At Home Group Inc.

Second Quarter Fiscal 2017 Earnings Call

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CORPORATE PARTICIPANTS

Bethany Perkins, *Director, Investor Relations*

Lewis L. Bird, III, *Chief Executive Officer and President*

Judd T. Nystrom, *Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Daniel Binder, *Jefferies & Company*

Denise Chai, *Bank of America Merrill Lynch*

Joshua Siber, *Morgan Stanley & Co.*

Matthew Fassler, *Goldman Sachs*

Daniel Hofkin, *William Blair & Company, LLC*

Oliver Wintermantel, *Evercore ISI*

John Heinbockel, *Guggenheim Securities*

PRESENTATION

Operator:

Good day and welcome to the At Home Second Quarter Fiscal 2017 Earnings Call. Today's conference is being recorded. At this time, I'd like to turn the conference over to Bethany Perkins. Please go ahead, Ma'am.

Bethany Perkins:

Good afternoon everyone and thank you for joining us today for At Home's second 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 provisions of the Private Securities Litigation Reform Act of 1995. In particular, statements about our outlook and assumption for financial performance for Fiscal 2017 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-

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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, such as Adjusted EBITDA, adjusted and pro forma adjusted net income, and adjusted and pro forma adjusted earnings per share on this call. 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.

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

Lewis L. Bird, III:

Thank you, Bethany. Good afternoon, everyone, and thanks for joining us for our first conference call as a public company. I am pleased with our second quarter financial performance which reflects solid execution by the entire At Home Team in delivering strong top line growth and bottom line performance as we continue to make planned investments to support our growth initiatives.

Net sales increased 20.8% over the same period last year to $188.4 million. This increase was driven by strong contributions from new store opening and a 0.9% comp store sales increase. Additionally, we continue to invest in the long-term growth of our business given the significant potential we see before us. In the second quarter we continued to support our key growth drivers by deploying capital behind new stores and investing in local and national brand advertising designed to drive overall consumer awareness of the At Home brand. As a reminder, this is on top of the significant non-linear investments we've already made in previous years to solidify our foundation and add capabilities that will support our future growth.

For the second quarter, we delivered operating income of $18.9 million, net income of $6.3 million, pro forma adjusted net income of $8.2 million, and ultimately, pro forma adjusted EPS of $0.13.

Our continued success is rooted in the strength of our business model, which we've developed to emphasize differentiation and value to our customer. We are the home décor superstore and we provide an unmatched breadth and depth of assortments for any room, in any style, and for any budget in stores averaging a 120,000 square feet. Approximately 70% of our 50,000 SKUs are private label, unbranded or are co-developed with our suppliers, and are a key driver of our differentiation and value proposition.

In line with our everyday value orientation, 80% of our sales occur at full retail price and our industry-leading profitability is driven by a lean operating model and compelling store economics. We're making sure that our customer understands just how compelling our value proposition is by increasing in-store signage and messages to highlight our very attractive pricing strategy that consistently delivers savings to our customers.

We're extremely excited about the growth runway we see ahead of us. We have a very flexible and disciplined real estate strategy that has proven to be successful across a variety of geographies, markets, and types of real estate locations, with our new stores generating average payback periods of less than two years. During the quarter we opened up 10 new stores, bringing our net year-to-date openings to 15 stores and increasing our total store count to 115 locations. We are pleased with the performance of our new stores opened so far this year and we look forward to the additional stores opening in the second half of this year.

We are on track to complete a total of 22 net new store openings that we have planned for Fiscal 2017. Longer-term, we believe that we have the opportunity to grow at least 600 stores, targeting annual store

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unit growth in the high teens. In conjunction with our new store growth plans, we are focused on driving comp store sales growth. We delivered our 10th consecutive quarter of positive comps in Q2, driving a recovery from early quarter adverse weather in our denser markets to deliver a 0.9% growth. Despite the softer weather-driven start of the quarter, I am pleased with our Team's ability to successfully execute on our strategic comp drivers and delivering improved performance to finish the quarter with a 0.9% comp, maintaining our history of positive comp stores sales. I'm also pleased that this momentum has continued thus far into the third quarter of this fiscal year.

With approximately 20,000 new SKUs that we introduce each and every year, we are able to communicate freshness to our customer and give her a reason to shop with us again and again throughout the year. We continue to enhance our inventory capabilities from the planning and allocation standpoint to ensure that we have the right products at the right store, at the right time.

As many of you are aware, we are branded relatively young, having re-branded from Garden Ridge to At Home during Fiscal 2015 to better communicate our positioning as the leading home decor superstore. Given the newness of our brand, we believe there is a significant opportunity to grow our brand awareness in both new and existing markets.

During the quarter we continued to drive awareness of the At Home brand through marketing, digital media and community engagement, and we've participated in an ongoing dialog with our customers through growing social and mobile channels. We have already increased marketing spend from nearly zero in Fiscal 2013 to 2% of net sales in each of Fiscal Years 2015 and 2016 and we intend to increase our spend to approximately 3% of net sales over the next two years.

We are very proud to have entered into a marketing partnership with HGTV this year on their Spring House 2016, which showcased more than 300 At Home products selected by HGTV's own designers, and was supported by branded TV entertainment, online-driven programming, and in-store signs during the first and second quarters of Fiscal 2017. We're also excited to be HGTV's exclusive sponsor of the ultimate High/Low List which will utilize content sponsorship and videos to show audiences to affordably style their own home with designer looks at value price points utilizing At Home products.

We continue to expand our digital presence with an engaging and user-friendly website that allows our customer to browse our online offering for integration and compare our value pricing to other retailers before visiting our stores. Online traffic continues to increase as our digital marketing efforts direct customers to the website where we are consistently adding new features and functionality. Increasing our digital presence is a key initiative for us and we are also exploring opportunities to eventually develop e-commerce capabilities in a very disciplined manner, with a keen eye towards maintaining a profitability of our overall business. However, with 115 stores at quarter-end and a long-term potential to grow to at least 600 locations with payback periods of less than two years, store growth remains our most compelling opportunity and a growth area that we are most focused on.

In summary, I'm pleased with our year-to-date performance which reflects the strength of our business model and solid execution by an exceptional Team that I could not be more proud to lead. We have consistently delivered on or exceeded our financial goals as a private company, and we look forward to building on this track record of consistency as a public company.

However, it's the growth that lies ahead that has us even more excited. We have a differentiated specialty big box format within an unmatched depth and breadth of product, most of which is private label. We have a compelling value proposition and a mission to enable our customers to make their house a home at the lowest prices in the industry. We enjoy industry-leading profitability with levers in place to drive further improvement and fund various initiatives and we have a flexible and disciplined real estate strategy with proven success and compelling payback across a wide range of formats and markets, and with 115 stores today and a potential for at least 600, we have a long runway of growth in front of us. This is reflected in our longer term targets, which include annual sales growth in the high teens, driven by

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high teen store growth and low single-digit same-store sales growth, operating income growth of approximately 20%, and net income growth of approximately 25%.

We have a disciplined, systematic approach to everything we do here At Home, whether in selecting new store locations, collaborating with our suppliers, managing our lean operating model, or responsibly investing our capital. As we look to the rest of this fiscal year, we feel very good about our positioning and readiness for Halloween, Harvest, and the Christmas seasons. Our stores will be easier to shop than last year. The merchandise assortment is even better. The in-store presentation will more clearly emphasize our value message with signage and end-caps that highlight our attractive everyday low prices, and we will communicate this value more effectively through our increased marketing efforts.

In the second half, we expect to see some of the benefits from our non-linear investment that we've made as we work to create the infrastructure and capabilities to support our future growth. We are focused on delivering our near and longer term financial and operating goals and we look forward to updating you on our progress.

I'll now turn the call over to Judd to go over our financial results in more detail, as well as provide our Fiscal 2017 outlook.

Judd T. Nystrom:

Thank you, Lee. Good afternoon, everyone. I will begin my prepared remarks with a review of our fiscal second quarter and year-to-date results, and then discuss our outlook for Fiscal 2017.

During our fiscal second quarter we increased net sales by 20.8% to $188.4 million, driven by new store sales and a 0.9% increase in comparable store sales as compared to a 3.5% comparable store sales increase in the second quarter of last year. As Lee mentioned, this quarter represents our 9th consecutive quarter of 20% plus net sales growth and our 10th consecutive quarter of positive comparable store sales increases.

Continued strength in new store performance was accompanied by positive comp store sales growth despite being impacted by early quarter adverse weather in our denser markets. While we will not be reporting monthly comp results on a go forward basis, we believe it is prudent to provide color on the sales cadence throughout this particular quarter, given the specific challenges we face.

Our current store base is more concentrated in the South, including our home state of Texas, Midwest, and Mid-Atlantic regions of the country. Therefore the prolonged adverse weather conditions that occurred in those areas during May of this year had a negative impact on our performance. While May was certainly challenging, our business rebounded and performed consistently in June and July as we were able to not only compensate for May's weather headwinds but also deliver a 0.9% comp store sales increase, which exceeded the comp sales estimate we provided in connection with our initial public offering.

As Lee said, we're pleased that the momentum has continued into the fiscal third quarter. It's important to emphasize that our differentiated business model is based on highly profitable stores with a typical ramp to maturity of less than six months which drives strong cash-on-cash returns, which Lee shared with you earlier. Because our new stores experience a grand opening effect of typically three months, and then behave like comps store sales, they enjoy payback periods of less than two years. As a result of the very quick ramp-to-maturity, our new stores do not have the natural comp waterfall that many other retailers enjoy. Therefore, we target chain-like comps in the low single-digits overtime driven by our strategic initiatives.

Our 20.8% top line growth reflects the compelling results of our new stores that continue to exceed our targets. We focus on driving sales per store and store-level Adjusted EBITDA because our store size may vary by location due to our opportunistic real estate strategy. We target first year annualized sales of

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approximately $5 million with store level Adjusted EBITDA of at least $1 million in the first year. Our average new store net investment is approximately $2 million to $3 million which varies based on our lease, purchase, or build decisions. Over the past three years, average first-year new store sales have increased 45% and our store level Adjusted EBITDA has increased 64%. Their performance has exceeded the parameters of our new store model consistently and driven 75% cash-on-cash returns, resulting in new store paybacks of less than two years.

In the second quarter of Fiscal 2017, we opened 10 new stores, which represents almost half of the net 22 new store openings we anticipate for the full fiscal year. Gross profit increased 17.6% to $62.1 million from $52.8 million in the second quarter of Fiscal '16. Gross margin decreased by 90 basis points to 32.9% from the 33.8% reported in the same period last year. The decrease in gross margin was primarily due to increased occupancy costs associated with lapping of the sale-leaseback transaction that occurred in the third quarter of Fiscal '16, as well as the liquidation of merchandise in our Plano, Texas store prior to its successful relocation.

It is important to note that we employ a proven and disciplined approach of extracting capital from our store purchases and ground-up builds through the use of sale leaseback transaction. As of the second quarter, we have completed approximately $125 million of such transactions in the past few years, and in the third quarter of Fiscal 2017, we have executed two additional sale leaseback transactions for $63.2 million in proceeds, bringing our total to six transactions generating $188 million. We utilize sale leaseback transactions to help fund our new store growth, which is why we focus on net cap ex.

We observe store sales and store-level Adjusted EBITDA for approximately one year after a new store opens, before extracting our capital in order to reduce the risk of signing a long-term lease commitment. The timing of our sale leaseback transactions, along with the unique mix of leases, purchases, and ground-up builds opened in any given period, can cause occupancy costs and, therefore, gross margin to vary year-over-year. That said, when you look at our historical gross margin, we've delivered very consistent results on an annual basis, which is a direct result of 80% of our net sales occurring at full retail price.

Before we turn our attention to operating performance below gross profit, I would like to point out that my discussion of the remaining items will focus on adjusted and pro forma metrics which will enable Investors to understand our core business on a comparable IPO-adjusted basis between periods. You should refer to the terminology and reconciliation between each of our adjusted metrics and their most directly comparable GAAP measurements in our earnings release issued earlier today.

Adjusted SG&A, adjusted operating income, and adjusted net income are shown net of one time nonrecurring items triggered by our initial public offering, as well as debt extinguishment charges incurred as a result of the refinancing in the second quarter of Fiscal 2016. Specific to our August 2016 IPO, we incurred nonrecurring IPO transactions in Fiscal Years 2016 and 2017, although we anticipate the majority of those expenses to be recognized in the upcoming third quarter of Fiscal '17. Additionally, beginning in the third quarter of Fiscal 2017, IPO-related adjustments will also include a non-cash stock-based compensation expense specific to a special onetime IPO transaction bonus grant. Non-cash compensation expense triggered by the grant will be recognized in accordance with GAAP, almost entirely over the next eight quarters. However, our adjusted metrics going forward will exclude the impact as it is onetime non-cash expense that was specifically tied to the IPO. Our existing stock-based compensation expense, as well as future stock-based compensation expenses for equity incentive grants will continue to be included in our business result.

Pro forma adjusted net income, pro forma diluted weighted average shares outstanding, and pro forma adjusted EPS reflect our performance as if the IPO had occurred at the beginning of each period presented and are tax adjusted using normalized effective tax rates for Fiscal Year 2016 and 2017. This will allow you to more easily compare our core operating performance between periods.

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Returning to the statement of operation, adjusted SG&A was $42.2 million in the second quarter of Fiscal '17 as compared to $31.4 million in the second quarter last year. The increase in adjusted SG&A was driven largely by the addition of 22 net new stores since the second quarter of last year, preopening expenses associated with the timing and volume of new store openings compared to the prior year, and an increase in home office capabilities to support our growth, and incremental investment brand advertising to support overall consumer brand awareness, as Lee discussed earlier.

Additionally, the second quarter of Fiscal 2016 contained a $1.8 million gain on the sale of property compared with a onetime $300,000 loss in the sale of land in the second quarter of Fiscal '17 associated with the expansion of our distribution center. We expect to complete this DC expansion project by the end of the fiscal year which will enable us to support approximately 220 stores. Including the $300,000 loss on the sale of land, adjusted operating income was $18.9 million in the second quarter of Fiscal '17. This compares to $21 million in the second quarter of Fiscal '16 which included the aforementioned $1.8 million onetime gain on the sale of property. As a percentage of sales, adjusted operating margin was 10% compared to 13.4% in the same period last year. The decrease was driven both by the lapping of the prior sale leaseback transaction and the store liquidation gross margin, as well as by the additional expenses to support store growth and the brand awareness initiative previously described.

Store-level Adjusted EBITDA remained strong with 13% growth over prior year and 27.1% margins. We focus on store-level Adjusted EBITDA as we believe it is a good leading indicator of our future Company performance. Our net interest expense in the second quarter of Fiscal '17 was $8.5 million compared to $9 million in the second quarter of Fiscal '16. The decrease in net interest expense was driven by the redemption of the $360 million, 10.75% senior secured notes which were refinanced June 5, 2015.

Our effective tax rate for the second quarter of 2017 was 39.0% compared to a negative 91.7% in the second quarter last year, which reflected changes in the valuation allowance on our deferred tax assets, as well as our state income taxes. Our valuation allowance was substantially reversed in the fourth quarter of Fiscal 2016. Because year-over-year growth rates and net income will appear uneven in Fiscal '17 as we lap the unusual effective tax rate observed in Fiscal '16, we have presented pro forma adjusted net income with normalized tax rates for comparability purpose.

As of the result of the factors I just walked through, pro forma adjusted net income for the second quarter was $8.2 million or $0.13 per share based on 61.8 million pro forma diluted weighted average shares outstanding as compared to $9.7 million or $0.16 per share based on 60.4 million pro forma diluted weighted average shares outstanding in the second quarter of last year. From a year-to-date perspective for the first half of Fiscal '17, net sales increased by 21.3% to $360.4 million. We opened 16 new stores, including one relocation, and comparable store sales increased 1.4%. Adjusted operating income increased by 2.3% to $38.9 million or 10.8% of sales from $38.0 million or 12.8% of sales in the first half of last year. Interest expense decreased to $16.7 million from $19.8 million in the same period last year due to the June 2015 refinancing of our senior secured notes.

Income tax expense also improved to $8.5 million on a 38.4% effective tax rate from $26.4 million on a negative 146.8% effective tax rate in the first half of Fiscal '16. As I mentioned earlier the prior year tax rate was impacted by changes in the valuation allowance on our deferred tax assets, as well as our state income taxes. As a result of these year-to-date factors, pro forma adjusted net income increased to $17.3 million or $0.28 per diluted share based on 61.9 million pro forma diluted weighted average shares outstanding versus $17.2 million or $0.28 per share based on 60.4 million pro forma diluted weighted average shares outstanding in the corresponding period in Fiscal '16.

We ended the second quarter of Fiscal '17 with $8.1 million in cash and cash equivalents on our balance sheet, $79.5 million of availability under our ABL facility, and $427.8 million in outstanding term loan borrowings. In June 2016 we amended our ABL facility to exercise the $75 million accordion feature which increased the aggregate revolving commitments from $140 million to $215 million, an increase of sub-limit for the issuance of letters of credit from $10 million to $25 million. The other terms of the ABL facility remain unchanged.

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As you are aware, we completed our initial public offering in August 2016 subsequent to the close of our second fiscal quarter. The IPO resulted in net proceeds of $132.9 million which were used to repay in full our second lien term loan of $130 million. In connection with that payoff, in the third quarter of Fiscal '17, we expect to record a $2.7 million loss on the early extinguishment of debt. Assuming we do not make any incremental principal payments on our term loan other than what is required under our credit agreement, we expect interest expense to be approximately $11 million in the second half of Fiscal '17.

In terms of our capital allocation policy, given the attractive return profile of our new stores, our focus is on continuing to allocate capital to grow our store base and generate strong cash-on-cash returns. We are also committed to reducing our leverage overtime. Since the end of Q2 Fiscal '17, we've generated $196 million in proceeds as a result of our IPO and two sale leaseback transactions that we have completed in the past 45 days. As a result, both Moody's and S&P upgraded our corporate family ratings to reflect our reduced leverage as a result of the IPO, as well as their views that our continued solid operating performance, driven by our new store base expansion and positive comparable store sales growth, will support further credit metric improvement. Again, we are focused and committed to continuing to reduce our leverage overtime.

Now, moving to our Fiscal 2017 outlook, we will be providing an annual outlook and updating you on the annual outlook each quarter. For the full Fiscal Year 2017, net sales are expected to be in the range of $738 million to $750 million, which when compared to net sales of $622 million for Fiscal 2016, represents a growth rate of 19% to 21%. Our top line performance assumes a low single-digit comparable store sales increase of 1.5% to 2.0%, as well as the opening of 22 net new stores this year, including 1 relocation. Therefore, we expect to end the fiscal year with 122 stores as compared to 100 stores at the end of Fiscal 2016.

Pro forma adjusted net income is expected to be in the range of $33.5 million to $35.5 million, which represents a growth rate of 32% to 40% over Fiscal 2016 and excludes the anticipated pre-tax impact of approximately $1 million in onetime IPO expenses and $5.6 million of non-cash stock-based compensation related to the special onetime IPO bonus grant. Related to the extinguishment of the $130 million second lien term loan, pro forma adjusted net income also excludes $2.7 million of debt extinguishment incurred in Fiscal '17 as well as the $6.2 million of interest that would have been avoided if our IPO had occurred at the beginning of fiscal year.

Based on approximately 63 million estimated pro forma diluted weighted average shares outstanding, full year pro forma adjusted EPS is expected to be approximately $0.53 to $0.56. We anticipate a full year Fiscal '17 effective tax rate of 38.5%.

As it relates to capital expenditures, we expect to incur approximately $140 million to $160 million of gross cap ex in Fiscal '17 or $75 million to $85 million net of assumed sale leaseback proceeds. The vast majority of our capital investment will be spent on 22 net stores, including 2 ground-up builds, 3 purchases, and 17 net second-generation leases. The remaining investment is earmarked for information technology initiatives, maintenance on our existing stores, and the expansion of our distribution center.

Before I close, many of you have asked about the impact of the Hanjin bankruptcy on our Company. We do not use Hanjin directly. Also, because we have large format stores and use space to our advantage, we bring our product in early. For example, our holiday assortment is already in our stores. As a result, we do not expect any product disruption from the bankruptcy.

We are confident that our Fiscal Year '17 will be another strong year of top and bottom line growth. We are very focused on delivering the back half of Fiscal Year '17 to achieve our full year expectation.

We would now like to turn the call back to the Operator who can open it up for questions.

Operator:

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Thank you. If you would like to ask a question, please signal by pressing star, one on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, press star, one to ask a question. We'll pause for just a moment, to allow everyone an opportunity to signal for questions.

Once again, that is star, one for questions.

We'll take our first question from Dan Binder with Jefferies.

Daniel Binder:

Hi. Good afternoon. It's Dan Binder. Congrats on a good quarter. My question was around merchandise margins. I'm wondering if you could comment on that specifically year-over-year. You mentioned that your sales are occurring at 80% full price. Obviously the whole furnishing space has been fairly promotional, so we're just curious how you're navigating that and what you're seeing on the competitive front?

Judd T. Nystrom:

Sure. Dan, this is Judd. So we look at merch margins in every quarter, and if you look at it for the fiscal second quarter, merch margins were roughly flat for the quarter. As we said, our gross profit was down year-over-year in the second quarter, driven by occupancy expenses as well as the planned relocation of our Plano store that was a very successful relocation. So when you look at merch margins overall, they were actually flat and when you look at it on a year-to-date basis, it's been consistent from that perspective. As we look to the back half, we would expect that our merch margins will improve for the back half.

Lee, do you want to address the second part?

Lewis L. Bird, III:

Yes, Dan. Around how do we communicate value and how do we handle the promotional nature of the marketplace, we saw an opportunity in our stores to communicate value more clearly to our customer earlier in this year and what we've done is in the back half of this year, we've actually rolled it out in all of our stores. Our vignette, which we have at least four of them in every store, which is an entire room of every different style that we carry, our end-caps, our feature tables, all of them carry value prices, very clear price points. Some of them have compare app prices where we can compare ourselves versus similar looks in other stores. Some of them are just straight price points that are very low price points.

We've also added a flash find. We added that in the second quarter, which is a special buy. Think of it as a kind of a Black Friday type of item that's a special buy. It's generally about 50% of the price that we normally would carry an item like that. We buy it at special buy through our supply partners and that value item is only available for one week and it's been very successful. It's communicating value and it's haloing to our entire store. We want people to know that these value prices are available in our store. We haven't had to change our pricing structure. We just didn't communicate it as well as we could. So we want it to be very sharp in the way we communicate that going forward.

Daniel Binder:

Great. If I could just add one follow-up question. You talked about benefiting from non-linear investments in the back half. I was wondering if you could be more specific. As it pertains to inventory allocation and changes in the holiday assortment, I was wondering if you could also be more specific as to what the changes are year-over-year.

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Judd T. Nystrom:

Sure. So, related to the nonlinear investments, we actually ramped up a couple of things. New stores, when you look at the number of stores, we opened 10 in the quarter during Fiscal Q2 and when we did that, that obviously—we incurred more preopening expenses. So that would be an example where we pulled some investment forward. We also increased our brand advertising. Lee talked about the importance of that. That takes time. We have a new brand. It's less than two years old and we spent some dollars earlier on the front half of the year that we didn't spend last year on the front half, and that's going to help us position to have a much better second half of the year.

Then over the past several years, we made investments to be able to scale this business and deliver consistent results, and what we were pleased with is the first half of the year when you look at the number of stores we opened—we opened 16 stores—that gives us proof points that as we continue to grow, we can open a larger number of stores and we have the infrastructure in place and the people in place to be able to support that growth in the future.

Lewis L. Bird, III:

Dan, this is Lee. One of the investments we made that Judd mentioned was an inventory allocation system. We invested in that last year. It's a JDA allocation system. We have JDA merchandising systems already, so we did a bolt-on of the inventory allocation system. That allows us to allocate the inventory based on rate of sale or expected rate of sale. So last year we implemented it in the fall and this holiday season or the back half of this year is the first time that we're able to fully allocate based on that system. We've been able to do that this year with patio furniture, for example, on getting the inventory at the right places, where demand is and has been. So we can look at prior year sales, prior stock out rates where we would've had sales if the inventory was there. So we've been able to allocate our fall merchandise with this new system and that should help our performance overall in having the right inventory at the right place, at the right time.

Daniel Binder:

Great, thank you.

Lewis L. Bird, III:

Thanks Dan.

Judd T. Nystrom:

Thanks Dan.

Operator:

We'll take our next question from Denise Chai with Bank of America Merrill Lynch.

Denise Chai:

Thanks. Thanks so much for taking my question and congratulations on the quarter. Just on sale on leasebacks, can you give us some idea of how much visibility you have going forward? I mean, for example, should we expect any more in the back half of the year?

Judd T. Nystrom:

Sure, Denise. This is Judd. So, given what we provided in the third quarter around the two transactions—we also disclosed that in the Q—there may be a modest sale leaseback of $4 million to $5

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million that we may have later this year. But outside of that, we are comfortable with the sale leaseback transactions being able to fund our growth for this year, as well as be able to have net cap ex of between $75 million and $85 million for the full Fiscal Year of 2017.

Denise Chai:

Got it. Thank you, and just a follow-up. You mentioned the adverse weather in your denser markets earlier in the quarter; could you give us an idea of the gap between those weather-affected markets and comps in the rest of the chain?

Judd T. Nystrom:

Sure. So, Denise, one of the things that we would highlight is weather evens itself out when you look at it on a full year. We highlighted that May was challenging. We actually had a benefit that we highlighted previously that fourth quarter last year was actually a tailwind. So when we think about it overall, the weather can hit us but it will balance itself out for the full year.

Lewis L. Bird, III:

Yes. I would say for the quarter itself we were adversely affected in May. If you look at just our footprint, we have a lot of stores in Texas and the Mid-West. They were hit by a whole lot of rain. What we did was we focused on what we could control, and our Team executed our plans in that quarter. So, June and July rebounded nicely and what we're pleased to say is that momentum has continued into this quarter as well.

Denise Chai:

Great. Thanks so much.

Lewis L. Bird, III:

Thanks Denise.

Operator:

We'll take our next question from Simeon Gutman with Morgan Stanley.

Joshua Siber:

Good afternoon. It's Joshua Siber on for Simeon. Can you help size up the monthly comp cadence, and did you exit the quarter running ahead above the implied 2% comps for the second half?

Judd T. Nystrom:

So, Josh, we don't want to get specific on what the number was by month. What we wanted to be able to do was given that the 0.9% comp is lower than what we aspired to deliver, we wanted to give you some color commentary of what happened in May, how things bounced back in June and how they performed in July, and most importantly, the fact that it was a blip on the screen because when you look at it quarter-to-date, we're actually performing consistent with the low single-digit back to what we've committed to from a model perspective. So we'd rather not get into specifics on what each month was just for a lot of different reasons. But I think it's important for you to understand the color that we did provide.

Joshua Siber:

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Sure. My follow-up and it's—I'm wondering if you can talk about the health of the consumer given the unevenness across different retail sectors? Are you guys seeing any changes in shopping patterns?

Lewis L. Bird, III:

Yes, this is Lee, Joshua. You know, I think the consumer's been very careful with their money for some time now and people are thoughtful about where they spend it. That plays very well into us because we're a value player, and so for what we've tried to do is, we try to make sure that our customer sees the value in our store. I mentioned before in one of the answers about our value pricing that we've put in our store and the end-caps and feature tables and the flash find up front so they can see the value. They're very careful with their money but they're still spending, and so what we want to make sure is that we get our portion of that spend, and that communication is going to continue to get stronger in our store.

Joshua Siber:

Okay. Thank you very much.

Judd T. Nystrom:

Thank you.

Lewis L. Bird, III:

Thank you Joshua.

Operator:

We'll take our next question Matt Fassler with Goldman Sachs.

Matthew Fassler:

Thanks a lot. Good afternoon and congratulations on a great start to your life as a public company. I think a lot of the questions about the near-term have been asked and answered. I wanted to ask a question about real estate, and just an update on the kind of opportunities you're seeing. As your credit profile has evolved with the IPO and the debt pay down, are you getting different looks, are you seeing different terms emerge at this point in time that impact at all your view on expansion and the kinds of opportunities you'll have?

Judd T. Nystrom:

Sure, Matt. Happy to discuss that. I'll cover the real estate portion of that. What I would tell you is we've got a great Real Estate Team. We've built the capability over the past three years. They all have big box experience. With that experience comes relationships and those relationships have been built over the years at prior employers and now with us. They've helped us market plan every single one of the DMAs in the US, so we know where our stores—where we'd want to have stores. We also have built an analytical capability to be able to sight score any box operating and we've now pre-scored 20,000 big boxes that are operating today in the US, so we know what those boxes would do if they were At Home stores.

So with that capability and those relationships and those analytical tools, we've been able to work closely with retailers that may decide to right-size their fleet, and when they do that, we already have the relationship with them, and we've been able to work closely with some of those major players. In fact, all of the major players we've got great relationships with, and we've been taking a lot of their—of the boxes that they've decided to shed. What I would say is that pipeline for us is deeper than it's ever been. I love the quality of it. It's better than it's ever been. That gives us the opportunity to be more selective in those

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choices by having a deeper pipeline. What I would say is that allows us to look further out into the future as well. So I feel very comfortable with next year's pipeline and we're already looking to the following year as well.

Lewis L. Bird, III:

Just to answer the second portion of the question, the build-out, what we highlighted. As we think about real estate in terms of the 20,000 big box locations in the United States, we believe there's going to be more supply, and as you look at the demand, there's going to be less demand. We're one of the only ones taking over the boxes, which is going to position us to maintain or improve our industry-leading economics of cash-on-cash returns.

Your question specifically on credit profile, as I mentioned, we are committed to reducing our leverage over time and improving our free cash flow. Obviously, paying down debt is going to put us in a better credit profile, which was recognized by Moody's and S&P. We will benefit over time on sale leaseback transactions because we'll have a better credit profile for the REITs. We believe overtime it will help us reduce interest expense and when you look at that together, given the amount of leases we have and the amount of debt outstanding, we'll be better positioned to improve our net income over time.

Matthew Fassler:

If I could just ask a quick follow-up, you answered questions I think directly on Hanjin and its impact. Can you talk about the duration of your shipping contracts and pricing because one of the things we hear about Hanjin is that even for firms that have no direct exposure, over time capacity coming out of an industry that had been arguably have excess capacity could raise pricing on the element of cost of goods that have been quite advantageous. So, how long are your current agreements typically in force and any observations you have on cost impact there?

Judd T. Nystrom:

Sure. So our current agreements actually get renewed typically with the industry in the spring, summer timeframe. So our current agreements will cover us into, call it, May, June Calendar Year '17. That's number one. Number two, we are seeing an uptick in the amount of what it costs to ship a container. Based on what we've heard, it's a couple of month type increase, not a huge increase overall when we look at it. Now we're on our weighted average cost, so—and we turn our inventory two times a year—so when you think about the implication for this year, there isn't one. When you think about the implication for next year, and we assume several months of higher shipping costs, there will be a modest headwind—and I want to emphasize modest because when you look at the average cost and so forth, plus turning two times a year, when we did the math, it's not even enough to mention.

Offsetting that, what we want to highlight is we embarked on a journey to outsource our transportation to reduce transportation expenses. We did that in May of this calendar year, and that is on pace to deliver benefits that will be manifesting itself in our growth profit rate. So the good news is we already have work underway that was going to help reduce our transportation costs. While this will be a slight headwind, it's not enough to even change our feeling or our outlook.

Matthew Fassler:

Thank you so much for that detail.

Judd T. Nystrom:

You're welcome.

Lewis L. Bird, III:

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Thanks, Matt.

Operator:

We'll take our next question from Daniel Hofkin with William Blair & Company.

Daniel Hofkin:

Good afternoon. Nice quarter, guys. Just a couple of questions; first on advertising and the general advertising and then CRM, what do you see as the biggest opportunities for you overtime and do you think your ad expense rate as a percent of sales will continue to rise, where might that go? Then I just had one follow-up clarification at gross margin.

Lewis L. Bird, III:

Sure. Daniel, this is Lee. Advertising for us, we're on a journey to build a great brand overtime, and this journey started two years ago when we rebranded At Home to make it more clear to our customers in existing markets and clearly more easy to understand what we offer in new markets of us being the home decor superstore.

What we've done is we have a playbook that we use that has proven to be very successful because you can see by our new store performance. As we open up new stores, it's a playbook around introducing them to the brand, and so that, in each market, the playbook may vary a little bit, assume that it's going to have elements of out-of-store, a lot of social media, a lot of digital, as well as other types of maybe growing marketing and street teams. We use a formula and we adjust it by the market, but it's been very successful.

What we look at from a national brands—so that's the local side of marketing, and when we do campaigns in season, we use that type of playbook in certain markets as well to build the brand that may be in existing markets. On the national level is the partnership we started with HGTV that we are using to build our brand awareness overall. We feel that's an opportunity to make our brand feel bigger than even our footprint today. It's a national footprint. It'll cover markets were we don't even have stores today, but people will become aware of our brand overall.

There've been opportunities going forward in the future to add a loyalty program, a credit card program, both of which we're working on right now. We intend to roll those out in the next 18 months. You should expect those to help us better understand who our customer is, a lot more visibility in who that customer is, a lot more detail, we can start to target our communication better than we do that today. But what we like is the progress we've made so far and we still see a real opportunity to build our brand awareness overtime.

Daniel Hofkin:

Okay. Great. Then on the gross margin, is that just a one-off situation with the liquidation of inventory prior to relocating a store, or is that—when you do that in the future, would you expect the same approach?

Judd T. Nystrom:

Yes. So that is an event that occurs when we relocate stores. We don't have a lot of relocations but when we do, do a relocation, what we like to do is liquidate the inventory in place and get—we end up attracting a new customer, and when we move the store we have historically seen our net sales for that location to increase roughly 20% even when we are decreasing the box size by up to 50% to 60%. It's

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still very profitable for us to liquidate the store. It actually will generate positive gross margin dollars and we do it in a very disciplined way, but it can create a margin rate headwind in that quarter.

Daniel Hofkin:

Right. How much was that just in isolation within the margin?

Judd T. Nystrom:

Thirty basis points in the second quarter.

Daniel Hofkin:

Okay. Thanks very much.

Judd T. Nystrom:

Welcome.

Lewis L. Bird, III:

Thanks Daniel.

Operator:

We'll take our next question from Oliver Wintermantel with Evercore ISI.

Oliver Wintermantel:

Yes. Thanks. I had a question regarding the comp in the second quarter, the 0.9%. Can you maybe break that down into transactions versus that tickets, please?

Judd T. Nystrom:

Sure. So, as we've been consistent all along, we're focused on driving all the metrics. What we need to do is be able to deliver a balanced comp overtime and what we shared with you is in any particular quarter there could be a different driver of our comp store sales, and to run a healthy business we've got to actually have all of those metrics moving overtime. So to piggyback on what Lee talked about earlier, some of the marketing and advertising loyalty program, credit card program, that's going to drive traffic. Activities like good, better, best will drive our basket. Our units per transaction around some adjacencies and attachment and conversion will also drive it, but we don't break it out on a quarterly basis. But make no mistake, we're focused and committed to driving the organic metrics consistently overtime.

Oliver Wintermantel:

Got it. Thanks. Then just lastly on the working capital side, in the back-end of the year is there any big moving parts that we should be aware of in inventories or anything else?

Judd T. Nystrom:

Yes. One thing I will highlight is, you'll see an uptick in inventory and part of that is going to be the timing of Chinese New Year, and because of that, we're going to bring it in a little bit earlier. So year-over-year, we're going to have an increase in our inventory, and we'll also have an increase in accounts payable associated with that. But that would be the biggest piece.

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In terms of cap ex, when we look at the back half of the year, given the fact that we opened 16 stores in the first half of the year, the cap ex will have some related to next year overall, but it's not going to change too much as we look at it year-over-year.

Oliver Wintermantel:

Okay. Thanks very much and congrats on a successful IPO.

Lewis L. Bird, III:

Oliver just one other question just to build on Judd's point on our inventory, one thing that I didn't mention when we talked about the economy and focus on value is we see an opportunity as a value player to invest against that and people being very careful, and what we, in the beginning part of this year, we identified an opportunity where when you think about good, better and best assortment, the good being the basics that are commodity-like and sound (phon) where prices our super sharp, we found in stores that didn't have as much inventory versus stores that had more inventory on the goods, the ones that had more inventory on the goods did better and so we want to buy into that and so our inventory investments will be balanced around that. But we want to feed that consumer demand for very accessible price points, and so that's an opportunity that's going to help us drive our business going forward is continue to meet not only higher average retails but also the basics and the better price points to be more accessible to more and more customers.

Oliver Wintermantel:

Thank you. Appreciate the additional detail.

Lewis L. Bird, III:

Thanks Oliver.

Operator:

We'll take our final question today from John Heinbockel with Guggenheim Securities.

John Heinbockel:

So, Lee, just to hit on that last topic, in terms of the good, is that—where are we in flowing that product into the stores and is that more sort of deeper buys on existing items or actually new incremental SKUs at the good level?

Lewis L. Bird, III:

Yes, John, that inventory is flowing into our supply chain now and it will be fully in the store by Q4. What we found was it was the existing commodity-like items and it was new items as well. So we looked at price points that are lower price points in certain categories, it could be under $10 and some other category where under $25 is the more accessible price point for some things in that larger, like furniture items, accent furniture items, it's these (phon) accessible price points. When we look across departments and across categories, we felt like we were underrepresented versus the demand. So we acted on that in the first part of the year. There was a missed opportunity in the first part of the year that we were now feeding the business, so we feel—that's why we feel even better about the back half of the year, specifically the fourth quarter when that inventory will be there.

John Heinbockel:

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Okay. Then secondly, so if I look on your website you've got the price comparison similar style elsewhere signage, right, the blue and the green, is that identical in the stores? How many—when you think about the stores, how many items do you want to highlight at any one point in time? Would you highlight the same items on the web and in-store, and when you think about the comparisons, are you targeting more e-commerce competitors, more brick-and-mortar, some mixed, or both?

Lewis L. Bird, III:

Yes. The items that you'll see on the website will be highlighted in the store. Specifically, the vignettes have all of that compare at pricing and you can see a whole room and you can compare it to other players and they're for similar looks. It may not be an identical—it's not the identical branded items. Our product is privately developed, private branded and exclusive to us. That's how we're able to tell most of it at full price. But it is compare at pricing, so people can see the value.

We weren't really getting enough credit. We didn't feel like we were giving ourselves enough credit and our customer wasn't seeing the value that was already inherent in their product. So the vignettes, which are highlighted online—also many of our end-caps show similar kind of price comparison, and we'll update those as we update those vignettes and end-caps.

We look at our competitive base very broadly. We look at brick-and-motor players, we look at online players depending on the category. As you know, as we walk through the stores with you, we showed you each department may have a different competitor set. So some—one department may have a completely different competitor set from the top five competitors than in other departments. Think patio furniture, some of the home improvement guys show up in patio furniture but they don't show up in wall art. In wall art we would have some online players that are very large players against us. The same with accent furniture or rugs. So each one of them has a set of competitors. So each department is in charge of comp shopping, their assortment, and their pricing every single month to make sure that we're competitive, and we look online and we look at the brick-and-mortar guys as well because everybody shops in all channels anyway.

John Heinbockel:

Then just lastly, can you remind us, in reverse engineering process, you're getting how close to the quality level of the branded product or stuff that you would see elsewhere?

Lewis L. Bird, III:

John, that would depend on it's good, better, or best. So if it's good, it's going be at the same quality level. If it's better, it's roughly the same quality level. At best, we're going to be a discount off of that quality level. So that value engineering process is a journey that we work with, and what we do is we say, "We like this look. We need it for this price," and we work our supply partners to specifically design it for us and to value engineer those costs so that the customer gets great value. So, as you move up that quality continuum from good, better, and best, you'll start to have that come off of that 100% off the goods.

John Heinbockel:

Okay. Thank you.

Lewis L. Bird, III:

Thanks John.

Judd T. Nystrom:

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Thanks John.

Operator:

That does conclude the question-and-answer session for today's call. I'd now like to turn the call back over the Management for any additional or closing remarks.

Lewis L. Bird, III:

All right. Noah, thanks so much. Thank you for everyone for joining us. We appreciate your interest in and in support of At Home. We look forward to speaking with you in the coming days and in the coming week. Thanks so much.

Operator:

That does conclude today's conference. Thank you for your participation and you may now disconnect.

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