At Home Group Inc.

Third Quarter Fiscal 2017 Earnings Conference Call

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PRESENTATION

Operator:

Greetings and welcome to the At Home Third Quarter 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 Third 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 assumption for financial performance for Fiscal Years 2017 and 2018 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, such as Adjusted EBITDA, adjusted and pro forma adjusted net income, 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. In addition, from time to time, At Home expects to provide certain supplemental materials or presentation 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 and thanks for joining us today as we discuss our third quarter results which reflect continued momentum in our business and the broad appeal of our value-centric product offering that continues to resonate with customers.

Net sales increased 22.4% over the same period last year to $170.7 million dollars, driven by strong contributions from new store openings, as well as a 4.2% comp store sales increase. The sales growth was accompanied by over 100 basis points of operating margin expansion, driving adjusted operating income to $7.9 million and pro forma adjusted earnings per share of $0.03 versus an adjusted loss per share of a penny in the prior-year period.

This quarter marks our 10th consecutive quarter of over 20% net sales growth and our 11th consecutive quarter of positive comp store sales growth. I firmly believe that these results demonstrate our dedication to our strategic priorities which are: first, to know the home décor customer, and specifically our customer well; second, 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 at every store to meet the needs of our customers; third, ensure when our customers come to At Home they find our self-help shopping experience easy and enjoyable; fourth, grow our store footprint in new and existing markets; fifth, run all aspects of our Company efficiently and effectively; sixth, be a great place to work and build your career; and, finally, thoughtfully but aggressively expand the At Home brand.

We developed these strategic priorities right after I assembled our highly talented Leadership Team almost four years ago, and we have focused on them each and every quarter. There'll be quarters that we execute on all of these objectives well and some when we fall short, but we remain committed to delivering positive comp store sales growth like we've done every quarter for almost three years. Over time, we believe that keeping this laser focus on the fundamentals of high-growth retail will enable us to deliver strong, consistent results for our customers, our Team Members, and our Shareholders.

Our Fiscal 2017 third quarter performance reflects an even greater emphasis on our priorities and investments made to support them, which I'll cover on the call today. Among our strategic objectives, opening new stores remains our most compelling growth opportunity. During the quarter, we opened up 7 new stores, and early in the fourth quarter we opened our final new store for the year, bringing our Fiscal 2017 store count to 123 stores on 23 net new openings, including one relocation. We are very pleased with the performance of our new stores which have demonstrated strength across small, large,

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existing, and new markets. As an example, the class of Fiscal 2017 include some of the strongest grand openings to date under this Management Team. The diversity of these locations, ranging from suburban Detroit and Minneapolis to Lafayette, Louisiana to the greater Salt Lake City area, and even our first location in the state of New York, highlights the portability of our concept and the success of our broad appeal. Our expansive product offering, combined with our very attractive value price points, are continuing to resonate with customers across a variety of markets.

As I mentioned earlier, I'm very pleased that we delivered our 11th consecutive quarter of positive comps which was a 4.2% increase over last year. Despite a challenging retail environment, our business strengthened in the second and third quarters, primarily driven by our merchandising initiatives. As I discussed on last quarter's call, we believe we made some missed—that we had some missed opportunities in the first half of the year in our lower-priced point inventory. We knew if there were customer appetite for these basic items we'd began flowing them into our stores in the third quarter. While we did incur some additional costs to deliver that inventory, our strong comp store sales performance represented a worthwhile return on that investment. We're continuing to invest against this priority in the fourth quarter and we have raised our full-year comp guidance as a result.

Along the same lines of giving our customers the assortment they want, we continue to remain focused on our cadence of category reinvention where we refresh and elevate our product offering. The reinventions keep our product trend relevant and communicate newness to our customers. In the third quarter, our seasonal offerings centered on fall décor and Halloween, which we reinvented in Fiscal 2016. This year, we upgraded the assortment, enhanced our visual merchandising to better showcase our seasonal assortment, pulling together themes to more cohesively present and enrich the in-store experience. We've also applied this approach our Christmas assortment and early reads in the fourth quarter have been very positive so far.

Also, regarding our second objective, this quarter we continue to focus on making sure our customers understand the affordability of our offering. We communicated our value message more effectively, which we believe resonated with our customers and helped drive our strong quarterly comp sales increase. In-store signage and visual merchandising highlighted the appealing price point of our products, which generated demand in both Everyday and Seasonal categories. We also refreshed our Flash Finds, which are one-week specials that we introduced in the second quarter as one way to more clearly message value to our customers and ultimately drive comps.

We continued to highlight our compelling value through multichannel marketing programs with our Any Reason to Redecorate Campaign, which invites customers to take advantage of our everyday low prices to redecorate their homes for any occasion. We also introduced our brand to a potentially new younger customer through our improved back-to-campus offering, showcasing campus collections through expanded social media and targeted influencer programs. Ultimately, our efforts to enhance the in-store experience and emphasize our value proposition have been very well received, providing a halo effect throughout the entire store, contributing to top line growth.

We continue to investing against our objective to thoughtfully and aggressively expanding the At Home brand. As part of our ongoing relationship with HGTV, this fall we're the exclusive partner of their Ultimate High/Low List on HGTV.com, which featured value-priced on-trend At Home products while referencing competitors' similar higher priced merchandise. We supported this sponsorship through online videos, television and print advertisements, and social media generated by both HGTV and At Home, all of which we leveraged in in-store signage.

Regarding our fundamental priority of running our business efficiently and effectively, we're continuously investing in systems and infrastructure to solidify our foundation and add capabilities that will further support growth. During the quarter, we launched our JDA Merchandise Planning System which, when coupled with a JDA Inventory Allocation System we implemented last year, will better enable us to get the right inventory to the right store at the right time. Additionally, we implemented a new program tool to more effectively manage our real estate projects. We're also nearing completion of our distribution center

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expansion project which will increase the capacity of our already efficient cross-dock DC to over 200 stores.

Speaking of additional stores, our real estate pipeline continues to be very promising with numerous opportunities. We will be providing more detail on specific plans for Fiscal 2018 on our fourth quarter call, but we currently see a mix more heavily weighted to second-generation leases versus new builds. Our flexible and opportunistic real estate model allows us to take advantage of the increasing supply of available locations. We feel very good about our ability to consistently expand our store footprint and an annual rate in the high teens as we progress towards our longer-term potential of at least 600 stores from our fleet of 123 locations today.

So, in summary, it was a great quarter for us. I want to sincerely thank our Team Members who executed on our strategic priorities with discipline to drive these strong top line and bottom line results. We completed our initial public offering using the proceeds to pay down debt and further strengthen our balance sheet, receiving credit rating upgrades from both S&P and Moody's. We announced a partnership with Synchrony Financial to bring customer rewards and flexible payment options to our customers. We saw a strength across new and existing markets, small and large markets, and across product categories, illustrating the wide appeal of our value-oriented merchandise, our engaging in-store presentation, and our expanding customer communication that emphasizes our attractive everyday low price. We have made and continue to make the appropriate investments in our business to support our future growth.

Looking ahead, there is still so much opportunity. We believe we can consistently move the needle on brand awareness. As a reminder, our aided brand awareness is less than half of many of our competitors'. As we increase our advertising spend toward 3% of sales from 2% last year, and grow our store footprint at the high teens rate annually, we have confidence our brand will continue to expand.

On a merchandising front, we believe our continued reinvention and enhanced store experience will drive both comp and new store performance. In the short term, we expect investments in our entry-level and basic inventory to continue resonating with our customers. Longer term, as a launch and ramp our direct sourcing efforts, we expect margin benefits that we can reinvest in price and quality to further deliver sales and profitability. I could not be more excited about the opportunities we have ahead of us and we remain very well-positioned to execute on our near and longer-term goals.

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

Judd T. Nystrom:

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

During our fiscal third quarter, we increased net sales by 22.4% to $170.7 million, driven by new store sales and a 4.2% increase in comparable store sales as compared to a 1.2% comparable store sales increase in the third quarter of last year. As Lee mentioned, this quarter represents our 10th consecutive quarter of 20%-plus net sales growth and our 11th consecutive quarter of positive comparable store sales increase.

In the third quarter of Fiscal 2017, we opened 7 new stores, bringing our net year-to-date openings through the end of the quarter to 22, including one relocation. As many of you are aware, 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. Because our new stores experience a grand opening effect of typically three months, and then behave like comp stores, they generally 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 do. Therefore, we target chain wide comps in the low

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single digit's overtime, driven by our strategic initiatives. Our 22.4% top line growth this quarter reflects a strong performance of our new stores that continue to exceed parameters of our new store model, as well as stronger-than-expected comparable store sales increases driven by the factors Lee discussed.

Gross profit increased to 24.0% to $51.4 million from $41.4 million in the third quarter of Fiscal 2016. Gross margin increased by 40 basis points to 30.1% from 29.7% in the same period last year. The increase in gross margin was primarily due to product margin improvement driven by vendor contributions to support our brand awareness efforts. This improvement was partially offset by investments to bring in incremental inventory, as Lee mentioned, which help fuel top line growth in the quarter. Additionally, we incurred higher occupancy costs resulting from the sale leaseback transactions that occurred in the third quarter of Fiscal 2017. In line with our disciplined approach of extracting capital from store purchases and ground-up builds through the use of sale leaseback transactions, we executed two sale leaseback transactions for $63.2 million in proceeds during the third quarter. We have now completed approximately $188 million in six such transactions over the past few years. As we've discussed, we utilize sales leaseback transactions to help fund our new store growth, which is why we focus on net cap ex.

Before I continue my discussion on our 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. Adjusted SG&A, adjusted operating income, and adjusted net income are shown net of one-time non-recurring items triggered by our initial public offering in the third quarter of 2016 and are not presented in accordance with GAAP. You should refer to the terminology and reconciliations between each of our non-GAAP adjusted and pro forma metrics and their most directly comparable GAAP measurements in our earnings release issued earlier today, which is available on our website.

Beginning this quarter, IPO-related adjustments include non-cash stock-based compensation expense specific to a special one-time IPO transaction bonus grant. Non-cash compensation expense triggered by the grant will be recognized in accordance with GAAP almost entirely over the next seven quarters. However, adjusted metrics excluding (phon) its impact, as it is one-time non-cash expense that was specifically tied to the IPO. Our existing stock-based compensation expense and future expenses for equity incentive grants will continue to be included in our GAAP and pro forma metrics.

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 our normalized effective tax rate for Fiscal 2016 and Fiscal 2017. This will allow you to more easily compare our core operating performance between periods.

Returning to the statement of operations, adjusted SG&A was $42.4 million in the third quarter of Fiscal 2017 as compared to $35.9 million in the third quarter of last year. The increase in adjusted SG&A was driven largely by the net addition of 22 new stores since the third quarter of last year, an increase in home office capabilities to support our growth, as well as labor costs associated with the inflow of incremental inventory and brand advertising to further drive consumer awareness. As a percentage of sales, adjusted SG&A improved 100 basis points over the third quarter of Fiscal 2016 to 24.8%.

Adjusted operating income was $7.9 million in the third quarter of Fiscal 2017 compared to $4.8 million in the third quarter of Fiscal 2016; as a percentage of sales, adjusted operating margin increased 130 basis points to 4.7% as compared to 3.4% in the same period last year. The increase was driven by our improved gross margin, as well as leverage in our home office expenses as a result of our 22.4% top line growth.

Store-level Adjusted EBITDA remained strong with 13.9% growth over prior year. 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 third quarter of Fiscal 2017 decreased to $5.2 million from $8.4 million in the

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prior year, driven by the repayment in full of our $130 million second lien term loan facility during the third quarter in connection with our IPO.

Our effective tax rate for the third quarter of 2017 was 44.8% compared to a negative 187.9% in the third quarter last year, which reflected changes in the valuation allowance on our deferred tax assets. Our valuation allowance was substantially reversed in the fourth quarter of Fiscal 2016. Because year-over-year growth rates in net income will appear uneven in Fiscal 2017, as we lap the unusual effective tax rates observed in Fiscal 2016, we have presented pro forma adjusted net income with normalized tax rates for comparability purposes.

Pro forma adjusted net income for the third quarter was $1.8 million, or $0.03 per share based on $61.7 million pro forma diluted weighted average shares outstanding. This compares to pro forma adjusted net loss of $400,000, or one penny per share based on $60.4 million pro forma diluted weighted average shares outstanding in the third quarter of last year.

Looking at our results on a year-to-date basis through the third quarter, net sales increased by 21.6% to $531.1 million. We opened 22 net new stores, including one store relocation, and comparable store sales increased 2.3%.

Adjusted operating income increased 9.4% to $46.8 million or 8.8% of sales from $42.8 million or 9.8% of sales in the first nine months of last year. The decrease in our adjusted operating margin is primarily the result of an increase in advertising costs to support our brand awareness initiative, as well as incremental store pre-opening expenses due to the number and timing of new store openings compared to last year. Interest expense decreased to $21.9 million from $28.2 million in the same period last year due to the repayment of our second lien facility.

Income tax expense also improved to $7 million on a 37.2% effective rate from $33.5 million on a negative 154% effective rate in the first nine months of Fiscal 2016. As I mentioned earlier, the prior-year tax rate was primarily impacted by the changes in the valuation allowance on our deferred tax assets. As a result of these year-to-date factors, pro forma adjusted net income increased to $19.1 million or $0.31 per share, based on 61.9 million pro forma diluted weighted average shares outstanding versus $16.8 million or $0.27 per share based on 62.3 million pro forma diluted weighted average shares outstanding in the corresponding period in Fiscal 2016. We ended the third quarter of Fiscal 2017 with $7.7 million in cash and cash equivalents on our balance sheet, $124 million of availability under our ABL facility, and $296 million outstanding of term loan borrowings.

Assuming we do not make any incremental principal payments on our long-term loan, other than what is required under the credit agreement, we expect interest expense to be approximately $4.8 million in the fourth quarter of Fiscal 2017. This assumes a mid-quarter rate step down of 50 basis points on our existing term loan, resulting from the payoff of the second lien and subsequent improvement in our leverage ratio.

Now, moving on to our Fiscal 2017 outlook, for the full Fiscal 2017, net sales are expected to be in the range of $750 million to $758 million, which when compared to net sales of $622 million for Fiscal 2016, represents a growth rate of 20% to 22%. Our top line performance assumes a low single-digit comparable store sales increase of 2.5% to 3% and factors in contributions from 23 net new stores this year, all of which are open as of the date of this call. Our updated net sales and profitability outlook contemplates the expected impact of incremental inventory investments made in the third and fourth quarters of Fiscal 2017, which we discussed earlier.

Pro forma adjusted net income for Fiscal 2017 is expected to be in the range of $34 million to $35.5 million, which represents a growth rate of 34% to 40% over Fiscal 2016 and excludes the anticipated pretax impact of approximately $700,000 in one-time IPO expenses and $5.6 million of non-cash stock-based compensation expense related to the special one-time IPO bonus grant. Pro forma adjusted net income also excludes the $2.7 million in debt extinguishment charges incurred in the third quarter, as well

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as $6.1 million of interest that would've been avoided if our IPO had occurred at the beginning of the fiscal year. Based on approximately 62.5 million estimated pro forma diluted weighted average shares outstanding, full year pro forma adjusted EPS is expected to be approximately $0.54 to $0.57. We anticipate a full-year Fiscal 2017 effective tax rate of 38.5%.

As it relates to capital expenditures net of sale leaseback proceeds of $63.2 million, we expect to incur approximately $75 million to $85 million in net cap ex in Fiscal 2017. The vast majority of our capital investments is funding 23 net new stores, including 2 ground-up builds. The remaining investment is earmarked for information technology initiatives, maintenance on our existing stores, and the expansion of our distribution center.

Regarding capital spending for Fiscal 2018, we wanted to give you some preliminary visibility to our expectations for next year's new store pipeline. We feel great about the availability of attractive second-generation locations and, therefore, anticipate a new store class that is weighted more heavily towards second-generation leases than we initially projected. Due to this opportunistic mix shift, our Fiscal 2018 projections will reflect lower gross and net capital spend, and higher operating expenses which will result in a small drag on pro forma EPS expectations, balanced by cash flow benefits.

As Lee mentioned, we will provide a more robust Fiscal 2018 sales, earnings, and cap ex outlook on our fourth quarter conference call next spring. Overall, we are pleased with our performance to date and remain confident that we will achieve our Fiscal 2017 objectives that include expectations of 20% to 22% top line growth and 34% to 40% pro forma adjusted net income growth.

Before we turn the call over, I would like to congratulate Peter Corsa and Becky Haislip who were promoted last week to Chief Operating Officer and Chief Accounting Officer respectively. Both of these highly talented individuals have been part of the At Home Team for several years and have contributed significantly to our success thus far, and we look forward to their continued partnership and experienced expertise in their new roles.

Operator, please open the line up 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; so, two things. If you look at brand awareness, have you seen much correlation between where brand awareness sits and performance of new stores and comps? Is there that correlation or, if not, do you expect there will be?

Lewis L. Bird, III:

Hey, John, it's Lee Bird. I will tell you our brand awareness studies—we do this at least once a year. We look at the brand awareness more than anything over time than necessarily by geography. We look at existing markets and new markets. We know that in our existing markets where we have brand awareness and have known the Garden Ridge and now At Home brand for a long time, those stores continue to perform well and they're comping positive. We also know in new markets where we've been

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open just a few years where the brand awareness is lower, those also comp positive. So, what we found is there's a consistent performance across all of our fleet on a same-store sales basis and there's an opportunity for brand awareness improvement in all the markets as well.

John Heinbockel:

Then as a follow-up to that, when you think about your marketing spend, right—so we get to 3%, what do you think or how do you think that evolves beyond the 3% longer-term? Where should that be? Should it be a fair bit higher as sort of you balance competing against not just brick-and-mortar, but e-commerce players? Where should that be and how fast should you get there?

Lewis L. Bird, III:

Well, we've been inching up our marketing spend over the past three years. The rebranding was when we started spending money in marketing; before that was practically zero as a percent of sales. So, what we've done is we've been thoughtful about that spend and what we feel like is there's opportunity build the brand in lots of different ways. I think for us, as we've spent the money, we've been thoughtful and analytical about how it's performed over time. We found really good mixes that worked, for example, a grand opening. We've really strong grand openings and that's a strong marketing message for us as we introduce people to the brand. That's actually a pretty heavy investment in a very short period of time, but then it evens down.

The question is: what's the right number? I would say we're going to test. We're going to continue to test. We test everything across the business. We test product strategies, we test labor strategies, we test marketing strategies. This coming year we'll actually do a couple of markets where we'll do a heavy up test where we'll actually spend more than we would've in other markets to see if that moves the needle. We've moved in new mediums, for example. We now do a mailer, for example, a new mover mailer. That's something we didn't do last year. We tested that, we liked that and now we're going to roll that across all markets that we have stores in. So, we'll do some testing and as we get the returns on it, if we see a good return on investment, we'll do it.

We've always said we're going to grow top line in the high teens and the bottom line slightly better than that. As we get better margins and better profitability improvements, we're going to reinvest against price and marketing and still deliver the earnings that we need to, but we may spend more in marketing to get there.

John Heinbockel:

Okay. Thank you.

Lewis L. Bird, III:

Thanks, John.

Operator:

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

Matthew Fassler:

Thanks a lot, and good morning. A couple of questions on the top line front. First of all, were there any categories or classifications that showed particular strength as you made your way through from the second quarter to the third? I know you spoke about having a better inventory presence in some of the

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lower priced goods that you had determined to stock up in, but from a category perspective, whether it's category-driven or through your own initiatives that might've contributed to the acceleration?

Lewis L. Bird, III:

Morning, Matt. Hey, the categories overall, I would say we had comp performance in Everyday and Seasonal. It's been broad across the whole business. I would say it was actually a greater improvement in the Everyday business because of the inventory we brought in was more never-out-of-stock kind of basics which would show up in Everyday. That was what we had identified as an opportunity in the first half of the year that we were missing some inventory that we could've sold that we didn't. So, as we brought the inventory in the third quarter, that lifted the Everyday business. The Seasonal business also comped. We were really pleased with our Halloween and Harvest performance, and as I mentioned in the call, the early reads on Christmas were also very good.

Matthew Fassler:

Then secondly, obviously, being in the midst of a volatile environment with some mix performance today from a number of retailers, and clearly with the election etc., etc. there's been no shortage of distractions and reasons for lapse around in the business. You had exited Q2, it sounds like, with a pretty good run rate and clearly finished the quarter strong overall. Were there any fluctuations or volatility worth discussing in the context of delivering that 4% comp increase?

Judd T. Nystrom:

Sure. Matt, this is Judd. So, first, we don't kind of want to get in the practice of breaking outcomes by month, but to answer your question and give you some color, we were very pleased with how we started the quarter—we highlighted that our conference call in September—and what we saw as we moved through the quarter, we added the inventory and we were pleased with how we exited the quarter. Overall, 4.2% comp is a little bit higher than what we have said this business is going to be delivering on a quarter in, quarter out basis. We have a lot of momentum. We increased the full-year comp sales guidance pretty significantly from where we were, which was a 1.5% to a 2%, now at 2.5% to 3%. We're halfway through the fourth quarter, so we feel confident in our ability to deliver those outcomes for the year.

Matthew Fassler:

Great. Thank you so much, guys.

Lewis L. Bird, III:

Thanks, Matt.

Operator:

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

Simeon Gutman:

Thanks. Good morning, guys, and nice results. I guess following up on the top line, just looking back at the prior quarter where it was a little slower, anything change? Was it consumer? Was it your inventory strategy? I don't know if you mentioned it, but can you give us some ticket and traffic color?

Lewis L. Bird, III:

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Sure, Simeon; it's Lee. I'll start and I'll let Judd finish. I would say from the second to third quarter—remember, when we talked about the second quarter, we were adversely affected. We hate talking about weather, but we were adversely affected by weather, specifically in the Texas/Oklahoma area dramatically in May. So, as we said, after that, the quarter performed nicely, but obviously, we weren't really pleased with the comp performance. It was a positive comp, but wasn't that strong. But, the momentum that we had coming out of the second quarter continued all the way through the third quarter.

Also, the extra inventory that we brought in, which was lacking in the first and second quarter and those were missed opportunities for us, we're now in it in the third quarter and that's been able to help us lift our comps to a 4.2%.

Judd T. Nystrom:

To add a little color around it, first of all, the growth was broad-based across all geographies, so that's important to note. Second, we're focused on driving the organic metrics over time, and as I've said before, we have initiatives in place to do so, so there's a lot of different levers that we feel good about in the future that are focused on driving traffic, that are focused on driving conversion, units, and so forth. So, it could be things like our flash-find, which is to signal value to our customer and to have her come to our stores more frequently; it could be our new credit card that's going to be coming next summer that's going to drive traffic and hopefully increase the amount of visits we have with our customer; or it could be our focus on our inventory to draw (phon) a bigger basket on these lower priced items that are more impulse or we need them always to be in stock, which will position us to grow our tickets. So, make no mistake, we're focused on driving all the metrics. We're committed to delivering low single digits. We've gotten pretty good at it—11 consecutive quarters of delivering positive comp store sales—and we're committed to doing that in the future.

Simeon Gutman:

Okay. Then a follow-up, I think, Judd, in your comments you talked about the product margin and you called out I think some vendor support, I guess, maybe from some additional buying, I guess. Can you just tell us about that timing of that? I guess I don't know if that had to do with some of the inventory you were buying on basics. How should we think about that? I mean, you do have a lot of store growth ahead of you, so I imagine these type of opportunities could still be available; is that a fair assessment?

Judd T. Nystrom:

Sure. So, what we've shared is we have great relationships with our product partners. They are enjoying rapid growth by when you look at the last three years, we've grown our top line more than 20% comp on an annual growth rate. As part of that partnership, last year we asked for a little more support from a vendor support perspective, around increasing our brand awareness. It's a win for our vendor partners. It's a win for us. We made the first investment. We actually made the whole investment first, and the way we recognized it from an accounting perspective is the benefits come at the turn of the inventory, so when our vendor partners provided that vendor support, what we saw was the first part of the year, our operating income dollars were constrained because we were spending the marketing before we actually had the benefits of the turn of the inventory. Now, as we get to the second half of the year and the first half of next year, we'll be turning that inventory. We can see that we have lower costs to buy that inventory, but we'll actually enjoy it over the next three quarters because it's going to be coming in at the turn of the inventory. Therefore, we should have a slightly higher gross profit rate.

Simeon Gutman:

This is something, I mean, you're constantly doing, but as related to as we think of the next year—at to your point—we just started to see the benefit from this and that sounds like it's going to last for the next three quarters. Is there another effort underway, like the way that last years was made where there should be another bump like this sometime in the following year?

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Judd T. Nystrom:

We don't have anything planned at this juncture. What we're focused on is making sure we grow our top line. The outlook that we provide at longer-term is we believe we can grow high teen sales growth and our vendors are excited about that because in retail there's really not a lot of retailers growing at that pace. At this juncture, we haven't shared anything with our vendor partners, but we're just focused on running a great business and delivering great outcomes.

Simeon Gutman:

Okay. Thanks, guys.

Lewis L. Bird, III:

Thanks, Simeon.

Operator:

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

Daniel Hofkin:

Good morning. Just another follow up on sales and then one additional on SG&A. On sales, obviously, your guidance implies a similar range for the fourth quarter sort of bracketing what you just did for the third quarter for comp. Just wondering, given that that's up against a harder comparison, what do you think is helping to drive that? I mean, is that a fair way to look at it, and if it is, what's helping drive that? That's my first question.

Judd T. Nystrom:

Sure. Dan, this is Judd. Overall, you're correct; when you look at what's embedded in our outlook for the fourth quarter, knowing that we're at a 2.3% comp year-to-date through the end of the quarter, it's about a 3% to 4.7% comp for the fourth quarter. Normally we would not get in the practice of increasing the comp above a low single-digit because we know that comps can be volatile. That said, we felt it was prudent to be able to provide that given the fact that we're already halfway through the quarter. So, when you think about it, it's not based on the time and the number of calendar days, it's based on the volume of business. We sell decorations—in terms of this time of year, we have a higher mix of Seasonal for the first half of the quarter as our customer is getting ready for the holidays, and as a result of that, the quarter-to-date performance, we feel comfortable with where we are and, therefore, have reflected it in our full-year guidance of a 2.5% to 3% comparable store sales increase for the full year.

Daniel Hofkin:

So, I guess the question would be: does that imply that on a two-year basis the fact—I mean, are you seeing an acceleration or is it something more related to what the prior-year comparisons maybe had some anomalies in them?

Judd T. Nystrom:

So, we're just focused on—a couple of years ago, we reinvented our holiday assortment. We had a great fourth quarter the last two years, and we had a benefit of weather last year. The weather was actually kind of similar this year where it was drier and a little bit warmer, which makes our consumer want to decorate inside and outside. So, we're focused on that, and, overall, while the stacks can be higher from

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a comp sales perspective on a two-year and a three-year basis, what we're seeing is the consumer responding to our assortment and our Store Tams executing very, very well, and as a result of it, that's why we provided outlook we did.

Daniel Hofkin:

Okay. Great. Then just on SG&A quickly, you highlighted the additional cost to bring in the incremental inventories and a couple of other things. Were there any expense categories that were higher than expected or, let's say, same thing for the fourth quarter too, are there any expense categories that are coming in higher as a result of, like, proactive growth-related investments, things like that, besides inventory?

Judd T. Nystrom:

Sure. So, Dan, this is Judd again. What I would tell you is the incremental inventory in the quarter to a cost to bring that in was roughly $2 million, okay. That appeared in gross profit, as well as SG&A. The gross profit is around distribution center-related cost and that was more rate-driven, more overtime plus more hours, so there's a bit of volume. From a store perspective, it was more around some temp labor, as well as some overtime to get the product on the shelves. We'll have more of that in the fourth quarter. That is embedded in our guidance. So, outside of that, we run a pretty tight ship here when you look at our overall cost structure as compared to our competitors, and there was nothing else really unusual. I would highlight that we opened one more store, so that had more pre-opening expense. That was also hit the third quarter; there'll be a little bit in the fourth quarter. So, that would be the only other thing I'd call out.

The other aspect is related to FY'18 and I provided some color from an expense standpoint. The mix of stores, we're seeing more second-generation leases, which is—we're opportunistic, so what we're focused on is taking advantage of those ample supply of real estate locations and we expect to have about 10 more leases versus ground-up builds, which will add some op ex—I highlighted that earlier—and that op ex overall, when you do the math on it, what you'll see is 10 leases. If you assume a midyear assumption, you assume $5 per square foot on a fleet average of about 120,000 square feet, what you end up with, including the pre-opening expense, is about $3.75 million to $4 million of higher op ex, which is a component where the net cash is going to be down significantly from a gross cap ex perspective, about $40 million, and in less cap ex. We wanted to make sure from an expense standpoint we give you visibility to that.

Daniel Hofkin:

That's very helpful. Thanks. Best of luck in the fourth quarter.

Judd T. Nystrom:

Thank you.

Lewis L. Bird, III:

Yes. Thank you.

Operator:

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

Daniel Binder:

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Great. Thank you and congrats on a good quarter. A couple questions. First on the better-than-expected comps in the quarter, would you say that most of that was driven by the inventory improvement? Secondly, if you could just talk a little bit about the importance of Thanksgiving Day weekend, Black Friday, if that—how you did on that weekend, that'd be helpful.

Lewis L. Bird, III:

Yes, Dan. Thank you. So, our third quarter continues to reflect the consistency of our business. We had a little over a 4% comp. If you look at a couple years ago, we had an 8% comp and that was with the rebranding. Take the rebranding out, that's a 3% comp. Last year we were about almost a 4% comp at a high 3% comp, and now we're forecasting to be 2.5% to 3% comp for this year. So, we continue to perform and consistently perform around that level. We were disappointed, honestly, with ourselves in the first half of the year where we were below that.

We saw opportunities, which we identified in the second quarter call around inventory. We brought that in. That did help fuel the business. We also saw a momentum in the back half of the second quarter that continued through the third quarter. The Seasonal business, as I mentioned before, did very well for us. Halloween was reinvented last year. We improved the assortment on that. The fall assortment, we took the learnings from last year's Christmas reinvention and applied it to there where we actually put décor, as well together by theme, and that helped very well for the product to sell well, so we liked that. The early reads on Christmas have been good, so Seasonal is strong for us and the Everyday is strong and the extra inventories have helped.

Daniel Binder:

Okay. Just on the real estate side for a minute, I know your expectations on the second-generation stores, as you noted, is different and that creates and op ex drag. Is there any kind of change in the sales productivity out of those? I think you did have a little bit of a sales gap from a productivity between build stores versus leases. I was just curious if we should expect anything on that front.

Judd T. Nystrom:

Sure. Dan, this is Judd. I give you some color as we think about FY'18. As I said in the prepared remarks, we'll give a full outlook in the spring, but there's a few things we want to make sure we land. Number one, nothing has changed in our long-term growth algorithm, so I want to start there. Second, we see the opportunities to eventually be a 600-store chain and there's ample supply of locations out there, and nothing has changed with our new store model. Third, as we think about the opportunities where there's more supply of second-generation leases, we're going to take advantage of that. We can always do ground-up builds, but we can move those around to ensure we deliver high teens, new unit growth each and every year, which is what we've done. The impact that I highlighted is really math around the mix and the productivity of the boxes, the way to think about it, Dan, is when we started as a Management Team nearly four years ago, our first vintage (phon) did about $4.2 million in sales. Over the last several years, we've actually been increasing the average unit volume, which is about $6 million. This year we only had two ground-up builds and we're still doing that. You can see new store productivity above 80% each quarter this year, so we feel very comfortable from the ability to find second-generation locations, whether it's lease or purchase, and deliver very strong new store economics.

Daniel Binder:

One last thing related to real estate if I could, you've talked about the $5 rent per square foot on average, but even in your press release today, you talk about some of the deals that you do have in escalation in rent. That's an area we've gotten questions on. I'm just curious if you could provide a little bit of color for us on what that rent escalation looks like in your typical lease and where that rent goes to overtime and options, etc.

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Judd T. Nystrom:

Sure, Dan. This is Judd again. So, what I would tell you is, first and foremost, when we actually negotiate a lease, we typically get about 20-plus years of control, and we'll sign typically for second-generation box a 5-year lease and we'll have four options on that. The accounting rules make you straight-line the rent overall, so while there are cash increases in what we pay from a rent perspective, from an accounting's perspective it's been straight-lined and we've pre-negotiated what those bumps are, and those bumps are actually quite low overall. So, we feel very comfortable with that. If you look on our balance sheet, there's the deferred rent component. A lot of that is related to our sale-leasebacks and they're actually gains that will come and offset what the cost of the rent is for those new locations.

So, that's the way to think about it overall.

Daniel Binder:

Great. Thank you.

Judd T. Nystrom:

Thanks, Dan.

Lewis L. Bird, III:

Thanks, Dan.

Operator:

Thank you. Ladies and gentlemen, as a reminder, to ask a question, please press star, one at this time. Our next question comes from the line of Oliver Wintermantel with Evercore ISI. Please proceed with your question.

Oliver Wintermantel:

Yes. Good morning, guys. I had a question regarding the preliminary for Fiscal '18. So, when I use the midpoint of your guidance range for this year and it gets to a lower 33% increase in EPS, so is that—are you guiding to or are you saying that the next year the EPS growth—this year versus last year—would be lower than that because of the second-generation stores; is that the right interpretation?

Judd T. Nystrom:

No. So, Ollie (phon), this is Judd. Here's the way to think about it. So, we haven't provided the actual EPS outlook for next year. One of the things you'll see from this Management Team is we want to make sure we're transparent with Investors and we avoid any surprises. This is merely math, so when you think about it, we've provided you with a framework for our earnings for the next several years and what we're focused on is delivering against that. We will give more color on FY'18 in the spring, but nothing's changed with our core business. Actually, if anything, when you look at the numbers that we provided, we've actually exceeded those projections. We felt it was prudent at this time to let you know the math. The math is on the leases where you have a higher mix. You're going to have higher op ex. You're also going to have lower cap ex. You're also going to have lower sale-leasebacks that you need to generate. You can do the math associated with it. I gave you a framework. It's about $4 million more in op ex.

But, nothing fundamentally has changed with our business from what we provided you. If anything, our business is stronger when you look at the numbers that we are projecting for the year as compared to what we initially provided.

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Oliver Wintermantel:

Great. That's helpful. Then just had a question regarding the new stores and new areas that you opened, for example, the one in New York, Detroit. The initial reaction of your customer's sort of from a performance of these stores, do you see any material differences to more stores in the South (phon) or from in other geographies? Thank you.

Lewis L. Bird, III:

Ollie, this is Lee. Our new store performance, what we are most pleased about, it continues to be broad and consistent to performances is very positive. We opened the stores, the ones that I called out in Detroit and Minneapolis. Detroit was another store in existing market, for example, Minneapolis was a new market for us this year and that was two stores in Burnsville and Blaine and those both opened up very strong. Then you've got Lafayette, Louisiana, which is a one-store market and that opened very strong and above our projections. Then the Albany, New York store, also a brand-new market, more than one store can go there. It was our first store in the market. It opened up really strong. If you look at those characters—and then added another store, and now our fourth store, in Salt Lake. It would tell you that we're working in Salt Lake. That means we work in the whole Southwest. With that, we work in the Pacific Northwest. The cost structure of a store in Salt Lake is similar to a Southern California or a Pacific Northwest, and those are proof points for a national concept, the fact that we do well in the deep South, and in a smaller market like Lafayette, it can tell you that we can be in big markets like Minneapolis and small markets like Lafayette.

There's always been the question, "Well, are you portable to the Northeast?" Well, we opened up—the store in Albany is doing well, Dale City in Washington, DC was another store we added in that market. Those—the DC market has common characteristics to Philadelphia to New York to Boston to Providence, and those are all proof points for us, and so we feel like that continues to gain confidence in ourselves and also, hopefully to you all, that this is a national concept because everywhere we go we make money the first year and we continue to hit our projections for those first-year sales, which open up near maturity actually.

Oliver Wintermantel:

Okay. Thanks very much. Good luck.

Judd T. Nystrom:

Thanks, Ollie.

Lewis L. Bird, III:

Thanks, Ollie.

Operator:

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

Greg Melich:

Hi. Good morning, guys. Good job on the quarter. I wanted to follow-up on the inventory. It sounds like it really worked and provided some nice momentum. Was that—is this the new level of store inventory we should be using going forward and were there any geographic differences as to where you positioned it?

Lewis L. Bird, III:

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Yes, Greg. This is Lee. I'll start and Judd will probably give you a little bit more color. The inventory itself is broad based. It did go across all stores. It did lift—a rising tide raises all ships, they say. It was inventory that we were lacking. We consider it basics, never-out-of-stock items. As we did our planning and thankfully now with our new Merchandise Planning System help identify this opportunity because we used to plan based on dollars and now we do dollars and units. When we started looking at units we realized that we were underrepresented in the lower price Basic items across the fleet. We've brought that in, in the third quarter and now in the fourth quarter and that's helped lift the business across the board.

Those are the levels—now we've got a never-out-of-stock list by department. We say these are the items that should never be out-of-stock. We review those stock levels on weekly and monthly basis. We make sure that each store is covered that way, not just the fleet average overall but by store. So, we've put those inventory disciplines in the system so it has brought inventory levels back in the store and we would expect that those inventory levels will be maintained.

Judd T. Nystrom:

The only thing I would add to that is, as Lee said, we're going to have a bit higher inventory to run the business. We'll have higher at the end of this fiscal year because of the Chinese New Year; we're bringing in product earlier. We also want to get our Seasonal, so patio and garden, set earlier, so we will end the year with higher inventories, and that's expected.

What we'd also highlight is as you move to more better and best, we want to make sure we protect the units on the good, and as a result of that, that's going to be increase in the level of inventory and the amount of units we have, both on a dollar basis and overall units. There's less margin risk associated with bringing in the lower price point items because they actually sell faster, the turnovers is higher and they have less markdowns. So, we feel there's less risk associated from a margin perspective as well.

Lewis L. Bird, III:

It's consistent with our good, better, best strategy. We just were underrepresented in that good from an inventory standpoint. The strategy remains the same.

Greg Melich:

That's helpful. Great. Thanks a lot. Good luck.

Judd T. Nystrom:

Thank you.

Lewis L. Bird, III:

Thanks, Greg.

Operator:

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

Lewis L. Bird, III:

All right. Well, hey, thanks everybody for getting up so early in the morning, and especially those that are in the West Coast; it's way early. So, we appreciate you joining us on this call. We appreciate your

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interest and support of At Home. We look forward to speaking to you in the coming days and weeks and appreciate your continued interest in our stock. Thanks so much.

Operator:

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

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