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The Container Store Group, Inc.

Second Quarter Fiscal Year 2017 Earnings Results Conference Call

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Jodi Taylor, *Chief Financial Officer and Administrative Officer*

CONFERENCE CALL PARTICIPANTS

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PRESENTATION

Operator:

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

It is now my pleasure to introduce your host, Shannon Devine of ICR. Thank you, Ms. Devine. You may begin.

Shannon Devine:

Good afternoon, everyone, and thanks for joining us today for The Container Store's Second Quarter Fiscal Year 2017 Earnings Results Conference Call. Speaking today are Melissa Reiff, Chief Executive Officer, and Jodi Taylor, Chief Financial and Administrative Officer. After Melissa and Jodi 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 regarding our plans, strategies, and goals, and our anticipated financial performance may constitute forward-looking statements and are made pursuant to and within the meaning of the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. 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 important factors are referred to in The Container Store's press release issued today and in our

Annual Report on Form 10-K filed with the SEC on June 1, 2017. The forward-looking statements made today are as of the date of this call and The Container Store does not undertake any obligation to update their forward-looking statements.

Finally, the speakers may refer to certain adjusted or non-GAAP financial measures on this call. A reconciliation schedule of the non-GAAP financial measures to the most directly comparable GAAP measures is also available in The Container Store'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 containerstore.com.

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

Melissa Reiff:

Thank you, Shannon, and thank you all for joining our call today. I'll begin with highlights of our Fiscal Q2 performance and then review the progress we are making with our key initiatives. Jodi will follow with a review of our financial results in greater detail and discuss our outlook.

We're happy to deliver second quarter results that are ahead of our expectations on both the top and the bottom line despite hurricane-related headwinds in our Texas and Florida markets. Our Custom Closets business once again contributed positively to our results. In addition, over the last three quarters, we saw a notable improvement in the comp store sales contribution from our other product categories, which included a slightly positive comp store sales contribution in Q2. We cannot point to one or two specific actions that have driven this broad-based improvement in trend. Rather, it reflects the collective impact of our sales revitalization initiatives across merchandising, marketing, store operations, and customer experience, along with the efficiency and optimization work that has been our focus these past few months.

These collective efforts, we believe, will continue to drive the productivity and profitability improvements we know our business is capable of. Given our performance for the first half of Fiscal '17, we are pleased to raise our outlook for the year as you saw outlined in our earnings release and as Jodi will discuss in more detail shortly.

Overall net sales for the second quarter of Fiscal '17 were $218.4 million, up 6.5% compared to the prior-year period, driven by new store sales combined with a 1.9% increase in comp store sales. Elfa third-party sales were up 0.7% in U.S. dollars, primarily due to the positive impact of foreign currency translation which increased third-party net sales by 4.8%.

Our 1.9% comp store sales increase was inclusive of an estimated 70 basis point headwind from Hurricanes Harvey and Irma. Despite the impact of these hurricanes, we did deliver comp store sales increases in each month of the quarter. Our four Houston area stores and our San Antonio stores were impacted by Harvey and our six Florida stores were impacted by Irma. In total, 12% of our store base was directly impacted, resulting in a headwind of approximately $1.4 million of consolidated sales and 70 basis points of comp store sales in Q2 and approximately $0.01 impact to EPS. Most importantly, we are glad that our employees and their loved ones are safe after these devastating storms and that our properties suffered only minimal damage. We are grateful to our employees for their help in getting our stores up and running so quickly.

With a slight mix driven increase in gross margin and leverage on SG&A, we delivered a 50% increase in adjusted EPS to $0.12 from the $0.08 in adjusted EPS in Q2 of last year.

I'd now like to update you on the progress we're making with our activities related to the central elements of our mid-to long-term strategic plan. Regarding our stores, we opened two new stores last month in Livingston, New Jersey and Staten Island, New York, bringing the total stores open for this fiscal year to four. We currently operate 90 brick-and-mortar stores. Our 18,000 square foot store in Albuquerque, New Mexico, which opened this past July—and as a reminder is our first reduced footprint location—continues to perform above expectations and overall we continue to be pleased with the performance of our new stores.

We have been testing different grand opening strategies in each of our Fiscal '17 new store openings—part of our test-and-learn approach—to determine the best grand opening strategy to ensure each store opens successfully and achieves or exceeds its first year pro forma sales expectations. We plan to continue evaluating investments and returns for our different strategies and testing different and tailored approaches for our store openings. To date, these tests have resulted in less pre- and grand opening costs with no degradation to sales results as compared to our pro forma sales expectations.

We're also making great progress in the redesign of our Dallas flagship store. We have a team of very talented people designing The Container Store of the future today, and we will fully evaluate and analyze results, tweak and refine along the way, and plan for future redesigns to our existing stores in the coming years. Construction is expected to begin in January with completion in Q1 of Fiscal '18. Among other things embedded in this redesign is SKU rationalization and applying the learnings obtained from the projects completed as part of our Optimization Plan.

Regarding product merchandising, Custom Closets once again delivered strong performance, contributing 140 basis points to our second quarter comp store sales driven by the June introduction of new Elfa products which continue to positively impact comps, as well as TCS Closets and our Closet completion products. In addition, we were very pleased to see our other product category deliver positive comps in the second quarter as our efforts to refresh our merchandise campaigns contributed to improved sales performance.

During the second quarter, we completed two big projects collaborating with a third-party, a cost of goods projects, as well as a consumer insight project. We're very encouraged by the results of this work, achieving our targeted savings and, in fact, are seeing opportunities to reinvest in our business in a responsible manner to further our growth strategies, including savings that we believe will allow us to fund certain needed infrastructure investments that I'll speak about in a moment. We are now also engaged in a comprehensive price optimization project with a third-party that will span the remainder of this fiscal year. Our objective is to use our deep data analytics to ensure that our retail pricing is maximizing gross margin dollars in our business and we will update you later in the year as we have more information.

Turning now to customer acquisition and marketing, we continue to work on optimizing our media mix model and are seeing traction from our increased digital spend, as evidenced by another strong quarter of sales. Web-generated sales were up over 25%, including our click-and-pick-up sales and 17.6% for online direct-to-consumer sales only. We also continue to elevate and improve our POP! program with a new online interface, positively impacting both POP! sign-ups, as well as welcome POP! perk redemptions. With our increased deployment of highly targeted offers, we've been able to drive more frequency and spend with less discounting.

As we announced on our last earnings call, we launched a national television campaign on August 7 with HDTV and DIY Cable Network. This 30-second commercial ran through November 5. As a reminder, the TV commercial is part of an integrated partnership that includes sponsoring the 2017 DIY Network Ultimate Retreat Home, selling the HDTV magazine in our stores, running full-page print ads in the magazine through January, as well as e-mails and digital banner ads. We plan to evaluate the estimated impact of this partnership on our brand and sales once the data is available. We further plan to assess

the impact of a television campaign for possible future reallocation of our marketing spend to this medium.

Regarding operational productivity and efficiency, you may recall that in Fiscal '16 we went live with automation in our Coppell, Texas distribution center coming in on-time and within budget for this big project. It's really been rewarding to see that during Fiscal '17 we are benefiting from considerable payroll savings and increased throughput in our distribution center due to both this automation investment, as well as continued process improvements throughout our operations. Additionally, we are also deep into the implementation of the first of three phases of best-in-class distribution and supply chain software. The first phase is scheduled to be completed at the end of Fiscal '17 with the final phases completed during Fiscal '18 and early '19. This investment is expected to enable us to provide an even more effective flow of merchandise throughout our supply chain.

Finally, on the people and talent side, as I mentioned earlier, we are making important investments to further strengthen our Leadership Team, create a more narrow and focused span of control, and increase the speed of decisions and execution. To this end, we are in the process of adding to our Leadership Team an EVP of Merchandising, as well as an EVP of Strategy and Analytics. We plan to continue to strengthen our incredible talent with needs we identify in this rapidly changing retail world, always keeping succession planning top of mind.

In summary, we're pleased with our financial performance in the second quarter, as well as the progress made towards our strategic priorities. Our Optimization Plan to drive sales and efficiency and ultimately improved profitability is proceeding according to plan, and we believe will set the stage for ongoing improved financial results in the future. We look forward to further building on our progress.

Now, Jodi, would you please go through our financial results and outlook in more detail?

Jodi Taylor:

Sure. Thank you, Melissa, and good morning, everyone. For the quarter-ended September 30, 2017, our consolidated net sales were $218.4 million, up 6.5% compared to the prior-year period. Sales for The Container Store retail business were up 7.0% to $202.3 million, driven by our new stores and a 1.9% comp store sales increase. This includes the total hurricane-related headwind of approximately $1.4 million to consolidated sales, or an approximate 70 basis point impact to comp store sales for the quarter.

Custom Closets continues to positively contribute to our comp store sales performance with 140 basis point contribution to our second quarter comp store sales. As Melissa mentioned, our comp store sales were positive throughout the quarter, including the hurricane impacted months of August and September, and the improved performance was broad-based across our Custom Closets and all other product categories, as well as geographies.

We ended the quarter with 88 stores and approximately $2.2 million of gross square footage as compared to 82 stores and approximately 2 million of gross square footage at the end of the second quarter of Fiscal '16.

Now turning to Elfa International AB, Elfa's third-party net sales were up 0.7% in U.S. dollars due to the positive foreign currency translation impact of 4.8%, partially offset by lower sales in Nordic markets. In the second quarter, consolidated gross profit dollars increased 6.8% to $126.4 million with a consolidate gross margin improvement of 20 basis points. The increase in gross margin was primarily driven by increased sales of higher margin Elfa products during the second quarter.

Gross margin at The Container Store retail business was down 20 basis points, reflecting higher costs associated with our Installation Services business and growth in lower gross margin business-to-business sales, both of which were partially offset by less spending on promotional activities and a positive impact from FX contracts. As we've previously stated, we've modified our Installation model, which has increased cost of goods sold, partially offset by lower SG&A expenses associated with these services. Elfa gross margin was flat at 38.2% as the impact of higher direct material costs was offset by production efficiencies.

Now, moving on to SG&A, as a percentage of net sales, consolidated SG&A increased 210 basis points to 48.7% in the second quarter of Fiscal '17 as compared to the prior-year period. This was primarily dues to third-party consulting expenses incurred as part of the implementation of the Optimization Plan which contributed 310 basis points to the increase. This increase was partially offset by 100 basis points of leverage of SG&A. The leverage in SG&A, when excluding the Optimization Plan costs, was primarily due to ongoing savings and efficiency efforts which include savings associated with the Optimization Pan, as well as lower self-insurance costs offset in part by increased occupancy costs.

As a reminder, we expect the benefits of our 2017 Optimization Plan, particularly with the expected benefit flowing through cost of goods sold, to be realized largely in the second half of this fiscal year. New store preopening expenses decreased this quarter to approximately $1.4 million from $2.5 million in the second quarter last year. We opened one store in Q2 this year as compared to two openings in Q2 last year. We also incurred some preopening expenses this quarter for our new Livingston, New Jersey and Staten Island, New York stores that both opened in October. As of today, the total new stores opened for the year is four.

Our net interest expense in the second quarter of Fiscal '17 was $5.9 million, up 39.7% from the prior-year period. During the second quarter, we completed the amendment of our senior secured term loan facility, which extends the maturity date to August 18, 2021. This amendment increased our applicable interest rate margins and we reduced the aggregate principal amount of the term loan to $300 million. As we outlined in the press release, issued upon completion of the amendment, we expect incremental interest expense for Fiscal '17 of approximately $7 million, resulting in total interest expense of approximately $25 million for the year. As part of this amendment, we also recorded $2.4 million of loss on extinguishment of debt in the second quarter.

The effective tax rate for the quarter was negative 144.4% compared to positive 41.6% in the second quarter of last year. The change in the effective tax rate is primarily due to the impact of the mix of domestic and foreign earnings, the exploration of certain stock-based compensation awards, and the effective state tax rate changes during the quarter. Despite this unusual tax rate for Q2, we continue to expect our full-year Fiscal '17 tax rate to be approximately 39%.

Our net loss for the quarter was approximately $900,000 or $0.02 per share as compared to net income of $3.5 million or $0.07 per share in the second quarter of last year. On an adjusted basis, we generated net income of $5.5 million or $0.12 per share as compared to adjusted net income of $3.7 million or $0.08 per share in the second quarter last year. These results include an approximate $0.01 per share negative impact attributable to the hurricanes.

Now turning to the balance sheet, we ended the quarter with $10.1 million in cash, $310.6 million in outstanding borrowings net of deferred financing costs with debt down $22.4 million from the same time last year, and combined availability on revolving credit facilities and cash on hand of approximately $85.9 million. We ended the quarter with inventory down 3.2% despite the increase in stores opened from 82 at the end of the second quarter last year to 88 at the end of the second quarter this year. On a per store basis, inventory levels at TCS were down 13.2% with the decline largely due to improved inventory management.

Given our second quarter results that were ahead of our expectations, we are raising our outlook for comp store sales, consolidated net sales, and adjusted EPS for Fiscal '17. Our press release outlines our updated outlook as well as our prior outlook on each line item that we guide to.

We continue to expect TCS and consolidated operating margin improvement in Fiscal '17, driven by our SG&A savings and efficiency program, as well as the impact of the Optimization Plan. We still expect our tax rate for the full Fiscal '17 to be approximately 39% and cap ex is currently expected to be approximately $30 million.

As you also heard Melissa mention, we are opportunistically and proactively investing a portion of the savings from our cost of goods project into selected talent and bench augmentation, most specifically in the areas of merchandising, technology, and analytics. We believe that these investments will allow us to continue to focus on and drive our strategic initiatives, as well as build on our business momentum.

Looking to the third quarter and SG&A specifically, we expect a year-over-year SG&A headwind of approximately 50 basis points, primarily related to a shift in timing of marketing and technology-related expenses. These costs are projected to shift from the fourth quarter of Fiscal '17 into the third quarter of Fiscal '17. This will play some pressure on SG&A leverage in the third quarter as compared to last year. As a result, we currently project to earn approximately one-third of our Fiscal '17 adjusted EPS in Q3 and two-thirds of our adjusted EPS in Q4 with virtually all of our profitability being derived in the second half of the fiscal year as we have historically seen.

In summary, we are very pleased with our second quarter performance and the progress we continue to make toward our strategic priority. We look forward to speaking with you on our third quarter call. Thank you.

Now I'd like to turn the call back over to the Operator so that we can open the line for your questions. Devon?

Operator:

Thank you. We will now be conducting a question-and-answer session. If you'd 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 would 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 keys. One moment please while we poll for questions.

Our first question comes from the line of Steven Forbes with Guggenheim Securities. Please proceed with your question.

Steven Forbes:

Good afternoon.

Melissa Reiff:

Hi, Steve.

Steven Forbes:

I want to start with the Custom Closet impacts you called out, right, so 140 basis points up from 50 basis points last quarter. Can you give us some context around the drivers of that sequential improvement whether it was TCS Closet to Elfa—I think you mentioned Elfa—or just the Closet department itself? Then just briefly touch on, right, the annual Elfa sale; is there any timing—the anticipated timing or I guess the window, right, of that this year and how it compares to last year?

Melissa Reiff:

Hi. Steven, it's Melissa. I can tell you the timing of the Elfa sale this year compared to last year is the same.

Steven Forbes:

Okay.

Melissa Reiff:

So that has not changed, Steven. Then, Jodi, do you want to address the other question?

Jodi Taylor:

Sure. Hi, Steve. On the Custom Closets question, you're right; we did see an acceleration in the sales growth or comp contribution coming from our Custom Closets. As you noted, it was 50 basis points in Q1 and it was 140 basis points in Q2. Really, we continue to see growth in that area, which is a key strategic focus of our business, and it's such a critical area of importance to us. That's why we shifted to sharing that stat versus simply the TCS Closet stat which, as you know, we've now had TCS Closets in our store since Q1 of Fiscal '15 so that's really become more part of the base, although it is still driving positive comp contribution.

If we kind of step back and look at what drove the acceleration, it's largely around even greater Elfa selling. We had a really, really successful quarter in terms of, overall, how that Custom Closets focus has shifted for us.

Steven Forbes:

Then as a follow-up, I believe—and correct me if I'm wrong here—the timing of the wage increases, right, you think about cycling the freeze that you guys had last year. I believe that hits in September, so can you just give us some context around, I guess, employee retention, the anticipated increase that you're seeing, and if you're seeing general market pressures with wages as we kind of think about some of the regulatory impacts that are out there and flowing through this last July and then upcoming in January?

Jodi Taylor:

I'll also take that, Steven. Melissa, you may want to add to it, but you're right; we did in fact in September lift our wage freeze as we had planned to do. That is embedded, of course, within our outlook, and despite that, we do expect to still be able to achieve leverage in our business.

In terms of the general market condition, we are, of course, monitoring that very carefully. As you know, we do tend to get pay higher than the typical retailer, so, for us, we don't see that as something that in this current environment is expected to cause us any sort of meaningful discussion in terms of wage pressures versus what we're currently paying.

Steven Forbes:

Thank you.

Melissa Reiff:

In terms of retention, Steven, we haven't seen—that has not really been an issue. We're always looking for great people, for great talent, and as Jodi said, we watch that market carefully so that we pay accordingly.

Steven Forbes:

Thank you all.

Melissa Reiff:

Thanks.

Jodi Taylor:

Thank you.

Operator:

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

Matt Fassler:

Thanks so much and good afternoon.

Jodi Taylor:

Good afternoon.

Matt Fassler:

My first question just relates to contrasting the year-on-year gross margin experience that we saw here in Q2 with the year-on-year gross margin experience that you saw in Q1 which was obviously less favorable. This was more or less breakeven year-on-year. Q1 you saw lots of pressure. Talk about the difference in business environment and drivers, if you would.

Jodi Taylor:

Sure. Hi, Matt. I'll take that. As you heard us say, on a consolidated basis, the overall gross margin was up 20 basis points. If you just look at The Container Store segment, gross margin was down 20 basis points. We had the same two variables play in, in terms of headwinds for us and that was the Installation Service model and the costs associated with that, as well as the strong growth we saw in the lower gross margin B2B sales. However, this was partially offset by benefits that we saw from FX contracts—that was a 20 basis point benefit this quarter—as well as lower promotional activities, promotional levels due to more targeted offers. Really, stepping back, the most significant improvement in gross margin from Q1 to

Q2 came from lower discounting associated with the merchandise campaigns and our more targeted promotional offers.

With the maturing of our POP! Loyalty program and the scale we have there, we continue to have even more intelligent data about our customer behaviors and we've seen some really good success and generated more targeted and more effective offers. So, this is something we do believe we can continue to replicate moving forward.

Just a couple of reminders, on the B2B side, that's still a relatively small portion of our total sales, but it is growing at a greater rate than other areas of the business. While it has a modestly lower gross margin profile, it has a lower SG&A structure so that the operating profit is at least at the Company average.

Then, also, just in terms of thinking forward—I'll read your mind for a second, Matt—the benefits of the cost of goods project, we concluded that project in Q2 and so the cost concessions that we have, that's embedded in our outlook and we would expect to start to see those benefits and Q3 with that accelerating as we move into Q4 and beyond just because of the impact it takes to get the cost to the ultimate new price.

Matt Fassler:

Understood. Then my second question—so, as you've spoken about the Optimization Plan, you have spoken about costs, which you expected to register up front, and then benefits, which you expected would lag. In your early August release you spoke about $0.12 to $0.14 of pretax charges. Today, I believe you narrowed that number to $0.14. How much of that $0.14 did you book in the current quarter and where did it show up?

Jodi Taylor:

Sure. This is Jodi again. We did book essentially all of our costs, we believe, that we're going to incur in this fiscal year for the Optimization Plan. That's why we were able to go ahead and nail down that amount at the higher end of the range which was the $11 million or $0.14 per share. Really, it breaks into two parts. In the first quarter, it was the severance costs related to the first two parts of the Optimization Plan at both TCS and Elfa. Then in this quarter it's the third-party consulting costs which are booked through SG&A. In our SG&A you see a 310 basis point hit because of those expenses. If you exclude them, we leverage by the 100 basis points we noted in terms of SG&A. Those costs are in fact all incurred.

As we have said before, incurring all the costs on the front end, but the benefit, particularly the cost of goods' side benefit, we've not had any of those at all flow through until we get to the second half of the year. Then on the SG&A benefits we expect, really the job elimination occurred at the end of Q1, so we started to see some of those SG&A savings in Q2, but those will benefit the entire second half as well.

Matt Fassler:

So most of the $0.16 to $0.19 of gross benefit that you expect for the year show up in the second half?

Jodi Taylor:

That's correct.

Matt Fassler:

Great. Thank you so much for that, guys.

Jodi Taylor:

You're welcome.

Melissa Reiff:

Thanks, Matt.

Operator:

Thank you. As a reminder, ladies and gentlemen, if you would like to ask a question, please press star, one on your telephone keypad. Our next question comes from the line of Dan Binder with Jefferies. Please proceed with your question.

Daniel Binder:

Thank you.

Melissa Reiff:

Hi, Dan.

Daniel Binder:

My question is around the comp store sales. First, I was wondering if you could just give us a little bit of color around traffic versus ticket within the comps. I know you don't specifically break it out in detail, but maybe just a little bit of color directionally might be helpful. Then when you had issued your 8-K after the July period, you were running about—I think it was a 4.6 comp. Adjusted for the hurricanes, you came in a little bit lower than that. I was just curious if there was something unique about July and how has moment looked quarter-to-date and do you expect a hurricane benefit now that people are in recovery mode and replacing household furnishings, etc.

Melissa Reiff:

Hey, Dan. It's Melissa. I'll take the first question. Then, Jodi, you want—you'll take the second one? The first question about comp improvement, well, obviously we are delighted with our Q2 results. Just a little color around that, it's truly not one specific thing. As I alluded to in the script, it's many things that we've been doing in our business of late. It's really kind of—the results reflect the collective impact of all of our sales revitalization initiatives across the merchandising, the marketing, the store operations, and customer experience. It's also, Dan, a lot to do with the incredible hard and focused work of all of our employees and of all of our team. We've really done, I think, a good job in communicating exactly what we're trying to accomplish and how to do that. So it's been a combination of many things, as well as the reallocation expend—we can't forget—to more digital, and that is in conjunction with our media mix model.

Then regarding traffic and ticket, you're right; we don't break that out, but all of our initiatives are designed to, Dan, improve trends in all the drivers. I will tell you that we have seen improvement in both traffic and tickets over the past few quarters, so that's a good thing.

Jodi Taylor:

Yes. I think you've answered the hurricane question as well, but just to—we said it was about 12% of the base affected and I know we quantified that impact to comps of about 70 basis points. We had four of our Houston stores close for five days. We had our six Florida stores close for four to five days. So, it was definitely impactful to the quarter. We're not seeing really any notable impacts to call out post-hurricanes. Everything seems to be stabilized and sort of back to where we expected and where it's been trending prior, so no callouts there for you, Dan.

Then I think you also asked a question about the trend, the cadence throughout the quarter. Yes, you're right that July ended up being our largest comp performance month and that's in part because we had a couple of things: one, in August and September they were obviously impacted by the hurricanes and that's the second half of the quarter. We also saw the flow of Elfa sales through in the quarter. It ended up that July ended up being the strongest month of the quarter. We did see some strong conclusions to our Elfa promo that we did around free installation. Overall, we would just say we're very pleased with second quarter and the improvement that we're seeing across all the metrics.

Melissa Reiff:

Well, and all three months were positive comps, so that's a good thing.

Daniel Binder:

If I could just—on a follow-up, you talked about being less promotional. That obviously had a big impact on your margins. I was just curious. If you look at the broader industry, was your lower promotional activity unique to you or were you seeing less industry promotion that allowed you to also be less promotional?

Jodi Taylor:

Dan, I would say that our year-over-year improvement was largely unique to us. I think we've really been able to use our data much smarter and be able to make sure that we're analyzing every promotion for profitability and returns, and eliminating those that simply don't make sense and making sure we really focus and are more targeted in those that we're doing.

Melissa Reiff:

Much more targeted.

Jodi Taylor:

I don't think it's broader. I think it's more specific to us.

Daniel Binder:

Great. Thank you.

Jodi Taylor:

You're welcome.

Melissa Reiff:

Thanks, Dan.

Operator:

Thank you. Our next question comes from the line of Matt McClintock with Barclays. Please proceed with your question.

Kate:

Good afternoon. This is Kate on for Matt. I just had a question on the SKU rationalization. Can you give any details on the process thus far? I apologize if I misheard this, but it sounds like the process has been embedded in the Dallas redesign, so, if so, will this be rolled out to all stores once the Dallas redesign is complete or is this kind of a test somewhere (phon) in activity as well? Thanks.

Melissa Reiff:

Hi, Kate. It's Melissa. Your absolute right, it is embedded in the redesign of our flagship store. Then once implemented and tested with a lot of analyzing it carefully and evaluating it, then our plan will be to roll out to other stores as appropriate. So, yes, I mean, it's SKU rationalization—we're also in the midst, as I said in the script, of our pricing optimization program, so they all kind of fit together. But don't forget too that we change out annually our new SKUs about 20% every year, so we are just going to be looking at SKU rationalization, what makes sense; pricing optimization, what makes sense, we'll test-and-learn, and then we'll, again, roll it out to all stores and new stores as appropriate.

Kate:

Great. Thank you.

Melissa Reiff:

Thank you.

Jodi Taylor:

Thanks.

Operator:

There are no further questions at this time. I'd like to turn this floor back over to Management for closing comments.

Melissa Reiff:

Great. Thank you, Devon, so much. I just want to thank everybody for your time and interest and attention today, and Jodi and I want to wish everyone a happy Thanksgiving and a wonderful holiday season. We will most definitely look forward to talking to you again at the end of Q3. Thanks so much.

Operator:

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