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Boot Barn Holdings, Inc. (BOOT)

Q3 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone, and welcome to the Boot Barn Holdings Third Quarter 2023 Earnings Call. As a reminder, this call is being recorded.

Now I'd like to turn the conference over to your host, Mr. Mark Dedovesh, Vice President of Financial Planning. Please go ahead, sir.

Mark Dedovesh

Vice President-Investor Relations and Financial Planning, Boot Barn Holdings, Inc.

Thank you. Good afternoon, everyone. Thank you for joining us today to discuss Boot Barn's third quarter fiscal 2023 earnings results. With me on today's call are Jim Conroy, President and Chief Executive Officer; Greg Hackman, Executive Vice President and Chief Operating Officer; and Jim Watkins, Chief Financial Officer.

A copy of today's press release, along with a supplemental financial presentation, is available on the Investor Relations section of Boot Barn's site at bootbarn.com. Shortly after we end this call, a recording of the call will be available as a replay for 30 days on the Investor Relations section of the company's website.

I would like to remind you that certain statements we will make in this presentation are forward-looking statements. These forward-looking statements reflect Boot Barn's judgment and analysis only as of today, and actual results may differ materially from current expectations based on a number of factors affecting Boot Barn's business. Accordingly, you should not place undue reliance on these forward-looking statements.

For a more thorough discussion of the risks and uncertainties associated with the forward-looking statements to be made during this conference call and webcast, we refer you to the disclaimer regarding forward-looking statements that is included in our third quarter fiscal 2023 earnings release, as well as our filings with the SEC referenced in that disclaimer. We do not undertake any obligation to update or alter any forward-looking statements whether as a result of new information, future events or otherwise.

I will now turn the call over to Jim Conroy, Boot Barn's President and Chief Executive Officer. Jim?

James G. Conroy

President, Chief Executive Officer & Director, Boot Barn Holdings, Inc.

Thank you, Mark, and good afternoon. Thank you, everyone, for joining us. On this call, I'll review our third quarter fiscal 2023 results, discuss the progress we have made across each of our four strategic initiatives and provide an update on current business. Following my remarks, Jim Watkins will review our financial performance in more detail, and then we will open the call up for questions.

I'm extremely proud of the entire Boot Barn team for their tremendous execution in the third quarter, as we delivered total sales at the high end of our guidance. Total net sales grew 5.9% on top of 60.7% growth in the prior-year period, driven primarily by strong sales from new stores opened over the past 12 months.

On a three-year basis, total sales have grown [ph] 81% (00:02:34) compared to the third quarter of fiscal 2020, just prior to the start of the pandemic. We are very encouraged that this third-year growth has been driven primarily by an increase in the number of transactions, as we have added a significant number of new customers to the brand while legacy shoppers seem to be purchasing more frequently.

From a margin perspective, during the third quarter, merchandise margin declined 190 basis points, driven by a 180-basis-point headwind from higher freight expense. We maintained our full price selling posture in what we believe was a highly promotional holiday season across retail.

As a result, we were able to achieve a merchandise margin rate nearly in line with last year's record-setting performance after normalizing for the transitory freight headwinds. Once again, this demonstrates the strength of the Boot Barn brand and our ability to drive the business forward without resorting to unnecessary sales or promotions.

I will now spend some time highlighting the recent progress we have made across each of our four strategic initiatives. Let's begin with expanding our store base. We continue to be pleased by our ability to grow new units each year. While historically, we targeted 10% new unit growth with each store generating approximately \$1.7 million annually, we have recently been overdelivering on both metrics. We expect to open approximately 43 stores in the current fiscal year or more than 14% growth. Even more encouraging is our new store model is now \$3.5 million, or more than double our original target. At this level of sales, our new stores are paying back in just over one year with nearly 100% cash-on-cash returns.

The pipeline for new store openings remains strong as we continue to broaden our retail footprint across the United States. During the third quarter, we opened 12 new stores, including our first store opening in the state of Connecticut, further expanding our Northeast presence.

The success of our new stores in new and existing markets, coupled with less sales cannibalization than we originally anticipated, gives us further confidence in our ability to expand to more than 900 stores across the country, or nearly triple our current store count.

Moving to our second initiative, driving same-store sales growth. We are pleased with our same-store sales performance in the third quarter, with consolidated same-store sales down 3.6%, while cycling 54.2% same-store sales growth in the prior-year period. We are particularly encouraged by the performance of our retail store sales, which declined a modest 0.8%, while cycling a 55.7% growth in the year-ago period.

During the third quarter, our strongest growth categories were work apparel and men's Western apparel. While sales of men's and ladies' Western boots, ladies apparel and hats declined, it is important to note that each of these businesses was up against incredibly strong double-digit or triple-digit growth in the prior-year period.

From a geographic standpoint, we saw growth in our East and North regions, a slight decline in our South region and a mid-single-digit decline in our West region, which is perennially our strongest region. Given the outsized growth we saw in all regions of more than 50% in our prior-year period, we are again pleased with the performance across the country.

From a marketing perspective, the team continues to expand our customer reach by modernizing the brand and carefully tailoring our communication to each customer segment. We use a combination of media formats to target our legacy Western and work customers in addition to our more recently added country lifestyle and fashion customers. We believe the content of our marketing not only showcases the Boot Barn brand within the industry, but has also garnered the attention of a much broader customer base for mainstream retail.

From an operational perspective, I am proud of our field organization across the country for another very successful holiday season. The team has not only risen to the challenge of the higher average store sales volume, but has continued to expand the brand's footprint through new stores, including 12 additional store openings in the third quarter. The store team's ability to deliver world-class customer service, manage the inventory levels needed to sustain the elevated store sales and allocate store labor hours to the many omni-channel offerings we now have in place is a testament to the dedication of our team and the hardworking nature of all of our store partners.

Moving to our third initiative, strengthening our omni-channel leadership. We continue to focus on our omni-channel capabilities by integrating our stores and digital channels. Approximately 60% of online orders involving store associate underscores the importance of our brick-and-mortar presence.

We've always believed that the most successful and profitable way to service an e-commerce customer is by seamlessly integrating the store and digital channel. As an example, we added in-store fulfillment to our omni-channel offering. Now when a customer places an order online, they have access not only to inventory that is in our distribution center, but they also can select merchandise from more than 300 stores across the country. This enabled us to enhance the in-store experience while also providing digital customers with a much broader selection of merchandise. In-store fulfillment has resulted in shorter delivery times and a pronounced expansion of exclusive brand sales online, which further contributes to the profitability of the business.

In the third quarter, our e-commerce same-store sales declined 15.2%, which was in line with our expectations. As we discussed on our prior earnings call, we believe the recent decline in our e-commerce channel is a result of competitors having a stronger in-stock position compared to last year. We believe this trend will continue for the next two quarters until we cycle the softer business that emerged in July last year.

It is important to note that this headwind impacts our digital business, but not the strength of our stores business for a couple of reasons. First, our e-commerce customer has historically been a less loyal customer. Secondly, we are very prudent with our online spending for new customer acquisition. As a result, our pay-per-click spending over the past several years has been pared back to a level that focuses more on bottom line profitability than top line sales growth, which could erode our earnings. Our focus on the long-term health of our e-commerce business has enabled us to grow digital sales by more than 45% over the past three years with an even greater growth in earnings.

Now to our fourth strategic initiative, exclusive brands. During the third quarter, our exclusive brand penetration grew to 34.1%, more than 570 basis points of growth over the prior-year period. On a trailing 12-month basis, our exclusive brand volume has exceeded \$500 million and now makes up 32.2% of sales.

Our exclusive brand team continues to design excellent merchandise on both a price and quality perspective. Consistent with prior quarters, three of the top five selling brands in the third quarter were Cody James, Cheyenne, and Idyllwind. We expect to drive continued growth in this area of the business with the 10 brands that currently comprise the portfolio. These brands not only provide us with competitive differentiation, both in stores and online, but they are also accretive to the business by approximately 1,000 basis points of margin.

The success of exclusive brands once again exceeded our original expectations. At the beginning of the year, we had anticipated expanding our exclusive brands by 300 basis points. We now are forecasting exclusive brands to grow to 33.4% of sales, or approximately 500 basis points of penetration growth versus last year.

I do want to express my appreciation to the entire exclusive brands team for continuing to provide product innovation and for the outsized growth in our exclusive brands business. We believe that the combination of our exclusive brands, along with the strength of our third-party vendor partners, provides for an exciting and diverse merchandise assortment, both in-store and online.

Turning to current business. Through the first four weeks of our fourth fiscal quarter, our preliminary consolidated same-store sales have declined 1.5% compared to the prior-year period, driven by a 16% decrease in e-commerce sales, partially offset by growth in retail store same-store sales of 1.2%. Please note that our retail store same-store sales growth for this short four-week period is artificially suppressed as it incorporates one day of zero sales given that our quarter began on Christmas Day this year.

Importantly, when looking at our January business on an annualized basis, we continued to maintain an average unit sales volume of approximately \$4.2 million per store. This elevated store sales volume began in April 2021 and has now sustained itself for 22 consecutive months. For reference, our average store sales volume historically had been \$2.7 million annually and is now more than 55% higher than that.

In an effort to better understand the reasons for this AUV growth and its sustainabilities, we conducted a survey of approximately 3,000 of our customers, both legacy and new to Boot Barn. Among the many questions that the survey asked, we were particularly curious to learn where the new customers came from, what made them shop Boot Barn, and whether they would continue to shop with us going forward.

On the first question, the survey feedback indicated that we gained new customers throughout the pandemic, not only from within the western industry, but we captured an even greater number of shoppers from mainstream retail channels. It was also quite encouraging to learn that these new customers were attracted to Boot Barn stores by a combination of our upgraded marketing and our expanded product assortment. Finally, when we

asked customers how likely they are to shop at Boot Barn in this calendar year, 96% of them said they are very likely or extremely likely to shop with us again.

To summarize, we believe that we have reached a new level of average store sales when we consider both the qualitative feedback from the customer research and the ongoing consistency of the monthly sales volumes.

I'd like to now turn the call over to Jim Watkins.

James M. Watkins

Chief Financial Officer & Secretary, Boot Barn Holdings, Inc.

Thank you, Jim.

In the third quarter, net sales increased 6% to \$515 million. Sales growth was driven by sales from new stores added during the past 12 months, partially offset by the decline in same-store sales. Higher average unit retail prices, driven in part by inflation, further contributed to the increase in net sales.

Gross profit decreased 2% to \$188 million or 36.5% of sales compared to gross profit of \$192 million or 39.4% of sales in the prior-year period. The 290-basis-point decrease in gross profit rate resulted from a 190-basis-point decrease in merchandise margin rate and 100 basis points of deleverage in buying, occupancy and distribution center costs. The decline in merchandise margin rate was driven primarily by a 180-basis-point headwind from higher freight expense.

Selling, general, and administrative expenses for the quarter were \$115 million or 22.4% of sales compared to \$99 million or 20.5% of sales in the prior-year period. SG&A expenses, as a percentage of net sales, increased primarily as a result of higher store-related expenses and store payroll.

Income from operations was \$72 million or 14.1% of sales in the quarter compared to \$92 million or 19% of sales in the prior-year period. Net income was \$53 million or \$1.74 per diluted share compared to \$69 million or \$2.27 per diluted share in the prior-year period and \$1 per diluted share two years ago.

Turning to the balance sheet, on a consolidated basis, inventory increased 54% over the prior-year period to \$592 million. This increase was primarily driven by added inventory in our distribution centers in order to support new store openings and our exclusive brand growth. Average comp store inventory increased approximately 20% over the prior year in order to support the elevated level of average unit sales volume per store.

On a three-year stack basis, our retail store same-store sales growth of 57% has outpaced our three-year stack average comp store inventory growth of 33%. The final portion of the increase in total inventory during the third quarter can be attributed to new stores, both the [ph] 44 (00:15:29) new stores opened over the past 12 months as well as the inventory for stores that will open over the next couple of quarters.

We continue to be pleased with our current inventory levels and that our forward weeks of supply are in line with our historical average. We finished the quarter with \$50 million in cash on hand and \$59 million drawn on our \$250 million revolving line of credit.

Turning to our outlook for fiscal 2023. We have updated our guidance for the fiscal year and now expect total sales to be between \$1.67 billion and \$1.68 billion, representing growth of 12.2% to 12.9% over the prior year. We expect same-store sales growth of 0.5% to 1% with a retail store same-store sales increase of 2.5% to 3% and e-commerce same-store sales decline of 10.5% to 9.5%.

We expect the gross profit to be between \$611 million and \$615 million or approximately 36.6% of sales. Gross profit includes an estimated 140-basis-point decline from freight expense, partially offset by 40 basis points of product margin expansion.

Our income from operations is expected to be between \$228 million and \$232 million or 13.7% to 13.8% of sales. We expect net income for fiscal 2023 to be between \$167 million and \$170 million and earnings per diluted share to be between \$5.51 and \$5.60.

We also expect our interest expense to be \$6 million and capital expenditures to be between \$90 million and \$95 million. For the balance of the year, we expect our effective tax rate to be 25.1%.

We now expect to open 43 new stores during the year, including the 33 stores we have opened through the end of the third quarter. The 10 stores we plan to open in the fourth quarter will be the sixth quarter in a row of opening at least 10 new stores. Please refer to the supplemental financial presentation we released today for further information on our revised fiscal 2023 guidance.

As we look to the fourth quarter, we expect total sales to be between \$438 million and \$448 million. We expect a same-store sales decline of 3% to 0.5% with retail stores same-store sales of flat to growth of 2% and e-commerce same-store sales declines of 20% to 16%.

We expect the gross profit to be between \$156 million and \$160 million or approximately 35.7% of sales. Gross profit includes 250 basis points of merchandise margin pressure, including an estimated 290-basis-point decline from freight expense partially offset by 40 basis points of product margin expansion.

Our income from operations is expected to be between \$59 million and \$63 million or 13.5% to 14% of sales. We expect earnings per diluted share to be between \$1.42 and \$1.51. As a reminder, the fourth quarter includes an extra week of business compared to the prior-year period, which we estimate will generate approximately \$34 million of sales and \$0.19 of earnings per share.

The primary driver of the revision in our guidance relates to freight expense. Our end-of-year inventory is now projected to be lower than what we expected, and freight charges are declining faster into lower rates than what we anticipated three months ago.

While both these developments are great news, it also means that, from an accounting standpoint, we will no longer carry as much capitalized freight on our balance sheet. We now expect that more freight expense will be recorded in the fourth quarter and will be 290 basis points higher than last year. While this freight expense negatively impacts the fourth quarter, it is overall very positive as our current inventory purchases are being burdened with lower freight charges, which will benefit merchandise margin more than we expected as we move into next fiscal year. While we are not yet providing guidance for fiscal year 2024, we would expect freight expense to be a benefit to next year's merchandise margin of approximately 100 basis points.

To summarize our changes in guidance, the high end of the guidance range provided at the end of our second quarter was \$5.90 per share, and we're reducing it by \$0.30 to \$5.60 per share. The \$0.30 reduction is driven by third quarter results that were \$0.09 below the high end of our range and freight headwinds in the fourth quarter that are expected to add an additional \$0.21 per share of freight expense compared to what we had previously guided.

With an improved retail store sales trend combined with an anticipated 100 basis points of improvement in freight, exclusive brand penetration growth and the continued opening of new stores, we are headed into fiscal 2024 with multiple opportunities to fuel earnings growth.

Now, I would like to turn the call back to Jim for some closing remarks.

James G. Conroy

President, Chief Executive Officer & Director, Boot Barn Holdings, Inc.

Thank you, Jim.

We're very pleased with our third quarter business and believe our runway for future growth is extremely promising. We've nearly doubled the size of the business in just three years and achieved store productivity levels that far exceed pre-pandemic levels. As we head into fiscal 2024, we have multiple levers of earnings growth from same-store sales and new store openings to margin accretion from exclusive brands and lower freight charges. I'm very proud of the team across the country and want to thank you all for your dedication to Boot Barn and your strong execution.

Now, I would like to open the call to take your questions. Doug?

QUESTION AND ANSWER SECTION

Operator: Thank you. Ladies and gentlemen, at this time we will be conducting a question-and-answer session. [Operator Instructions] Our first question comes from the line of Matthew Boss with JPMorgan. Please proceed with your question.

Matthew R. Boss

Analyst, JPMorgan Securities LLC

Great. Thanks. So, maybe, Jim, on current trends, could you speak to the progression that you've seen post holiday? Maybe by category, if you could break down western versus functional strength. And then, just with the continued positive comps at stores, maybe if you can touch on performance that you're seeing from your newer store builds and just the opportunity that you see, or is there a ceiling on the potential to accelerate unit growth as we think about next year and beyond?

James G. Conroy

President, Chief Executive Officer & Director, Boot Barn Holdings, Inc.

Okay. Sure. On the first part of your question, particularly if I focus on stores business, as we turned the calendar into January, we've seen some nice sequential acceleration in the business and feel like we're on pretty solid ground. We had a positive retail store same-store sales growth in January after making up for the first day of Christmas Day, which was obviously zero sales and minus 100%.

As we look at it by category, most categories have gotten sequentially better from the third quarter into January. We really love to see some of the very functional, more basic businesses performing positively. So, some of the things that have really been strong in Q3 and gotten stronger into January are things like work boots, men's cowboy boots. Work apparel had a nice third quarter. So we're really quite pleased that sort of the more staple, basic parts of the business, that drive tremendous volume, are improving.

We're also seeing less decline in some of the businesses that had been under pressure. For example, ladies' cowboy boots was up against ridiculously strong numbers last year as was ladies' apparel. And they've both gotten sequentially better into January. Ladies' western apparel is actually slightly positive as we got into January.

So, it's been a nice progression in categories. We've seen a nice progression in some of our softer regional businesses. Our western region has gotten better. We've seen a nice sequential progression in the transaction count. So, in the third quarter, our transactions were down mid-single digit, and now they're sequentially getting better than that. They're still slightly down, but that's been nice to see. So, it's a short- and low-volume month of January, but it certainly looks like things are, at bare minimum, sustaining if not improving.

From a new store perspective, we continue to just be thrilled with the new store performance, the number of stores that we're opening [ph] there, immediate (00:25:02) volumes, their ability to sell western product in Eastern parts of the United States, etcetera. So, we are well setup to exceed our original 40 stores for this year. Our pipeline is very strong going into next year. We have the good fortune that our new stores are performing at much better than the original algorithm for sure and even better than what we're modeling them now, and that is in new markets and existing markets.

So, maybe hearkening back a little bit to what we said at ICR, if we did nothing but continue to open stores for the next six or seven years, we double the size of the company even if we didn't grow comps. So, we'll continue to try to look for growth in every part of the business. The new store engine is really quite compelling.

Matthew R. Boss

Analyst, JPMorgan Securities LLC

Q

Great. And then maybe just to follow-up on gross margin given a couple of the moving parts here. I guess, maybe, Jim, could you help lay out the components of the gross margin in the fourth quarter, maybe between merchandise margin and freight?

And then as we look to next year, it sounds like you gave the freight expectation, but help us to think about merchandise margin between full-price selling and private label expansion. Any changes to the historical structural model in your view.

James M. Watkins

Chief Financial Officer & Secretary, Boot Barn Holdings, Inc.

A

Sure. So, on the fourth quarter, the guide for the product margin, and, again, I'll refer you to the deck on slide 15. Product margin expansion, we're expecting 40 basis points of product margin expansion excluding freight. The freight headwind in Q4 we've modeled at 290 basis points. And so, that works out to a merchandise margin decline of 250 basis points for the fourth quarter.

As we look to next year, again, we're not providing guidance at this time for fiscal 2024, but I think, particularly in the merchandise margin discussion here, what we said just a few moments ago is with the freight coming in so heavy from an expense standpoint in Q4, it's really removing a lot of the capitalized freight balances or the freight that we purchased at more expensive rates off of the balance sheet in this fiscal year. And as we move into next year, we expect that will be a tailwind of 100 basis points just right out of the gate from a freight standpoint. And so, again, that assumes that we've got freight rates and charges coming in similar to what we're seeing in the more recent weeks and months. So, that's a tailwind there. And then we've talked about exclusive brand penetration growth over the years, and we started a model of growing that 250 basis points to 300 basis points a

year. So, right out of the gate between those two items, we've got some really nice tailwinds as we look into next year.

Matthew R. Boss

Analyst, JPMorgan Securities LLC

Great. Best of luck.

Q

James M. Watkins

Chief Financial Officer & Secretary, Boot Barn Holdings, Inc.

Thank you.

A

James G. Conroy

President, Chief Executive Officer & Director, Boot Barn Holdings, Inc.

Thanks, Matt.

A

Operator: Our next question comes from the line of Peter Keith with Piper Sandler. Please proceed with your question.

Peter Jacob Keith

Analyst, Piper Sandler & Co.

Hi. Thanks. Good afternoon, everyone. [indiscernible] (00:28:27), just to follow-up on the freight question. So, it was a change from three months ago I think an extra 40 basis points. So, am I understanding it correctly that your sales is a little bit better? And so, that's pulling forward some of the excess freight costs out of fiscal Q1 now into fiscal Q4. Is that the key reason for this increased gross margin pressure?

Q

James M. Watkins

Chief Financial Officer & Secretary, Boot Barn Holdings, Inc.

It's not necessarily the sales component of it. And just going back to the numbers. We had originally expected – again, going back to three months ago – 90 basis points of freight headwind in Q4, and that's now 290 basis points of freight headwind. And so, there are two real components that are moving that. Again, this is great news with regards to the health of the business. Freight is costing us less money. We purchase our containers on spot rates. And so, we're able to take advantage of [ph] the cost coming (00:29:27) down quite quickly. And the other piece of that is that we're managing our inventory down faster than we had expected. So, as we look to our end of the year balances for fourth quarter around inventory, that helps us.

A

So, the accounting rules dictate that we match the freight paid to the inventory when it's sold through. And so, between those two things, the projected inventory balance coming down during the last three months for that year-end of balance and then also the freight rate on the inventory purchased during the last three months have come down more than anticipated. And that allows us to, to your point, Peter, expense more in the fourth quarter than what we had anticipated. And that does come from next year's freight expenses moving it up to this year.

Peter Jacob Keith

Analyst, Piper Sandler & Co.

Okay. And then just on that is – so, will freight remain a bit of a headwind in fiscal Q1, fiscal Q2, or is it going to pretty quickly reverse as a tailwind?

Q

James M. Watkins

Chief Financial Officer & Secretary, Boot Barn Holdings, Inc.

A

It should quickly reverse as a tailwind. And, again, as evidenced by the last 12 months, I mean, we guided the year at 100 basis points of freight headwind. It looks like it's going to come in closer to 140 basis points. We've talked about the complication of guiding freight and what goes into that. But assuming that the rates kind of stay where they are today and we would expect that to reverse pretty quickly into Q1 and then also through the rest of the year.

Peter Jacob Keith

Analyst, Piper Sandler & Co.

Q

Okay. That's great. And then for Jim Conroy, I just want to pivot to a separate topic. So, the subject of stretch denim has actually hit my radar for Boot Barn in the western and work areas. I'm wondering you do have some stretch denim products and some kind of basic looks. Is the stretch denim trend starting to hit your customer? And I guess what are you seeing there? It seems like there could be like a meaningful refresh cycle if that's starting to take hold.

James G. Conroy

President, Chief Executive Officer & Director, Boot Barn Holdings, Inc.

A

Sure. It's a great question. If I break it down by men's and ladies, on the ladies side, the vast majority of denim sales are stretch already, and we've been in that business for several years. And for us, as you know, most of our denim sales on both sides, men's and ladies, are pretty functional in nature. So, I think we'll continue to have a pretty standard replacement cycle.

I'd love to say and promise we're going to get even more sales in denim because there's been a new trend or something different. But, for us, it's something that we've been in quite a bit, particularly on the ladies side.

On the men's side, it's probably two-thirds of our sales are stretch with the balance being sort of more rigid denim. And there's been a little bit of an uptick there, but nothing meaningfully that will – I don't think will change our trend going forward.

So, I think we're well-positioned to take care of that customer. It is a little bit more than it has been in the past, but it's not such a big number that it's been a sales driver and nor do I think we can promise it's going to be a replenishment cycle sales driver going forward.

Peter Jacob Keith

Analyst, Piper Sandler & Co.

Q

Okay. Great. That's helpful color. Thanks so much, guys.

James G. Conroy

President, Chief Executive Officer & Director, Boot Barn Holdings, Inc.

A

Thank you.

Operator: Our next question comes from the line of Steven Zaccone with Citi. Please proceed with your question.

Steven Zaccone

Analyst, Citigroup Global Markets, Inc.

Q

Great. Good afternoon. Thanks for taking my question. Wanted to ask on the regional outlook in more detail for the fourth quarter. Just given some of the weakness you've seen in the west, is there something specific happening there or is it just a function of tough comparisons? And then as we think about this quarter, Texas rodeo season, Jim, what's your expectation for performance this year versus last year? Just remind us how you performed last year.

James G. Conroy

President, Chief Executive Officer & Director, Boot Barn Holdings, Inc.

A

Sure. On the first part on the west, I would sort of say this for the entire business. Our business was so incredibly strong last year that the way we view it internally, the fact that we're not down 15% in our third quarter is a victory. The west business, in particular, was a little bit less strong or down relative to last year, but that's on top of multiple years of growth and just phenomenal execution.

As I look forward for the western region, one of the things that could help them grow from this new elevated base, yes, it [ph] gave quite (00:34:18) a bit back in the third quarter, but the base is so much higher than it had been historically, is with the persistent rain that we've seen in California, oftentimes we call out the short-term benefit of that in our business. But there's been so much rain that it could have a positive impact on the ag markets that were – part of the reasons that the western region declined in the quarter was difficulty in the agricultural markets in the Central Valley. And that's where we have a tremendous amount of sales volume.

In terms of what we're looking at for our fourth quarter and rodeo season in Houston, we had a pretty solid fourth quarter last year. But if you look at all of the quarters, from our comparison standpoint, there was nothing notably stronger about our Q4. The Houston concert lineup looks pretty good. And I think we'll be well-positioned to take on that business. So, we'll see. But I don't think there's anything particularly high or ominous from a year-over-year comparison standpoint other than what we've been cycling for the last several quarters.

Steven Zaccone

Analyst, Citigroup Global Markets, Inc.

Q

Great. That's helpful. The follow-up question I had is just commentary about the pricing and promotional environment. I think the expectation was promotions will remain confined to the holiday quarter. Is that still the plan as we look forward through calendar 2023?

James G. Conroy

President, Chief Executive Officer & Director, Boot Barn Holdings, Inc.

A

Sure. I can take it. We run the business with very few promotions 12 months out of the year. When we get into holiday, we have a couple of "sales" on different things. And our promotional posture this year was very similar to prior years, maybe slightly more than last year when everything was essentially full prices. We were short on goods and comping up 55%, but very similar to two years ago.

As we get into the other 11 months, there's even fewer sales promotions that happen throughout the year. January tends to be a month where everybody, including us, clear some of our inventory. We're doing that as we – sort of normal course of business. That's actually has not put any undue pressure on our margin rate from a year-over-year perspective, which is why we're calling [ph] that accretion (00:37:03) for this fourth quarter.

So, we don't expect any change in our promotional posture, very little impact from competitors changing their price or promotion or clearance strategy. And while there has been some noise there, we just don't react to it anyway. So, I wouldn't expect anything differently than full-price selling, an occasional clearance sale to move through the small amount of clearance products that we have, and sort of standard course of business for the balance of the quarter.

Steven Zaccone

Analyst, Citigroup Global Markets, Inc.

Okay. Thanks for the detail.

Q

Operator: Our next question comes from the line of Max Rakhlenko with Cowen and Company. Please proceed with your question.

Max Rakhlenko

Analyst, Cowen and Company, LLC

Great. Thanks a lot and congrats on a solid quarter. So, your active customer counts continue to grow at a pretty impressive rate. I think you're at 6.8 million now. Can you just provide some color on customer behavior, whether there's a way to stratify them by spend or what segment of them has shopped in the past year? And then, how should we think about growing loyalty members versus small declines in traffic?

Q

James G. Conroy

President, Chief Executive Officer & Director, Boot Barn Holdings, Inc.

So, on the first piece, our average customer shops with us approximately twice a year. One of the things that's been very encouraging is as we've grown our customer count and expanded the definition of the Boot Barn brand to bring in customers from other retailers and, in many cases, mainstream retailers, those new customers are also shopping with us twice a year and have proven to be repeat or, to use a different expression, sort of sticky customers, which is great.

A

They continue to shop. They continue to shop the same frequency, sort of legacy shoppers, and their spending per trip and per basket is continuing to be in line with legacy customers, which is [indiscernible] (00:39:14). All of that triangulates back to our average unit store volume remaining at \$4.2 million up from \$2.7 million. I know you know these numbers, Max.

In terms of reconciling the additional customers and transactions being down, if you look at it over a long period of time, customer [indiscernible] (00:39:40) dramatically and the average transactions per store are up meaningfully. If you look at it over a shorter period of time, we continue to add customers in total because we're adding new stores, even if our average transactions per store, on an average basis, comes down slightly. So, that's how you can reconcile the math.

But bigger picture, we're just thrilled that we've been able to grow the customer database, invite so many new customers into a Boot Barn store and hold on to them. And I think as we get past some of these 55% LY comparisons, we'll settle back into sort of more normalized growth. But I've been in retail for a long time and just the mere fact that we grew 55-plus percent and haven't given it all back makes us incredibly pleased.

Max Rakhlenko

Analyst, Cowen and Company, LLC

Q

That's very helpful, Jim. And then what do you attribute all the strength in exclusive brand penetration growth to this year? Is it some of the omni-channel initiatives? I think the new stores in the east have a little bit higher mix. Or is there anything else to call out? And then just how are you thinking about, longer term, whether it could be a little bit higher than the historic algo that you've spoken to?

James G. Conroy

President, Chief Executive Officer & Director, Boot Barn Holdings, Inc.

A

Sure. A portion of it is maybe compositioning higher in new stores in the east. But I think just arithmetically, that would only give you a slight growth. I think the bigger piece is maybe two different things. The first, last year our business was so strong that we were outstripping many of our third-party branded partners' ability to [ph] ship us (00:41:39). And the single vendor, if you will, "vendor" that was able to ship us in full was our exclusive brands. And I think that really introduced the six legacy brands and then the four additional brands to customers that perhaps had never tried them before. And now that they've tried Cody James or Shyanne or Idyllwind or Moonshine, they're maybe long-term lifetime customers.

So, I think that free trial that we had last year when we were in stock and many of our branded partners were working their butts off to try to get us in stock but we're falling a little bit short, we had the product available and had the trial. The second piece is we've added [ph] the four (00:42:32) brands. We've expanded the original brands into new categories. And I think when you put all of that together, we just wind up getting outsized growth.

Going forward, we haven't guided next year. We've got some work to do before we lay out our guidance for next year. My intuition is we'll probably say we'll grow 2.5 points to 3 points of penetration next year. And we really do want to see some nice continued growth from our strong branded vendor partners as well.

Max Rakhlenko

Analyst, Cowen and Company, LLC

Q

Got it. Thanks a lot. It's really helpful. Best regards, guys.

James M. Watkins

Chief Financial Officer & Secretary, Boot Barn Holdings, Inc.

A

Thanks, Max.

James G. Conroy

President, Chief Executive Officer & Director, Boot Barn Holdings, Inc.

A

Thanks, Max.

Operator: Our next question comes from the line of Sam Poser with Williams Trading.

Sam Poser

Analyst, Williams Trading LLC

Q

Thanks for taking my questions. I want to ask, like usual, about the inventory. But you said the inventory is going to be lower than expected. So, where do you anticipate the inventory being at the end of the year? Can you give us a number, like the range of what you anticipate?

Gregory V. Hackman

Chief Operating Officer & Executive Vice President, Boot Barn Holdings, Inc.

A

Sam, it's Greg. I don't think we can give you a good prediction on the balance sheet. What I would tell you is the number is lower than we thought as our merchants worked really hard to cancel orders where appropriate, etcetera, etcetera. So, we brought the inventory down, as Jim described, and that's relevant from a cap freight perspective, but it will also put us in better position.

You saw that at the end of Q2, our inventory was up about 83% and now it's 54%. And that is a combination of our merchants doing a really good job of managing their receipts based on sales and their inventory position coming in, if you will, to the quarter, but I can't quantify a number for you.

Sam Poser

Analyst, Williams Trading LLC

Q

Well, let me just – let me – one more try here. You were \$641 million at the end of Q2. You're at \$592 million at the end of Q3. Can we look at another \$40 million drop? Is that a reasonable number, or I mean is it sort of working its way down? Because it sort of worked – it bounced way up. It went up \$55 million and another \$35 million, then almost \$100 million and then another \$50 million that from – it kept going up sequentially. So, can we expect the inventory to now start to come sequentially down sort of the way it looked like in Q3 from Q2?

Gregory V. Hackman

Chief Operating Officer & Executive Vice President, Boot Barn Holdings, Inc.

A

Let me just continue and then Jim can chime in. I mean, if you think about the drivers of the growth that Jim outlined on the call and we've talked about before, it's to support the exclusive brand product, right? That's the growth in the DCs. That was about half of our overall growth year-over-year. So half of that is DC inventory that primarily is driving or supporting the exclusive brand penetration growth, and then the remaining roughly 50% is split pretty evenly between comp store inventory levels and in terms of new stores. When you think about the comp stores, we're really happy about how that inventory is positioned. The weeks of supply at the end of Q3 is in line with non-COVID historical weeks of forward supply.

So, could that come down a little bit? Perhaps. But we're pretty happy with kind of that normal 27 weeks of supply. And then if you think about that remaining quarter, it's new stores, and we're going to continue to grow new stores. So, maybe it comes down a bit, but I would tell you, overall, we're pretty pleased with the level of inventory. Are we a little bit heavy in men's work boots still? Yeah, we are. Are we concerned about that from a markdown liability? Absolutely not.

James M. Watkins

Chief Financial Officer & Secretary, Boot Barn Holdings, Inc.

A

The only thing I was going to add, Sam, to try to help you, if you look back historically, the inventory at the end of Q3 is depleted a little bit just coming out of holiday, and so we typically have a build into the end of the year of inventory. And so I would think of it as more of the build coming out of holiday is going to be less than what we had originally expected and less than what we've seen historically, particularly last year where we had a very sizable build as we're chasing inventory to have enough for the sales.

Sam Poser

Analyst, Williams Trading LLC

Q

Okay. And then, I just missed this. Can you just – I know the West was the weakest, but can you just give me that North, South, East, West, how the sales performed in the quarter?

James M. Watkins

Chief Financial Officer & Secretary, Boot Barn Holdings, Inc.

A

The West was down mid-single digits. The South was slightly negative, and the East and the North were positive.

James G. Conroy

President, Chief Executive Officer & Director, Boot Barn Holdings, Inc.

A

And, of course, Jim is quoting same-store sales. One of the things that we are trying to continue to focus investors on is if we were to quote those numbers in total sales, you might get a slightly different answer. And investors should be virtually indifferent between sales growth from new stores and sales growth from comp stores.

I often joke that we'll – we're going to threaten to stop reporting comps. I'm only kidding. We won't do that. No one has spiked my cappuccino. But I do think we want people to be really focused on new store sales and total sales growth going forward, because they're almost as accretive as same-store sales growth to earnings.

Sam Poser

Analyst, Williams Trading LLC

Q

In all due respect, you're opening a new store that's opening – I mean, I think you originally – I think you said at ICR, you're planning to open new stores, you're originally planning to open at \$1.7 million, they're opening much higher than that. Now they're leveling off at \$4.2 million versus a much lower number. Well, the same-store sales tell us if you're actually getting to that \$4.2 million. The new stores are accretive. They're opening better than they were but, unfortunately, Wall Street standards go up as your standards go up.

James G. Conroy

President, Chief Executive Officer & Director, Boot Barn Holdings, Inc.

A

Sam, I'm not sure, with all due respect, I even understood your question, but...

Sam Poser

Analyst, Williams Trading LLC

Q

Well, I mean, your stores are averaging – your stores are topping off around \$4.2 million on average, which is way above where you originally thought they would be. And you mentioned at ICR that you opened – you had four stores in Phoenix that you went to [ph] eight (00:49:32) and all the business went up. Your stores in Delaware and probably in Connecticut are opening well above their pro forma.

But, I mean, when you start talking like that, everybody's expectations go up and then you sort of need the comp to make sure that those stores that opened two years ago are getting to that same place. I mean, do we all want to know that? That's why, I mean, it's...

James G. Conroy

President, Chief Executive Officer & Director, Boot Barn Holdings, Inc.

A

Understand, we'll continue to provide comp, but total sales growth is what's going to drive earnings.

Sam Poser

Analyst, Williams Trading LLC

Q

Okay. All right.

James G. Conroy

President, Chief Executive Officer & Director, Boot Barn Holdings, Inc.

A

And also, it's part of why our inventory continues to grow, right? We're continually asked about our inventory levels. And, yeah, I can tell you, and this might disappoint you, Sam, but I'm not sure our goal is to massively ratchet down our inventory.

It seems that running with the inventory levels that we've had over the past few years have enabled us to grow our business to the extent that we've been able to grow our business. And in each of the last five years, we've had margin accretion. So that's also something – just to set your expectation, something we're really setting out to achieve is to spin our inventory much faster than we presently are.

Sam Poser

Analyst, Williams Trading LLC

Q

Well, I was asking more about the sales and the same-store sales. I wish you all the best and continued success. Thank you.

James G. Conroy

President, Chief Executive Officer & Director, Boot Barn Holdings, Inc.

A

Thanks, Sam.

James M. Watkins

Chief Financial Officer & Secretary, Boot Barn Holdings, Inc.

A

Thanks, Sam.

Operator: Our next question comes from the line of Jeremy Hamblin with Craig-Hallum. Please proceed with your question.

Jeremy Scott Hamblin

Analyst, Craig-Hallum Capital Group LLC

Q

Thanks. So I was going to ask about store growth. You've exceeded expectations in an environment where a lot of other retailers had to reduce their unit growth guidance. As we look ahead beyond FY 2023, do you see kind of that continuation of 13%, 14%? It almost feels like you're stepping on the gas a little bit more. Any color you might be able to share at this point in time? I'm sure that you have a lot of leases signed already for FY 2024. But any additional color you might be able to share on that at this point.

James G. Conroy

President, Chief Executive Officer & Director, Boot Barn Holdings, Inc.

A

Sure. Well, I think you're alluding to a lot of companies are calling out supply chain challenges, permitting challenges, et cetera. And the honest answer is we are feeling many of those same challenges. The real estate team has done a really nice job of just casting a wider net, so we can continue to have a very healthy new store pipeline.

So while we don't have intentions of guiding next year, we've been opening up double-digit stores in terms of store count every quarter now for several quarters in a row. We thought we would get 40 stores this year. We'll get more than that. So next year, I think it would be surprising if we didn't guide 40 or 45 or 50 stores for fiscal 2024.

And we'll face into some of those challenges that the whole retail industry is facing, at least those that are growing stores. But we've, I think very strategically and carefully, made sure that there's enough stores in the pipeline that we can continue the pace that we're going. So I think it's a momentum that will continue as we look forward for at least the next few years.

Jeremy Scott Hamblin

Analyst, Craig-Hallum Capital Group LLC

Q

Okay. Thanks. And then I'm going to avoid gross margin inventory questions and switch gears to SG&A. So I just wanted to understand. As we look back, as you point out, 80% total sales growth since pre-COVID December quarter. As I look at your SG&A rate, 22.4% in the quarter, it was 21.9% back three years ago with a much lower sales base. Just wanted to get a sense for – I might think that given that massive amount of total sales growth that you'd see a little bit of leverage. But can you help us talk through and think through the puts and takes on that 50 basis points of deleverage over that three-year period?

James M. Watkins

Chief Financial Officer & Secretary, Boot Barn Holdings, Inc.

A

Sure. I think as we've level set the business and we've – yeah, I think as we move forward and we get to the fiscal 2024 guidance and lay that out, I think we can probably build you a little bit better bridge on what the new level of business and a normalized year looks like going forward, Jeremy. I think there are some variable costs in there that will continue to rise with sales, and that's marketing and store labor. And so we'll continue to have those.

And then there's some other things that we've done. We've had one hurdle this year is just around the inflation around the supply that we have at the stores and so getting that through the system. Hopefully, those costs come down over time. But we have had some inflationary pressures. We haven't called those out specifically in much detail, but that is putting some pressure on us this year in Q3.

And so the other thing is the wage pressure. I mean, the wage rates in the tight labor market is something that we've been working through also. And so while nothing we call out on a regular basis, that's something that we're dealing with. And I think as we get into next year, we continue to open new stores, and we'll be able to kind of work those through the system a little bit more evenly than what we saw this last year and even the year before as we've called out. I think last year, in the first half of the year, we saw tremendous leverage when it came to wage rate and marketing because we were able to keep up enough to support the sales that were in there.

So, it's a great question. It's something that we're very focused on, expense control and keeping the SG&A rate down as much as possible, and we're going to continue to focus on that. But there are some inflationary and wage pressures that are hurting us this year.

Jeremy Scott Hamblin

Analyst, Craig-Hallum Capital Group LLC

Q

Would you be able to elaborate? Can you give us a sense for what hourly wage rates are up on a year-over-year basis and then again versus three years ago pre-COVID?

James M. Watkins

Chief Financial Officer & Secretary, Boot Barn Holdings, Inc.

A

Yeah, I don't have that number. Yeah, I don't have that number available to share on this call.

Jeremy Scott Hamblin

Analyst, Craig-Hallum Capital Group LLC

Okay. All right, guys, best wishes. Thank you.

Q

James M. Watkins

Chief Financial Officer & Secretary, Boot Barn Holdings, Inc.

All right. Thanks so much, Jeremy.

A

James G. Conroy

President, Chief Executive Officer & Director, Boot Barn Holdings, Inc.

Thanks, Jeremy.

A

Operator: Our next question comes from the line of Mitch Kummetz with Seaport Research. Please proceed with your question.

Mitch Kummetz

Analyst, Seaport Research Partners

Yeah, thanks for taking my questions. Let's start with Jim Watkins. Looking at the gross margin guide for Q4, I think you said 35.7%. So that's down, I think, 310 bps year-over-year. But if I compare that to pre-COVID Q4 2019, it's up like 280 bps. And if I ex out the freight, it's up something like 570 bps over that four-year period.

Q

I was hoping you could maybe just sort of parse out that increase by kind of the main components. I mean, how much of that is just leveraging the occupancy versus what you've picked up in exclusive brands versus anything else? I'm just trying to better understand like how structural that gross margin gain over the four-year period?

James M. Watkins

Chief Financial Officer & Secretary, Boot Barn Holdings, Inc.

Yeah, I think the big piece of that is the merchandise margin, particularly if you exclude freight. And I'd refer you back to the ICR deck where we kind of have a depiction of what that merchandise margin rate looked like over the last several years. Over five years, it's up 400 basis points and it's 640 basis points if you exclude the freight. And so that's driving a lot of that gross margin expansion that you're talking about there.

A

Mitch Kummetz

Analyst, Seaport Research Partners

How structural do you feel that merch margin improvement is? Can you maybe speak to some of the strategies that have driven that increase?

Q

James M. Watkins

Chief Financial Officer & Secretary, Boot Barn Holdings, Inc.

Yeah, great question. We think it's very structural, with the exception of the freight, which is going to go away, which will help our merch margin going forward. Again, Jim alluded to it earlier in his remarks that from a promotional standpoint, and you know us well, Mitch, that we're not a promotion-driven business. We have some promotions throughout the year, but it's more of a handful of styles that are on promotion. And we'll continue to find ways to increase our merchandise margin via exclusive brand penetration growth. And Jim talked about some

A

of the product and the expansion we've seen earlier and the team that is working on developing the product as a first rate team.

We'll continue to roll out product that's compelling to our customers. And so that will help us from a merchandise margin standpoint. We talked about – Jim in his prepared remarks talked about the in-store fulfillment and the benefit that, that is to us. And one of those benefits is ability to clear any product that we have that needs to be marked down and moved out of the store.

We're able to do that more quickly as customers can find that online versus just going into that one store and hoping that somebody in that size and with that style preference purchases that product. So we've got lots of ideas to continue to grow that merchandise margin and not to sustain it at the level that it's currently at.

Mitch Kummetz

Analyst, Seaport Research Partners

Q

Okay. And then maybe just one for Jim Conroy. Jim, when I look at your store comp, your store comp has held up well, particularly on a multi-year basis. And correct me if I'm wrong, but I believe your e-comm of late has maybe been negatively impacted by competitors being better inventory than they were a year ago. But I would guess that your store competition could probably make the same claim. And I know you talked about your store customer a little bit more loyal. Could you just kind of talk to the strength of your stores, just from a retention standpoint? I know that slide that you presented at ICR kind of spoke to that in terms of where you've polled customers and their intent to repurchase. But why is it that store customer is behaving so well, especially maybe relative to the e-comm customer?

James G. Conroy

President, Chief Executive Officer & Director, Boot Barn Holdings, Inc.

A

Sure. It's a great question, Mitch. Thank you for asking it. As you know, we have always been a stores-first brand. And we really invest in the in-store experience through inventory assortment, where we've remodeled a number of stores. We've got a new store prototype. We've brought digital capabilities into the store and so on and so forth. That coupled with the brand has continued to build strength and momentum over the last several years.

We've completely changed our creative five or six years ago. We've changed our marketing and media mix to really make the brand more top of mind for customers. And when you look at our core customer, they are extremely loyal to us, where the authoritative source for our types of product, our lifestyle products. Most of our customers that shop with us join our loyalty programs. So the vast majority of our sales go through our loyalty program. So we can reach out to them again. They are continually pleased when they come in and they find the product that they need in their size and so on and so forth.

So that customer has just demonstrated time and time again that they are extremely loyal to us, rarely will shop other competitors, and shockingly, rarely shop online. They shop our stores, and the overlap even between our stores customer and our bootbarn.com customer is very low. So it's a phenomenon that works for us, where 85-plus percent of our business continues to go to our store, and we expect that to maintain. We would like to see our e-commerce business start to get back to growth once we cycle the software business in July, and we expect that to happen. But if we continue to sustain the levels within our stores and hopefully grow from this new floor, that just bodes well for the future.

Mitch Kummetz

Analyst, Seaport Research Partners

Q

Got it. All right. Thanks for that and best of luck.

James G. Conroy

President, Chief Executive Officer & Director, Boot Barn Holdings, Inc.

Thanks, Mitch Kummetz.

A

Operator: Our next question comes from the line of John Lawrence with the Benchmark Company. Please proceed with your question.

John Lawrence

Analyst, The Benchmark Co. LLC

Great. Thanks guys. When you look at these new stores just doing the volumes, Jim, at \$4 million, has it changed any of the strategy of how you go to market, where you place those stores to more tenant improvements? Anything that you could point to that the success of these stores are changing how you look at where the next 10 are going to go?

Q

James G. Conroy

President, Chief Executive Officer & Director, Boot Barn Holdings, Inc.

I'd say yes and no. The underlying model is virtually the same. The size of the box is virtually the same. I think the things that have changed a little bit is, historically, and this goes back 5 or 10 years, we were really looking for a destination location that somebody who was squarely in the Western and perhaps work customer segment would drive to us to shop.

A

Then when we tried to take the brand and broaden its definition to attract more customers and we expanded the merchandise assortment that was outside of just Western product and brought in some more casual country product and changed our marketing and branding and media mix to also reach out to customers outside of the Western industry, our new store locations followed suit.

So we are now in more traditional power centers that might be next to a Costco or a Home Depot or a Walmart or Dick's Sporting Goods, et cetera, where in the past, we were sometimes sort of by ourselves in maybe a third rate center, but now we really are trying to attract a broader customer base. So all of those pieces have come together nicely. And as we mainstreamed the brand, we've also looked for slightly more mainstream retail locations, which for us came relatively easy because there was a lot of available real estate.

John Lawrence

Analyst, The Benchmark Co. LLC

Great. Thanks for that color. Good luck.

Q

James G. Conroy

President, Chief Executive Officer & Director, Boot Barn Holdings, Inc.

Thank you.

A

Operator: There are no further questions in the queue. I'd like to hand the call back over to Jim Conroy for closing remarks.

James G. Conroy

President, Chief Executive Officer & Director, Boot Barn Holdings, Inc.

Well, thank you, everyone, for joining the call today, and we look forward to speaking with you on our fourth quarter earnings call. Take care.

Operator: Ladies and gentlemen, this does conclude today's teleconference. Thank you for your participation. You may disconnect your lines at this time, and have a wonderful day.

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