our website, more than doubling our number of pages viewed. We grew our social media following by 50% across Facebook, Instagram, Pinterest and Twitter, as millennials became a bigger part of the picture across the industry. Due to the visual nature of our business, we used videos for the first time to better showcase our products. We are extremely encouraged by the viewer engagement results and we expect to build on the success of visual media in fiscal 2018. Finally, enhance the overall look and feel of the At Home brand across digital, social and traditional media, to better communicate with and inspire our customers and home décor enthusiasts.

Our final priority, and the foundation of all others, is our team. Our success is the direct result of solid execution by an extraordinarily team of individuals. They are the heart of At Home and making sure that At Home is a great place for our team members to work, grow and build a career. In fact, we were named one of North Texas' best places to work this past year. The excellent team we've assembled has consistently delivered above plan results every year. I'm thrilled to announce that fiscal 2017 is the first year that every single team member was eligible to participate in our bonus program, from our part-time hourly associates that could earn up to 5% of their annual wages to our store directors who already have an unlimited bonus incentive plan. We continue to drive consistent annual reductions in store turnover, promoting the highest number of field employees to date. We also promoted a significant number of home office and distribution center people, including promotions into both of our new Chief Accounting and Chief Operating roles. In our fast-paced, high-growth world, we expect a lot from ourselves, and once again, I couldn't be more pleased with the great outcome we delivered together.

Looking back, fiscal 2017 was a momentous year for At Home. We completed our Initial Public Offering, becoming one of the few retail IPOs in recent memory. Over the past four years, we have delivered a 20% top line compounded annual growth rate, positioning us as one of the fastest growing retailers in America. This year, we continue to bring great trends at affordable prices into the homes of our customers, made substantial operating progress, and ultimately outperformed our financial expectations.

As we look ahead to fiscal 2018, we remain committed to building upon this progress by focusing on the same strategic objectives I just laid out, with an even greater concentration on the two areas that we believe present the biggest growth opportunity, driving brand awareness and opening new stores.

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To support our brand awareness effort, this year, we're increasing our marketing by budget to 3% of sales, while continuing to focus on maximizing the productivity and effectiveness of every dollar spent. We issued a press release earlier this morning announcing that for the first time as the At Home brand, we're launching a fully integrated marketing campaign called *Unleash your Inner Decorator*, that will support the expanding footprint with advertising in more twice the number of markets in fiscal 2017. This is our first marketing effort of this magnitude, and it utilizes a holistic customized approach that includes television commercials on national programming, aired specifically in our priority markets across the country. The national campaign launch is next week and draws on our own unique brand personality to highlight a seasonal and everyday assortment, an enjoyable self-help experience, and everyday low prices. We also plan to launch our credit card program late this summer, that will not only provide attractive financing options for our customers, but eventually allow us to communicate with them in a more commercialized manner and deliver an even better shopping experience. Finally, this past month, we welcomed Ashley Sheetz as our new Chief Marketing Officer, who we are excited to have lead the fiscal 2018 initiatives.

Turning to new store growth, I am excited about our fiscal 2018 pipeline, that reflects our core competencies being flexible and opportunistic. Judd will cover our outlook in more detail shortly, but at a high level, we'll be expanding our store count by 20% through 25 net new store openings this year, and early indication is that this will be another strong class. We're ramping our new unit growth for the fourth year in a row and have more new At Home stores planned in 2018 than we ever had. I mentioned earlier that our newly expanded distribution center can support up to approximately 220 stores, but, consistent with our disciplined and thoughtful approach to everything we do, we already have cross-promotional team in place that is analyzing the requirement of developing an optimal plan for a second DC to be opened in the coming year, as we continue our high growth journey.

With that, I'd like to turn the call over to Judd to walk you through our financial performance in more detail and provide an outlook for fiscal 2018. Judd?

Judd T. Nystrom:

Thank you, Lee. Good morning, everyone. I will begin my prepared remarks with a review of our fourth quarter and fiscal 2017 results, and then discuss our outlook for fiscal 2018. As a reminder, additional information is available in our earnings release, which can be found on our IR website.

During our fiscal fourth quarter, we increased net sales by 26.4% to $234.5 million, driven by the strong performance of our new store sales and a 7.1% increase in comparable store sales, on top of a 6.4% comp store sales increase in the fourth quarter of last year. As Lee mentioned, this quarter reflects a multi-year effort we have made to provide our customers with an unmatched assortment of value priced décor, especially during the holidays. It also illustrates the broad-based positive response our customers have to the additional low priced inventory we brought in, and represents our 11th consecutive quarter of 20 plus percent net sales growth and our 12th consecutive quarter of positive comp store sales increase.

Fourth quarter gross profit dollars increased 28.6%, driven by the 23.6% increase in sales, as well as a 60-basis-point increase in gross margins to 32.3%. As expected, we saw merchandise margin improvement driven by vendor contributions to support our brand awareness efforts, as well as the reduction in our shrink and damage as a result of operational and process improvements we implemented in fiscal 2017. This was partially offset by an increase in distribution center costs to process the incremental inventory that helped drive sales in the quarter.

Despite these inventory processing costs, as well as higher incentive compensation, our top line outperformance enabled us to further leverage our adjusted SG&A by 250 basis points and deliver 60% growth in adjusted operating income in the quarter.

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Our 36.4% effective tax rate for the fourth quarter was favorable to our outlook and partially impacted by items discrete to fiscal 2017, including some tax benefits related to sale-leaseback transactions executed in previous years.

We are very pleased we have doubled our bottom line results, relative to the fourth quarter of fiscal 2016. Pro forma adjusted net income for the fourth quarter was $17.4 million, or $0.28 per share, compared to pro forma adjusted EPS of $0.14 in the fourth quarter of last year.

Looking at our results for the full year, net sales increased 23.1% to $765.6 million, driven by a 23% store growth and a comparable store sales increase of 3.7%. Gross margins increased 10 basis points due to the same factors that impacted the fourth quarter, largely offset by an increase in occupancy costs as a result of sale-leaseback transactions. We generated more than $62 million in gross sale-leaseback proceeds in fiscal 2017, which we use, along with cash from operations, to self-fund our new store growth.

As Lee shared, we are committed to delivering value to our customers and driving brand awareness. Therefore, we continue to reinvest sales and margin upside back into the business through initiatives such as our *Flash Finds*, which help ensure our value proposition remains fresh for our customers, and through incremental marketing spend, which increased as a percentage of sales by 60 basis points from fiscal 2016. Despite this reinvestment, we are very pleased to have increased our adjusted operating income 26% and expanded adjusted operating margins by 23 basis points to 10.3% of sales, while simultaneously investing in all of our strategic objectives, as Lee discussed.

Our tax rate for fiscal 2017 was 36.7%, driven partially by the three items benefiting our rate in the fourth quarter. The fiscal 2016 tax rate of 133.8% was primarily impacted by changes in the valuation allowance on our deferred tax assets, which was substantially reversed in the fourth quarter last year. As such, we used a normalized 39% tax rate to pro forma last year's results for comparative purposes. Factoring in this normalized rate, we generated a year-over-year increase of pro forma adjusted net income of 44% to $36.5 million, or $0.59 per diluted share.

Turning to the balance sheet, year end inventory increased 38%, driven by three factors. First, approximately half of the increase is due to the 23% new store growth we delivered in fiscal 2017; second, almost a third of the increase is related to an acceleration in purchase timing, which includes the impact of an earlier Chinese New Year in 2017, and a pull-forward of certain seasonal items to better meet customer demand; and, finally, our incremental inventory investments in lower priced inventory in the second half of the year drove the remainder of the overall inventory growth. Adjusted for the timing of year end shipments, on a comp unit basis, we are roughly flat to fiscal 2015 inventory levels.

From a debt perspective, we significantly improved our leverage ratio as a result of payoff of our second lien term loan using the proceeds from our third quarter IPO, as well as contractual principal payments. We expect to see interest expense continue to decrease in fiscal 2018, due to a fourth quarter rate step-down on our term loan. I would like to emphasize again that we remain committed to reducing our leverage over time.

Now, I'd like to cover our fiscal 2018 outlook.

In fiscal 2018, we expect net sales in the range of $903 million to $910 million, which represents a growth rate of 18% to 19% over fiscal 2017. Given the opportunity to expand our store footprint by approximately five times, new stores are the primary driver of sales growth. We anticipate opening 28 stores this year, or 25 on a net basis, when considering one relocation, one rebuild and one closure due to an expiring lease term.

As we mentioned on our third quarter call, the availability of high-quality, second-generation locations for fiscal 208 is greater than we initially expected. Since August 2016, there have been over 400 big-box closures announced, 300 of those announced year to date, 2017, presenting us with an even greater

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pipeline of leases than we had contemplated a year ago, or even a quarter ago. Given our flexible and opportunistic real estate strategy, we are very excited to be in a position to capitalize on this opportunity. As a result, we have shifted our planned mix of fiscal 2018 openings towards more leases versus owned stores, impacting fiscal 2018 EPS by $0.06, given associated occupancy and preopening expenses. We've also added one additional store to fiscal 2018 store operating plan, impacting fiscal 2018 EPS by a penny, as well as we moved up the timing of some of our fiscal 2019 openings, resulting in one cent of additional preopening expenses being absorbed in this fiscal year. In summary, we now expect 20 lease stores, seven new builds and one purchase for fiscal 2018. As Lee mentioned, our fiscal 2017 class of At Home stores was our strongest to date, which gives us a tremendous amount of confidence in our fiscal 2018 pipeline.

Our top line guidance also assumes a low-single-digit comp store sales increase up 2.5% to 3%. This reflects expected comp performance higher than this range until we anniversary fiscal 2017 incremental inventory investment in the third quarter and lower comp performance in the second half of the year as we lap strong prior year comparisons.

Pro forma adjusted net income for fiscal 2018 is expected to grow 25% to 30%, based on a range of $45.5 million to $47.5 million, which excludes approximately $11 million of pre-tax non-cash stock-based compensation expense related to the special one-time IPO bonus grant.

We expect a full year effective tax rate of 37.5%, which does not consider the potential impact of the new stock-based compensation accounting standard that became effective at the beginning of fiscal 2018. We will separately disclose any impact of that accounting treatment as we experience it on a quarterly basis.

Based on an estimated 63.5 million diluted weighted average shares outstanding, we expect pro forma adjusted EPS of $0.72 to $0.75, which reflects the $0.08 impact of the opportunistic shift in store mix, incremental new store openings and preopening expense, with the timing related to fiscal 2019 new stores I just discussed. This has been partially offset by the strength in our top line existing 2017, resulting in expected pro forma adjusted net income growth of 25% to 30% for fiscal 2018.

We also wanted to provide some color on the cadence of our fiscal year outlook. We expect that capitalized transportation costs related to our fiscal 2017 incremental inventory will disproportionately impact the second quarter gross profit, and we expect our marketing costs to be more heavily weighted in the first half of the year as we elevate our annual expense to 3% of sales and continue to increase our customer awareness, which is a key growth strategy. As a result, we expect to realize approximately 45% of our annual pro forma adjusted net income in the first half of fiscal 2018, with a relatively equal distribution between the first and second quarters.

From a capital standpoint, we expect capex to be $110 million to $130 million in fiscal 2018, which is net of expected of sale-leaseback proceeds of $100 million. The majority of our capital investments is funding new store growth in fiscal 2018. As is typical for us, the timing and mix of new store openings in the following year can have a meaningful impact on capital spend in the current year. Therefore, a portion of our fiscal 2018 capital investment will support our objective to open stores earlier in fiscal 2019, compared to previous years. The remaining investment is earmarked for refreshing and maintaining our existing stores, as well as information technology initiatives.

Overall, we are very pleased with the progress we have made against all of our strategic priorities, which has driven our strong performance in both Q4 and fiscal 2017. I would like to thank our team members for their dedication to our customers and for their strong execution on our strategic priorities. Our team is focused and committed to deliver on our operational and financial goals, which should result in another fantastic year for the Company. The fundamentals of our business remain strong and consistent. With our compelling value proposition resonating with customers now more than ever, ultimately, we believe we have the right initiatives in place to build on our progress in 2018, and to achieve our long-term targets of high-teens sales growth and 25% net income growth.

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I will now turn the call back to Lee for closing remarks.

Lewis L. Bird, III:

Thanks, Judd. At a high level, we believe At Home has all the pieces in place to be a leader not only in home décor, but all of specialty retail. The home furnishing sector is growing and highly fragmented, leaving us well positioned to continue to take share. We're a value player at a time when value is resonating more than ever with consumers not only in our industry, but across all of retail. We have some of the best store level economics in specialty retail and our new stores continue to outperform year after year. Finally, we have tremendous white space and the long-term potential to grow our current store footprint almost five times. We're excited about the growth we have right in front of us and we look forward to fiscal 2018, which we believe will be another record year for At Home.

Operator, please open the line for questions.

Operator:

Thank you. At this time, we'll be conducting a question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you'd like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star key.

Our first question comes from the line of John Heinbockel with Guggenheim Securities. Please proceed with your question.

John Heinbockel:

Hey, guys. Can you hear me?

Lewis L. Bird, III:
We can. Thanks, John.

John Heinbockel:

Okay, good, good. So, two things on real estate. How would you characterize the 2018 class as it stands today versus '17, in terms of quality of location? Then, given what's gone in retail, what's your current thoughts on non-linear expansion and the potential for that?

Judd L. Nystrom:

Yes, John, I'll tell you the nice thing about situation is there's a whole lot of big-boxes that have become available, and that's why we mentioned that we've got more leases than we originally planned. When you have a lot of options, you can be more selective. So, with that selection process—and you've spent time with us, you know how disciplined we are around real estate, but we're super-disciplined analytically, we look at every single site on paper, we run through a model that we run with—we're now on our third generation with the Buxton model, to help us analyze specifically a location. We've got qualitative assessments, as well. So, I feel really good about our 2018, because we've been able to be selective, because we had more options to choose from, and we did pick more leases this year. Because that was available, we could push out some of our ground-up build plan, and then we can also front-end load next year, which has some capital implications, but it just means we had a really nice supply of things to look at, but we could be even more selective than ever. So, that's the first thing.

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On the non-linear move, we're going to continue to focus on delivering consistent growth performance for our Company. There's more options. We're just going to be more selection about them. So, as we've mentioned before, we build the plant upfront, we're opportunistic. There's happens to be more to choose from, but we're just going to take what we need to to deliver our growth expectations every year, and if there's some more available next year, because those that became available this year will still be around, that'll be great, and then help our economics in the future.

John Heinbockel:

All right. Then, the second one, when you think about the right marketing spend long term—so you gave 3% this year. When you think about your model looking out, where should we be or could we be in let's say three years, and what do you think is a steady state level to be at relative to sales?

Lewis L. Bird, III:

Well, we're financially disciplined all along the way. So, what we said is we'll spend more if we can afford more to build our brand. Some companies do it the other way around, they spend up front and they don't worry about profitability. We've focused on profitability and performance consistently. So, we've been building that spend. We'll do it at 3%, we'll measure, we'll make sure it's effective. We'll make sure it's effective in every medium that we choose. We're going to national media now and buy locally. As we measure, if it's more effective at driving the outcomes we're looking for, we'll spend more against it, and you'll see the outcomes. We've committed to a long-term financial model, that we're committed to. As we have better improvement in margin and profitability, we said—as Judd has always mentioned, and I have, too, we'll plough it back into better price points and more marketing to build our brand over time.

John Heinbockel:

Okay. Thank you.

Lewis L. Bird, III:

Thank you, John.

Operator:

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

Simeon Gutman:

Hi, can you hear me okay?

Lewis L. Bird, III:

We can, Simeon, thank you.

Simeon Gutman:

Okay, thanks. Okay, so two questions. First, on the top line, can you give us a sense—when you preannounced earlier in the quarter, I feel like early January—I think at the time you said you were running like 4.5 to five-ish—I guess, were you being conservative at that point, anticipating that there was choppiness, or was there a pretty big step-up at the end of the quarter, and I'll ask my second question as part of this, in case my phone cuts off? In thinking about, you know, you're leasing more stores, you're going after more favorable real estate, I'm assuming that the top line performance of the stores may look

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better on paper than what you're also expecting. Is that fair and is that reflected in your 2018, in your fiscal 2018 guidance? Thank you.

Judd T. Nystrom:

All right, Simeon, this is Judd. What I would tell you about Q4, we provided the updated outlook in early January. At that point in the quarter we had strong comp store sales momentum. We know that January typically can be choppy, just weather can impact us in the month of January. We actually had a very strong January, weather was actually a bit of tailwind associated with that, but we felt very strongly the momentum through the quarter, and how we exited fiscal 2017. So, that provided the comp upside overall.

Your question around leasing more stores, what we'd tell you is we leased more stores as a percentage of the portfolio mix last year, and as Lee mentioned, both of us mentioned on the call, our vintage fiscal 2017 was our strongest new store class as a Management Team, but as we look at the mix at leases for 2018, we feel good about the stores we have, and the sales upside associated with that class of stores is based into our guidance, of what we provided for top line growth of 18% to 19%.

Simeon Gutman:

Okay, thanks, Judd.

Judd T. Nystrom:

Thanks, Simeon.

Lewis L. Bird, III:

Thanks, Simeon.

Operator:

Thank you. Our next question comes from the line of Matt Fassler with Goldman Sachs. Please proceed with your question.

Matt Fassler:

Thanks so much and good morning. I understand the role that inventory, incremental inventory has had and helping to drive the top line. The year-on-year increase accelerated a bit. So, I guess a couple of parts to this. Can you isolate the piece associated with Chinese New Year? Presumably, that's truly non-recurring. Then, talk about the quality of the inventory in terms of the magnitude of pack-away that you might have of seasonal goods, and at what point you would expect inventory growth to begin to converge with sales growth?

Judd T. Nystrom:

Sure. So, Matt, this is Judd. As I mentioned on the call, we had a 38% increase in overall inventory. Half of that was due to the 23 new stores that we opened last year, bout 20% is due to the incremental inventory, and about a third is due to the earlier timing, earlier Chinese New year, a pull-forward of some Q1 seasonal to better meet the spring demand, and then other incidental freight versus timing overall. What we'd tell you, as a retailer, is we don't pack anything away. We sell what we have and it's never a good a thing to pack it away. So, we feel really good about our ability to position our inventory in front of the demand for the spring, and what we can tell you is we have a history of, when you look at our Company, 80% of our net sales are at full retail price, and when we do have to take markdowns, it's still positive. We've done liquidations of stores, where we've relocated stores, and they still deliver positive

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gross margin dollars. Our third-party reviews us and audits our inventory for ABL and they, for four consecutive years, have actually increased the liquidation value of our inventory, which tells you the quality level of the inventory continues to get stronger. So, we would expect our inventory to more normalize in the third quarter, after we lap the incremental inventory that we brought in at low price points.

The other thing I would tell you is the lower price point inventory actually have a lower markdown, as well. So, we feel we're insulated from that perspective.

What we're trying to accomplish strategically is to capture the demand in the store where that customer can add on items in her basket and she can ultimately have a better customer experience. That's what we're trying to pull.

Matt Fassler:

That is super-helpful color. If I could ask one quick follow-up on real estate. Obviously, some of the same forces that are driving more opportunities to you are likely to drive further disruption down the road, and as plentiful as the opportunities, I'm sure you're being even more diligent and careful about where you plant your flat anew going forward. Is there a meaningful change to the kinds of sites that you're taking, in terms of adjacencies, centrality of the location, as you see these opportunities begin to sprout?

Lewis L. Bird, III:

This is Lee. I'll tell you, because we can be more selective, yes, we're finding better locations. We look for friends—we call friends. We want really nice co-tenancies and adjacencies, access and visibility. Those are the four key elements that we look for. So, I will you, this class, it was our best class ever, and fiscal 2017 had that. We had better co-tenancies, we had better adjacencies, much better visibility from the highway, and much better access, as well, from the arterial road, and we look for that. We want it to be as easy as possible to find and shop at an At Home store, and when people are already shopping, we like to draft off of people that are already stopping at other stores. Because we can be more selective, we can look for higher quality locations, and we've done that.

Matt Fassler:

Thank you, guys. I appreciate it.

Lewis L. Bird, III:

Thank you, Matt.

Judd T. Nystrom:

Thank you, Matt.

Operator:

Thank you. Our next question comes from the line of Dan Binder with Jefferies. Please proceed with your question.

Dolph Warburton:

Hi, this is Dolph Warburton on for Dan. Thank you for taking our question. Just on the merchandize reinvention, did you guy see that outperform over the quarter; and looking ahead over the next year, can you give us any color on what categories or what products you might target for reinvention? Thank you.

Judd T. Nystrom:

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You asked about the holiday reinvention; is that right?

Dolph Warburton:

No, just your overall program to rework merchandize, to reinvent merchandise, and going forward, I think you guys look to reinvent merchandise continuously, so I just want to know the stuff that was reinvented, did that out perform, and looking over the next year, kind of what categories can we see being affect.

Lewis L. Bird, III:

Okay, sure. Thanks for clarifying, Dolph. So, our reinvention strategy essentially is unchanged since we started it over three years ago. We decided a certain portion of inventory is going—we actually look at a three-year plan and we say what parts of the inventory are going to be reinvented, updated or sustained. Each of them have their own financial target. So, reinvention has to do a double-digit comp, low-double-digit comp, an update has to do a high-single-digit comp, and sustain a mid- to low-single-digit comp. We have a certain portion of our assortment that gets categorized that way every year for three years.

So, for example, for Christmas, the Christmas season, we put together a three-year plan against that. Because it was such a big portion of our business in the past, we want it to be a foundation for us as being a holiday quarters, we focused on continually updating that business for three years running, and that has outperformed our expectations for three years running. So, we were very pleased with holiday and that was part of a three-year update process, for example.

Other categories, like patio furniture, that's a two-year transition for us, a two-year reinvention, and last year we brought in six patio sets and we saw great success on that. We're very thoughtful in our approach to adjusting our assortment. So, we brought in six sets, we loved the performance on it, and now we have 12 sets. So, that was a two-year. One could have said you could have done all that in one year. We're very thoughtful. We want to test and measure performance. We use test and control on all of our analysis, and then we roll it forward.

So, I would say next year's reinvention plan, for this coming year's reinvention, it's consistent with prior years. It's a very methodical approach. We always have a running three-year plan. We're not doing any more than we did before, we're not going to do any less than we did before, and I will tell you we're getting better at executing against those reinventions. I will tell you the holiday assortment, both Halloween, Harvest and Christmas, reflected that better execution, and we're continuing to learn as we do it on how to become better and better at it.

Dolph Warburton:

Thank you for taking my questions.

Lewis L. Bird, III:

Thanks, Dolph.

Operator:

Thank you. Our next question comes from the line of Oliver Wintermantel with Evercore ISI. Please proceed with your question.

Oliver Wintermantel:

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Yes, good morning, guys. I had a question regarding your comp in the fourth quarter, 7.1. Can you maybe quantify ticket versus traffic, and what you think that the 2.5% to 3% comp, what are the driving forces are behind that is more ticket over traffic?

Judd T. Nystrom:

Sure. What we can tell you, and we're consistent with this every quarter, it's broad-based growth. The organic metrics, were focused on moving the needle on all of them over time, and each quarter it could be a different driver. What we commit to is low-single-digits, and, overall, we have initiatives in place to drive all the metrics. Lee talked about brand awareness, we've talked about private label and co-branded credit cards, so they should be driving traffic. We talked about baskets, the reinvention, the lower priced inventory, and that should be driving baskets, as an example. So, what we're focused on is moving all the metrics. For any particular quarter, I believe highlighted on previous calls, it can be different drivers, but ultimately what we need to do is make sure we move the needle on all of them to deliver consistent comp store sales growth. We're really proud of the fact that we've delivered 12 consecutive quarters of positive comp store sales growth averaging over 5%. That's what we're focused on, that's what we're committed to.

Oliver Wintermantel:

Okay, great. Just you mentioned that you invested in digital and have now more items online to browse. Is there any update on buy online, pickup in store or maybe even a transactional web page in the near future?

Lewis L. Bird, III:

Yes, our process and approach hasn't changed. We are consumer focused. We know that the top things that she is looking for in home décor, from the home décor, whether that be any channel, she wants price, she wants selection, she wants to see, touch and feel it, she wants to take it home immediately. We offer that today in our stores. But, we're thoughtful and disciplined about what we're doing. We're not going to make any trade-offs for a more expensive channel. We do look at our stores as warehouses that could be leveraged at some point. What we're doing is we're looking at making sure that right now, since we know that she likes to pre-shop, we're continuing to make sure that pre-shopping experience is the best possible, and that we're price competitive against all the online guys, against Wayfair and Amazon. I'll tell you that our prices are at or below our competitors' sales prices, even Wayfair and Amazon. You can check it out. We do all the time. We compare every single month against all of our top competitors. We continue to make some great investments, the Demand Ware platform, ND (phon), e-commerce enabled. We're focused on increasing our visibility of inventory for our sales associates and our customers over time, and our digital marketing spend has continued to grow and grow up and get even stronger. If you look at our social media, it's up 50%, our email database is 120%. So, we're on a journey, our process hasn't changed, we're thoughtful about it, and that's where we stand today.

Oliver Wintermantel:

Great. Thanks very much. Good luck.

Lewis L. Bird, III:

Thanks, Oliver.

Operator:

Thank you. Our next question comes from the line of Daniel Hofkin with William Blair & Company. Please proceed with your question.

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Daniel Hofkin:

Hi. I'm going to take one more stab at that last question on comp sales. Would it be fair to say that traffic was one of the contributors to the upside as the quarter progressed, particularly January?

Judd T. Nystrom:

What we can tell you is we're very pleased with the fourth quarter results. It was a 7.1% comp. It was very broad based. We don't get into the mechanics of each quarter providing that. We're committed to delivering consistent comp store sales growth, we've demonstrated it 12 consecutive quarters and we—what you need to ensure is, one, we need to deliver against the comp store sales growth, which we've done, and that we have enough initiatives underway in each of the drivers of comp metrics to ensure that we continue to consistently deliver comp. We feel really good about programs like our new credit card financing, marketing campaigns, the work we've done on JV8 (phon) planning and allocations, the value messaging, the *Flash* Finds, the reinvention, the in-stock opportunity, the low price points. All of those, I can point to a different lever of comp, of the organic metrics, but ultimately what comes down is each quarter can be a little different. We're extremely pleased with the 7.1% comp and we remain committed to delivering consistent comps going forward.

Daniel Hofkin:

Okay, great, and then just on cap ex and free cash flow, maybe can you tie together a little bit for fiscal '18 what you are expecting? It sounds like free cash flow is likely to be close to breakeven, maybe a little bit negative. When would you see that turning potentially positive on an annualized basis?

Judd T. Nystrom:

Sure. Dan, this is Judd. We provided in the outlook capex on a net basis of $110 million to $130 million. That assumes $100 million in sales lease-back proceeds, which we have a history doing $188 million of transactions over six different transactions. There's about $20 million to $30 million for maintenance remodelize fee, and we'll and will continue to invest in the future of our business. The remainder of the cap ex, and it's important to note, is related to FY19 timing. So, the ground-up builds that we have assumed could be this year. The nice part is when you have more lease opportunities, we can just slow the pace of that ground-up build and move it into the next fiscal year, but we spend money this fiscal year from a capital standpoint, which we intend to do, and that's why you see an elevated level of cap ex, but also a little bit more of drag on pre-opening related expenses.

What we'd tell you overall, from a free cash flow perspective, is we're committed to reducing our leverage and improving our free cash flow, and what we'd you also is there is an assumed use of cash overall, but if we were to slow down the pace or not pull up the pipeline as much, we'd actually have positive free cash flow overall. What we're focused on is making sure that, one, we reduce the leverage and we deliver consistent results, and we're committed to our long-term growth target of high-teens, as well as 25% net income growth, and overall we factor that in and make sure our plans are focused on delivering against it.

Daniel Hofkin:

Okay, great. Thanks very much.

Judd T. Nystrom:

Thanks, Daniel.

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

Denise Chai:

Thank you. I've got a couple of questions on gross margins. I think you mentioned that merch margin was up from vendor contribution and also reduction in shrinkage and damages. How much more is there to come from these initiatives? Are we still in the early innings? Then my second question on gross margin is—the back-half comp was, to some extent, driven by the lower ticket items that you introduced—was there any positive or negative impact on the gross margin from that mix? You had mentioned that there was a lower markdown and there was lower priced products, but do they also start from a lower margin because, say, shipping and distribution costs are just going to be relatively higher on that lower price point? Thank you.

Judd T. Nystrom:

Okay. So, what I would tell you from a gross margin perspective, your question around some of the operational improvements, there is some opportunity related to shrink and damages, but what I would tell you is the team has been focused and committed on that over the past four years and they've done a fantastic job making those operational improvements, which we saw really manifest in the fourth quarter. The Field Team did a fantastic job overall. When we look at some of the other opportunities, there are things out there that we are exploring related to direct sourcing, for example, which could be an opportunity for us to improve our margin rate, but as we communicated, we expect our operating income dollars from our long-term growth target to slightly out pace sales. So, if we get favorability from our gross profit rate, we'll look to reinvest it either in price or in marketing.

Back to your question regarding the third and the fourth quarter, from a gross profit perspective, what we'd tell you is the back half of the year had a higher amount of costs associated with bringing that inventory, most of which is expensed in the quarter, because it's a period cost. So, the costs to move the freight through our DC, cost to put the freight up to the store, that came through, and most of that actually hit gross profit, other than the cost of the stores to put the inventory up. There's a piece that was capitalized, that is actually from the distribution center to the stores, the delivery, and that goes over the turn of the inventory. As we highlighted in our prepared remarks, we expect that to hit primarily in the second quarter. That will be a gross profit headwind in the second quarter. That's factored in our outlook. We've provided more clarity on that and more color to make sure that you understood what that impact can look like.

But, overall, we feel really good of our opportunities to improve gross profit, but what we'd tell you is we're actually, I think, pretty good at managing it. When you look at the multi-year outcome, our gross profit rate is probably within tens basis points. So, where you see others that might have wild swings in gross profit, we're actually very disciplined and very true to our model to maintain our gross profit rate, and any improvement, we expect to reinvest back into the business.

Denise Chai:

Okay. So, are you able to size up the gross margin headwind in the second quarter, and also just maybe comment on margins on the lower priced products that you brought in on the back half, just from a pricing standpoint, the fact they are less expensive than your other goods?

Judd T. Nystrom:

Yes. So, two things. For the second quarter, the way to think about it is probably roughly a hundred basis points that we would expect, and that's not merch margin, that's just the costs that we're going to see of turning that inventory based on what we invested in the third quarter. Your question around lower price margins, what we can tell you it have a consistent margin profile. So, we're not going to have a

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mixed impact related to the lower priced items. The good news is those lower priced items also have typically less markdowns, but they can last longer. They're less back-end orientated. They're more practical for the customers to add onto their basket. So, ultimately we wouldn't expect a margin impact related to that mix.

Denise Chai:

Okay. Thank you.

Lewis L. Bird, III:

Denise, this is Lee. One thing that's unique about our business is margin is relatively consistent across all of our product categories. So, as we shift through our—where customer demand may shift by category and by season and during the year, we can maintain consistent margins across the board and, we actually like that because it's far more predictable, as well.

Denise Chai:

Thank you.

Operator:

Thank you.

Operator:

Thank you. Mr. Bird, there are no further questions at this time. I'll turn the floor back to you for final remarks.

Lewis L. Bird, III:

Great, thank you. Well, thank you, everyone, for joining our call today. We look forward to speaking with you again in the coming days and weeks, and look forward to your support for the At Home brand. Take care.

Operator:

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

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