DICK'S Sporting Goods, Inc. NYSE:DKS

FQ3 2020 Earnings Call Transcripts

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Presentation

Operator

Good morning and welcome to the DICK'S Sporting Goods Third Quarter Earnings Call and Webcast. [Operator Instructions] Please note, this event is being recorded. I would now like to turn the conference over to Nate Gilch, Director of Investor Relations. Please go ahead.

Nathaniel A. Gilch
Director of Investor Relations

Good morning, everyone, and thank you for joining us to discuss our third quarter 2019 results. On today's call will be Ed Stack, our Chairman and Chief Executive Officer; Lauren Hobart, our President; and Lee Belitsky, our Chief Financial Officer.

A playback of today's call will be archived on our Investor Relations website located at investors.dicks.com for approximately 12 months.

As a reminder, we will be making forward-looking statements, including our 2019 outlook for sales and earnings, which are subject to various risks and uncertainties that could cause our actual results to differ materially from these statements. Any such statements should be considered in conjunction with cautionary statements in our earnings release and risk factor discussions in our filings with the SEC, including our last annual report on Form 10-K and cautionary statements made during this call. We assume no obligation to update any of these forward-looking statements or information.

Today, we will be discussing our third quarter 2019 SG&A expenses, operating profit and earnings per diluted share on a non-GAAP basis. We will also be comparing these non-GAAP financial measures to the comparable GAAP financial measure from the prior period since there were no non-GAAP items excluded during the prior period. We believe this comparison is helpful to evaluate the company's third quarter performance relative to last year. Please refer to our Investor Relations website to find a reconciliation of any non-GAAP financial measures referenced in today's call.

And finally, for your future scheduling purposes, we are tentatively planning to publish our fourth quarter 2019 earnings release before the market opens on March 10, 2020, with our subsequent earnings call at 10:00 a.m. Eastern Time.

With that, I will now turn the call over to Ed.

Edward W. Stack
Chairman & CEO

Thanks, Nate. Good morning, everyone. As announced earlier this morning, we had a very strong third quarter from both a sales and profitability perspective. We delivered a 6% increase in consolidated same-store sales. Additionally, our third quarter non-GAAP earnings per diluted share of $0.52 represents a 33% increase over last year.

Our key strategies and investments are working as our comp sales continued to accelerate. We saw broad-based growth across our business, and strong comps were supported by increases in both average ticket and transactions as well as growth across each of our 3 primary categories of hardlines, apparel and footwear. Our brick-and-mortar stores continue to comp positively and we drove double-digit e-commerce sales while reducing promotions.

As we enter the holiday season, we remain very enthusiastic about our business and are raising our full year consolidated same-store sales and earnings guidance for the third time this year.

As we've discussed previously, our prior year inventory levels were running too lean and, therefore, we've been making planned strategic inventory investments into key growth categories. This resulted in our inventory increasing 17% at the end of the third quarter compared to the same period last year. Our athletes have continued to respond well to our improved in-stock positions and broader assortments of enthusiast-level product, driving meaningfully positive comp gains in key categories.

Our inventory remains clean and well positioned and importantly, our merchandise margin rate increased 60 basis points during the third quarter reflecting a healthy business.

We continue to be pleased with the results of our space optimization efforts. We have reallocated space -- we have reallocated floorspace to growing categories and adapted our product offerings to better align with the needs of each market.

As part of our broader strategic review of our hunt business, during the third quarter, we exited 8 of our Field & Stream locations. This strategic review is continuing and we will provide additional updates when available.

Looking ahead, we will continue to optimize our assortment with an emphasis on key items while ensuring we are meeting the needs of all athletes from beginner to enthusiast.

Our relationships with our strategic brand partners have never been stronger, and we are encouraged about the product pipeline into next year. Our private brands, including CALIA, Walter Hagen, Alpine Design and DSG, remain a key source of strength and differentiation within our assortment. We have been particularly pleased with the DSG brand, which we launched toward the end of the second quarter. We believe DSG will become our largest private brand by the end of next year.

In closing, I'm pleased with our strong third quarter results and remain very enthusiastic about the future of our business. I'd like to thank all of our teammates for their hard work and commitment to DICK'S Sporting Goods, which made this performance possible, and for their upcoming efforts during the holiday season.

I would now like to turn the call over to Lauren.

Lauren R. Hobart
President & Director

Thank you, Ed, and good morning, everyone. I want to start by emphasizing my shared enthusiasm for our business. We remain focused on building one of the best omnichannel experiences in retail and as Ed discussed, our strategies and investments are working and drove strong results during the third quarter.

This morning, I will review the exciting progress we have made in our stores and our e-commerce fulfillment capabilities, and I'll also provide updates on our marketing priorities and our Sports Matter program.

First, I couldn't be more excited about the momentum building across our stores. Earlier this year, we launched very extensive training around our new service standards focused on how our team should engage every athlete every time, use the power of their opinion to create confidence and excitement and execute the basics to create a hassle-free shopping experience. This, combined with a real focus on recognition of great results and performance, along with our improved in-stock positions and stronger marketing, has the flywheel moving. It is a very virtuous cycle.

Turning to eCommerce, we're also providing a stronger experience online through enhanced website functionality, faster delivery and better blending of our digital and store channels. We recently launched a new responsive web experience that allow us to deliver new features to our athletes more quickly in order to better meet the consumers' ever-changing expectations.

In addition, the opening of our 2 new dedicated eCommerce fulfillment centers earlier this quarter was a great success, opening on time and on budget. We've been quite pleased with the operations to date, including our new teammates and systems integrations as well as the robotics in our New York facility, our first DICK'S-operated eCommerce fulfillment center. These new fulfillment centers have expanded our direct-to-consumer capacity and along with our new strategic delivery partnership with FedEx, have successfully reduced delivery times to our athletes.

Moreover, one of the most important ways we continue to blend our digital and store channels is through BOPIS. During the quarter, we continued to see growth in the number of orders our athletes ordered online and picked up in store, significantly outpacing the double-digit sales growth we saw in our overall eCommerce business.

Next, in marketing, I'm pleased to announce that late in the quarter, we launched ScoreCard Gold, an enhancement to our loyalty program targeting our top-tier athletes. Gold benefits include many ways to earn ScoreCard points and member-only perks, including early access to sales and product launches, VIP events and more. We're enthusiastic about this program and are confident it will drive deeper levels of engagement with our most loyal consumers.

In addition, we are quite excited about our multichannel holiday campaign titled Unwrap the Magic of Sports. As part of this, we released our first animated TV spot called The New Kid. This spot showcases the magic of our stores and brings the DICK'S store to life in a unique and very engaging way.

Lastly, in partnership with the DICK'S Sporting Goods Foundation and in support of our pledge to provide access to sports for 1 million additional young athletes by 2024, we launched a fundraising campaign during back to school called To Whom It May Concern. This campaign highlighted some of the most vulnerable communities across the country where youth sports are disappearing at an alarming rate. I'm pleased to announce that our campaign has been a tremendous success, generating an increase in donations of more than 100%.

In closing, as we continue to execute against our strategic priorities, we are enthusiastic about our business and remain optimistic that our investments will drive differentiation in the marketplace and strengthen our leadership position.

I'll now turn the call over to Lee to review our financial results and outlook in more detail.

Lee J. Belitsky
Executive VP & CFO

Thank you, Lauren, and good morning, everyone. Let's begin with a brief review of our third quarter results.

Consolidated sales increased 5.6% to approximately $1.96 billion. Consolidated same-store sales increased 6% driven by a 3.3% increase in transactions and a 2.7% increase in average ticket.

Following a return to positive brick-and-mortar store comps in the second quarter, we saw an accelerating strength in our stores. Our eCommerce results were also strong with our eCommerce sales increasing 13% while we reduced promotions. As a percent of total net sales, our online business increased to 13% compared to 12% in the same period last year.

During the quarter, we delivered growth across each of our 3 primary categories of hardlines, apparel and footwear. And as expected, our hunt business continued to comp negatively, but we're able to more than offset these declines with meaningful growth across other categories.

While the removal of hunt in an additional 125 stores at the end of the second quarter contributed to the decline in the category during the quarter, these stores comped positively overall and in line with the rest of the chain. We continue to be quite pleased with the results of our space reallocation efforts and as Ed mentioned, the strategic review of our hunt business is continuing.

Gross profit in the third quarter was $580.6 million or 29.59% of net sales, a 140 basis point improvement compared to the same period last year. This improvement was driven by leverage on occupancy costs of 87 basis points and merchandise margin rate expansion of 60 basis points. The merchandise margin expansion was primarily driven by a favorable merchandise mix and fewer promotions. As expected, this was partially offset by start-up costs associated with the opening of our 2 new dedicated eCommerce fulfillment centers.

Non-GAAP SG&A expenses were $515.1 million or 26.25% of net sales, up 102 basis points from the same period last year. This deleverage was primarily driven by higher incentive compensation expenses due to our strong third quarter results.

In addition, we remain on track to achieve our 2019 productivity objective of eliminating approximately $30 million of expenses. These savings helped offset the majority of our investments in the third quarter. Driven by our strong sales and gross profit margin, non-GAAP operating profit was $62.2 million or 3.17% of net sales, up $9.3 million or 32 basis points from the same period last year.

Other income totaled $2 million in the quarter compared to $0.1 million expense in the same period last year. Substantially all of this change is related to higher deferred compensation plan investment values resulting from the increasing overall equity markets during the quarter, and this income is fully offset in SG&A expense and has no impact on earnings.

In total, we delivered third quarter non-GAAP earnings per diluted share of $0.52 compared to earnings per diluted share of $0.39 last year, which represents a 33% year-over-year increase.

On a GAAP basis, our earnings per diluted share were $0.66. This included a onetime $33.8 million pretax gain on the previously announced sale of our 2 technology subsidiaries, Blue Sombrero and Affinity Sports. This also includes a onetime $8.9 million pretax charge attributable to the exit of 8 Field & Stream locations as well as an additional $7.6 million pretax noncash asset impairment. For additional details on this, you can refer to the non-GAAP reconciliation tables of our press release that we issued this morning.

Now moving to inventory. As we planned, our inventory levels increased 17% in the quarter compared to the same period last year. As Ed discussed, our prior year inventory levels were running too lean and, therefore, we've been making strategic investments to support the key growth categories. Looking ahead, our inventory is clean and well positioned, and we expect our inventory to increase by a similar rate at the end of the fourth quarter.

Turning to our third quarter capital allocation. Net capital expenditures were $51 million and we paid approximately $23 million in quarterly dividends. During the quarter, we also repurchased 2.84 million shares for $99.5 million at an average price of $35.07. During the trailing 4 quarters, we've returned over $495 million to shareholders through share repurchases and quarterly dividends. These activities were funded through cash from operations and borrowings under our revolving credit facility, and we have approximately $1.1 billion remaining under our share repurchase programs.

We ended the third quarter with approximately $88 million of cash and cash equivalents and $719 million outstanding on our $1.6 billion revolving credit facility. This compares with $382 million outstanding on our revolving credit facility at the end of the third quarter last year.

Now let me move to our fiscal 2019 outlook for sales and earnings. First, as a result of our third -- our strong third quarter sales, we are raising our full year consolidated same-store sales guidance. We now expect full year comp sales to increase by 2.5% to 3% compared to our prior expectation of low single-digit positive.

Additionally, we are raising our full year non-GAAP earnings per diluted share outlook to a range of $3.50 to $3.60 compared to our prior outlook of $3.30 to $3.45, which was on a GAAP basis. Our updated earnings guidance is based on an estimated 89 million average diluted shares outstanding and includes the expected impact from all tariffs currently in effect as well as any new tariffs that are slated to go into effect later this year.
This concludes our prepared comments. Thank you for your interest in DICK'S Sporting Goods, and operator, you may now open the line for questions.

Question and Answer

Operator

[Operator Instructions] Our first question today comes from Robbie Ohmes with Bank of America.

Robert Frederick Ohmes
BofA Merrill Lynch, Research Division

I have to say, congrats on a great quarter. I don't want to nitpick...

Edward W. Stack
Chairman & CEO

Thanks, Robbie.

Robert Frederick Ohmes
BofA Merrill Lynch, Research Division

You're welcome, Ed. Yes, I don't want -- I don't mean to nitpick, but a couple of questions. First, the eCommerce, only up 13%. Can you give a little more color on the very successful Yeezy launch we know you guys had versus being less promotional? And then you commented on fewer promotions, Lee, helping the gross margin. Was that mostly being less promotional on the eCommerce side or was that also in the stores? That's my first question.

Edward W. Stack
Chairman & CEO

I think there was like 3 of them in there, Robbie, but we'll take them. So on the eComm being up 13%, we were much less promotional from an eCommerce standpoint than we've been in the past by design. We also -- some of the things that we do from -- a customer comes in, we're not in stock, we order something online for them, ship it to their home, that's been less than it had been because we are much better in-stocked than we had been in the past driven by the 17% increase in inventory, which we really felt was appropriate. And as far as we -- the promotions, we did less promotions in store and online that helped drive that. So we're very pleased with the business.

Robert Frederick Ohmes
BofA Merrill Lynch, Research Division

And then just my last question and I'll let you go, but the -- so the fourth quarter, your inventory is up 17%, as you guys pointed out. The implied guidance for comps for the fourth quarter, I think, is somewhere in the 1% to 3% range. A couple of things. Should we expect more launches of Yeezys or maybe even things from Nike? And also, would you view that as a conservative expectation for the fourth quarter or is that less selling days? Any color you can give us would be great.

Edward W. Stack
Chairman & CEO

Robbie, there's 2 things about -- it's an appropriate question based on kind of what our second quarter was and our third quarter was, but there are -- we're trying to be relatively conservative but realistic based on some of the things that are happening. Our business is dependent upon weather, so if we have a cold winter, that helps drive our outerwear business and our cold weather business. And with 6 less days between Thanksgiving and Christmas, that's a reality, and we're not really sure how that's going to play out, but that's -- we're trying to be -- we're trying not to get ahead of our skis, if you will.

Robert Frederick Ohmes
BofA Merrill Lynch, Research Division

And then just on the Yeezy launch in the third quarter and how much that helped and thoughts on further launches like that in the fourth quarter and beyond.

Edward W. Stack
Chairman & CEO

Well, they -- it was helpful. It didn't really move the needle a lot, but it was definitely helpful. We -- it was the first time we had a Yeezy launch, and we had 2 of them and we were very pleased with the results. I think adidas and the team and the Yeezy group was very pleased with how we handled it and how quickly we liquidated it, and we'll see what happens in the fourth quarter.

Operator

The next question is from Michael Lasser with UBS.

Michael Lasser
UBS Investment Bank, Research Division

So you're going to be on the run rate to have 5%, 5.2% operating margin this year. As you look out over the next couple of years, is that a sustainable run rate level that we should be modeling? Or do you think you'll be able to generate consistent and modest margin expansion per year over the next few years?

Lee J. Belitsky
Executive VP & CFO

Well, Michael, at this point, we're not ready to provide the guidance going forward. We're excited about the trajectory of the business right now, excited about the momentum, sales momentum we have going into next year, but we're not ready to give guidance on next year at this point from an operating margin perspective.

Michael Lasser
UBS Investment Bank, Research Division

Okay. Is there anything that would stand in the way from you continuing this trajectory that you've been on recently?

Edward W. Stack
Chairman & CEO

Michael, we appreciate the question, but we're very pleased with kind of how we've done so far this year. We've provided guidance, which we're excited about our business going forward. But getting into providing any type of guidance into next year, consistent with what we've done really since we've been public, we're not going to get into anything going into next year or beyond. We'll be happy to provide that information on the fourth quarter call that we have in March, which we will lay out next year's -- our anticipated results for next year, but we remain pretty enthusiastic about our business.

Michael Lasser
UBS Investment Bank, Research Division

Understood. My follow-up question is on your same-store sales growth in the quarter. It accelerated nicely on an absolute basis on the stacks. If -- as you look back and dissect the contributing factors to that acceleration, how do you size up various things like weather, inventory, the more time with the changed operating model that you implemented earlier this year and then any other factor like merchandising that might have contributed as well?

Edward W. Stack
Chairman & CEO

I think I'll let Lauren kind of comment on some of the service components of this. But I would say, there's not a silver bullet. It was really a combination of what we did from the planned strategic inventory investments we made, what the operations group did from a service standpoint raising those service standards, our marketing in the third quarter was really terrific. So I think it was a combination of all of them and there's not a silver bullet, which I think is why we remain so optimistic about our business.

Lauren R. Hobart
President & Director

Yes. And I would echo, I do think it's that flywheel that is turning and all those elements are contributing to the greater success. Momentum breeds momentum. There's a great positivity out in the stores right now focused on our athletes who are coming in and they have the product to sell. So all things are just firing on all cylinders.

Operator

The next question is from Simeon Gutman with Morgan Stanley.

Simeon Ari Gutman
Morgan Stanley, Research Division

Good quarter. A quick follow-up on the last question. First on -- so this quarter, the spread of outperformance relative to, I think, your guidance or your internal plans widened considerably. Can you talk about -- I know you've had strength in all of your categories. Can you talk about which departments performed the best relative to your plan?

Edward W. Stack
Chairman & CEO

Well, I'm not sure we're going to get to that level of granularity, but I can tell you, we were really pleased across hardlines, apparel and footwear. Our -- the changes we made to our baseball business continued to accelerate and do very well over the year before. Our apparel business, driven by Nike and our private brands and -- did very well. Our women's apparel business was great. Men's apparel business was great. Kids was great. The footwear business was really very good.

It's really across the board. And to kind of again look at a silver bullet in one of those categories is very difficult because our team, our merchandising team, our marketing team, our operations team, the logistics team, getting product to the stores, the whole -- I really believe we have the best team, best management team in the company today that we've had in a very long time. And they're just doing a great job and kind of hitting on all cylinders right now.

Simeon Ari Gutman
Morgan Stanley, Research Division

And another way to look at the question of, I guess, EBIT margin inflection for this business is looking at it through investments so, Ed, I don't know if you could share which inning we're in. I know it's been early innings for a while. Are we starting to reach the middle innings as far as eCommerce transformation, fulfillment? There's some big investments coming, but they should be in place by next year. Where are we in that part of the game?

Lee J. Belitsky
Executive VP & CFO

I would expect our investments to continue and we've got -- and they may move around a little bit. This year, we're kind of heavy on the fulfillment space. A couple of years before that, we were in -- building out our eCommerce website capabilities with heavy investment, and technology continues to be a theme throughout. But I would expect us to continue to be investing in the business.

Operator

The next question is from Christopher Horvers with JPMorgan.

Christopher Michael Horvers
JP Morgan Chase & Co, Research Division

Very impressed with the performance in the third quarter. Was curious, some other retailers have talked about weather headwinds in the month of September. How do you think that the weather played out in your business? Did you -- did it hurt in September? Do you think you recaptured the demand by the end of the quarter given how October played out?

Edward W. Stack
Chairman & CEO

I don't think weather had a real impact on our business this year. It may have with some others, but we didn't see weather really as a positive or a negative for our business.

Christopher Michael Horvers
JP Morgan Chase & Co, Research Division

Got it. And then to clarify, so on the fourth quarter, it seems like, well, you're raising the year and you're raising for the third quarter beat and maybe the share count update. So your existing 4Q expectations are intact, is that right?

And then as you look at the merchandise margin, very strong performance here in 3Q. You actually have 1- and 2-year "easy comparisons." So how are you thinking about the merch margins in the fourth quarter? And do you expect those to be up again?

Edward W. Stack
Chairman & CEO

We kind of have guided the fourth quarter based on what our expectations have been all year and it depends. This is always a difficult calendar shift. Retailers hate calendar shifts, and this is the worst calendar shift with 6 less days between Thanksgiving and Christmas. And so our margins will be depending on how sales do between that time frame, which we're optimistic, but you never know. And weather is an important part of our business of how it affects margin rate on that cold weather merchandise that we carry. So we're cautiously optimistic, and we're looking for a little bit of cold weather in December, which we did not really get last year.

Christopher Michael Horvers

JP Morgan Chase & Co, Research Division

Got it. And then my last question is for Lauren. On the eCommerce side, now that you have these 2 new direct fulfillment centers and the other technology improvements that you made, are you starting to narrow down the promise date to the customer? Previously, you had given a promise date that you wanted to exceed. Are you starting to narrow down the number of days that you say you can deliver a product to a customer?

Lauren R. Hobart
President & Director

Yes. We have narrowed the number of days already this year. Our FedEx partnership allows us to narrow it even further given delivery is on Saturday now. And we have many things in the pipeline from a technology standpoint that will enable us to be inventory aware when we quote orders, and we will be able to actually provide even faster delivery as we head into next year. So we're making great progress and it remains a big priority.

Operator

The next question is from Peter Benedict with Baird.

Peter Sloan Benedict
Robert W. Baird & Co. Incorporated, Research Division

Congratulations on a great quarter. Just following up on the allocation comments from earlier, can you just maybe talk a little bit more broadly about allocation trends across your brand partners and maybe how that's been evolving here over the last year and change? And where are you seeing the most change and any categories in particular that are breaking in your favor?

Edward W. Stack
Chairman & CEO

Well, we've talked about some of the things we've done from the enthusiast athlete piece and have really focused on the -- that enthusiast high school athlete. So our baseball business has been very good, the soccer business was not bad. Surprisingly, our football business was really very good from a team sports standpoint. So those are some of the categories that have done very well. We're pleased with our vendors. I think there is a great product line -- product pipeline out there. Nike, Columbia and North Face, the group, it's all been -- knock on wood, it's been pretty good.

Peter Sloan Benedict
Robert W. Baird & Co. Incorporated, Research Division

Okay. And then, Lauren, maybe one for you. You mentioned in your prepared remarks just changes in how you're recognizing, I guess, the stores for their performance. Can you maybe give us a little bit more detail on that? Is -- are there more discrete payouts or incentives based on the sales performance? What -- how has that kind of changed, that recognition of the stores changed in the last year or so?

Lauren R. Hobart
President & Director

Yes. I would say the culture of recognition actually is -- first of all, it's bigger than the stores. It's throughout the entire company in terms of how we serve athletes, and it's everything from -- you'll see, if you look online, sort of rewarding the extra 1% effort that each of our teammates give every moment of every day to an athlete. And it can be everything from small awards. We have a High Five award that goes out for quick moments when somebody does something special during the day. And then we have larger rewards leading up to Presidents Awards and big store -- full store celebrations. And the stores obviously participate in our compensation and incentive plans as well. So it's all over the place, but it's much -- it's coming through in ways that are everyday activities where we're rewarding people for their efforts.

Peter Sloan Benedict
Robert W. Baird & Co. Incorporated, Research Division

Okay. That's helpful. And maybe I'll sneak one in here for Lee. Just as we think about the fourth quarter, roughly it looks kind of flattish EBIT margins potential, I guess. There's certainly a range there. But anything we should think about in terms of either an opportunity on the gross margin line or the SG&A line in terms of improvement year-over-year relative to the others or any help you can give us on that?

Lee J. Belitsky
Executive VP & CFO

Yes. I would say that the biggest indicator of profitability for the fourth quarter is going to be with sales for the fourth quarter. I think that the SG&A is -- we've got our arms around pretty well where that's going to be. And margin rates can move around, too, depending on how promotional it gets and how the weather goes, but the real driver is going to be in the sales line.

Operator

The next question is from Michael Baker with Nomura Bank.

Michael Allen Baker
Nomura Securities Co. Ltd., Research Division

A couple here, if I could. One, and forgive me, I've been jumping around the calls this morning, but I think you said the stores where you took out the hunt and about another 125 stores at the end of the second quarter, did those stores comp in line with the chain average and no better? I guess I would have expected them to comp better. That's one question.

And then secondly, as it relates to that, the hunt business, I think, Ed, you were on CNBC some time ago had mentioned that the decisions you made after the Parkland situation hurt your business by $250 million, which is about 3% of sales. Is that just on the actual categories that you changed out? Or is that -- does that include the blowback from some customers who disagreed with your decisions?

Edward W. Stack
Chairman & CEO

Well, that was based on all the attachment rates and what we thought we would -- of people who wouldn't shop with us any longer and -- but you can see that, that's well behind us. With our comps in the second quarter being up 3.2%, our comps in this last quarter being up 6%, we're enthusiastic going forward.

And as far as the stores that took that hunt out, I'm surprised that you thought that they would have been better because we're taking that out, there was just some disruption to those stores as we cleaned that inventory out, did some construction there. And for those stores to comp in line with the rest of the company, we thought, was a pretty good feat.

Lee J. Belitsky
Executive VP & CFO

Yes. A couple of other notes on that, too, is that as we're in Q3 here, we're kind in our peak hunt period. So for us to pull the hunting department out going into that peak season and be able to replace that business and keep it in line with the rest of the chain is good and the margin rates are better as well. So we're really pleased with those results for the quarter.

Michael Allen Baker
Nomura Securities Co. Ltd., Research Division

Got it. That's makes perfect sense. And so I'm glad I asked. One follow-up, if I could. Your reaction to Nike's decision to sell -- to not sell directly to Amazon. How do you think that just impacts your eCommerce business or the sporting goods business in general going forward?

Edward W. Stack
Chairman & CEO

Well, I think Nike was pretty clear that it was a small test. It was more core product, and I don't think it had an impact on our business when they were selling them. And I don't think it's going to have a meaningful impact on what they were selling them going forward.

Operator

The next question is from Seth Sigman with Crédit Suisse.

Seth Ian Sigman
Crédit Suisse AG, Research Division

Great comps in the quarter. Obviously, a lot of initiatives driving that. I'm just wondering, if you step back, there were a couple of discrete items that you called out last year around hunting and also electronics and some decisions that you guys have made.

How do we think about the underlying trend of the business today relative to that 6%? If there's a way to sort of parse out how much of a benefit lapping those items may have had just so we could understand kind of the true trend here, that would be helpful.

Edward W. Stack
Chairman & CEO

Well, when you say lapping it, I mean we didn't sell them last year. There is no benefit really to them this year. The base that we had in the business is products that we're going forward with. And as we said, it was -- there's not a silver bullet. It was -- we're very pleased across hardlines, apparel and footwear, which I think is a pretty good sign that the structural foundation of the business is in pretty good shape.

Lee J. Belitsky
Executive VP & CFO

I'd say there's an absence of a meaningful headwind that's out there right now.

Edward W. Stack
Chairman & CEO

Yes, right.

Lee J. Belitsky

Executive VP & CFO

We're running base business against base business without any -- the meaningful headwinds are behind us at this point. Not to say there won't be anything in the future, but we don't know. But as of right now, there are no meaningful headwinds.

Seth Ian Sigman
Crédit Suisse AG, Research Division

Do you want to tell us more about that? No, I'm kidding. So let's just follow up on private label then and private brand. So there have been a lot of iterations around the private label strategy over time, and it seems like there's some momentum here with DSG. Can you just talk a little bit about the performance as you've rolled it out? What are you learning about the opportunity here? And just remind us if there's any sort of target in mind for penetration over time?

Edward W. Stack
Chairman & CEO

Well, there's no real -- we haven't guided to what a penetration is necessarily, but we're very pleased with it. DSG has been great. The CALIA brand has been great. Some of the other brands that we've done, Walter Hagen, Alpine Design is just getting started and we're very pleased with these.

DSG, in particular, is a value-based opening price point trend-right brand that has done great. And it's also -- we think it's helped our other branded business because if you take a look at our Nike business, the adidas business, some of the other brands that we've got, they've actually risen along with this because I think it's bringing in another customer who hadn't been in the store before who is then picking up some of the other branded product also. So our private brand business right now is -- we're -- we couldn't be happier with it and we think DSG next year will be our largest private brand.

Operator

The next question is from Paul Lejuez with Citi Research.

Paul Lawrence Lejuez
Citigroup Inc, Research Division

You mentioned the mix impact helping the merch margin overall. Can you just talk about that a little bit more? What specifically is the driver of that mix impact? And is it sustainable? Maybe also talk about which categories you're seeing the biggest merch margin improvement in like-for-like?

Lee J. Belitsky
Executive VP & CFO

The mix impact is largely driven by the reduction in the hunt business. As we've -- as the hunt category comped down and we pulled it out of 128 stores and we were able to replace that really with some meaningful strength in team sports, athletic footwear and athletic apparel, which are much higher margin businesses, so that's affecting the mix and that should carry forward because those business continue to be strong and we're out of hunt in those stores as well, so we should continue to get mix benefit going forward.

In terms of like-for-like, I don't want to get into kind of individual departments and which ones are performing more strongly year-over-year at that level, so we'll leave it at the mix discussion.

Paul Lawrence Lejuez
Citigroup Inc, Research Division

And a follow-up, just anything you can add on the performance of your mall versus off-mall stores? Maybe you talk about store traffic at each.

Lee J. Belitsky
Executive VP & CFO

Yes. The performance of the mall stores versus non-mall stores, they're basically in line. We're seeing similar comp sales performance in both. So we don't have any significant concerns with our mall portfolio at this point.

Edward W. Stack
Chairman & CEO

You got to think, too, that our mall-based stores are really destinations. They have surface parking. So we don't rely on -- we're not one of the in-line mall tenants that requires mall traffic walking up and down the mall to drive sales. People -- I think in virtually every store we have, our #1 entrance to our store is the parking lot entrance.

Operator

The next question is from Joe Feldman with Telsey Advisory Group.

Joseph Isaac Feldman
Telsey Advisory Group LLC

Congrats on the quarter. I know inventory is in good shape and it's up and helping to drive sales. That being said, just wanted to get a sense of how we should think about it. I know you said it would be around the same rate this year. Should it start to ease next year? Like are we at that level this year where you want to be at? Or do you think there could be even more growth in it next year?

Lee J. Belitsky
Executive VP & CFO

I think there will be more growth next year, but it will be at a much slower rate than we saw this year.

Joseph Isaac Feldman
Telsey Advisory Group LLC

Got it. Okay. And then another question, I want to ask about the footwear area. It seems, based on our -- just observation, that it seems like you guys have definitely skewed a little bit more towards the fashion side lately, like bringing in more. Not to say you've gotten away from the team sports stuff, but has that -- how has that been helping? And are you guys -- feel like you're taking market share from people in that regard?

Edward W. Stack
Chairman & CEO

Well, we think that we are still focused on that core athlete, that core baseball player, that core athlete who's a real runner, basketball player, so that's still the core of our business. But that lifestyle business, we have brought in more product, we have better allocations from some of our partners, and that's definitely helped our business.

And in the past, that athlete would have to walk into our store to buy their basketball shoes, running shoes and they would have to go someplace else to buy that lifestyle shoe, and they don't have to do that now. They can shop in -- our store is a one-stop shop for all of that. And they've responded very well and we're very pleased with that.

Operator

The next question is from Sam Poser with Susquehanna.

Frederick William Gaertner
Susquehanna Financial Group, LLLP, Research Division

This is Will on for Sam. So can you guys be a bit more specific on the brick-and-mortar comp? I know you said it was positive, but can you just give us a little bit more color on that? I mean on our math, we're getting something like up 5%. Is that sort of in line with what you guys saw?

Lee J. Belitsky
Executive VP & CFO

I'd say, the math is the math so...

Edward W. Stack
Chairman & CEO

You're good at math.

Frederick William Gaertner
Susquehanna Financial Group, LLLP, Research Division

Mid-single digit then is fair?

Edward W. Stack
Chairman & CEO

I think the math that you put -- that you just talked about is accurate.

Frederick William Gaertner
Susquehanna Financial Group, LLLP, Research Division

Great. And do you guys expect B&M comps to remain positive in 4Q?

Edward W. Stack
Chairman & CEO

That's what we -- we plan on that, yes. Again, there's -- the unknown is what can happen with the weather in the 6 less shopping days between Thanksgiving and Christmas, but we've got all of that baked into our guidance and we remain optimistic about our business.

Frederick William Gaertner
Susquehanna Financial Group, LLLP, Research Division

Great. That's great. And just one more for me. So the tariff impact, you touched on a little bit in your opening remarks. What are you -- can you just remind us what you're incorporating in the guidance? And do you have any expectation for next year of how it's going to impact you guys?

Lee J. Belitsky
Executive VP & CFO

I don't think we've specifically guided the impact of tariffs. Again, it's really evolving, and there's not much in it for this year. And we do get some of our products from China, and the momentum around pushing through price increases related to tariffs has been pretty slow with what we see in our space, either through negotiating better deals coming from the factories or moving selectively some production, not seeing yet that much pressure on our prices for next year that are -- that's tariff driven. And there's a long way to go, a lot to play out. But at this point, doesn't seem to be a tremendous factor for us for next year.

Frederick William Gaertner
Susquehanna Financial Group, LLLP, Research Division

I guess do you -- okay, for next year. So do you expect it to be a bigger headwind next year than you did this year, than it will be this year?

Lee J. Belitsky
Executive VP & CFO

Yes, I would expect it to be somewhat bigger next year, but I -- it's a vendor-by-vendor, product-by-product discussion that's going on right now. And as I said, the momentum to raise prices anywhere through the supply chain has been pretty slow so far, what we're seeing so far.

Operator

The next question is from Warren Cheng with Evercore ISI.

Warren Cheng
Evercore ISI Institutional Equities, Research Division

Great job. I just wanted to follow up on a couple of earlier questions on the product allocations. So I've noticed, really over the last 2 years, the allocations have really improved. I think an earlier question pointed out the fashion side has improved. I really noticed the premium running.

So for 2 questions. The first is are you seeing this bring in a new type of customers to DICK'S store? And then the second is, are there any conversations -- especially as you also ramp up some of your exclusives, are there any thoughts about bringing in some new brands, maybe some run specialty brands that often sit alongside some of the elevated products that you now house?

Edward W. Stack
Chairman & CEO

What I think is bringing in new customers -- I think it's bringing in some new customers, but I think what's more important is the customers we have coming in the store, that athlete, they're able to buy the shoes, those lifestyle shoes in our store today, which they didn't, so that's the biggest change. And as we take a look at other brands, we're looking at new brands all the time. Whether they're running brands, baseball brands, athletic apparel brands, we're always looking for new brands of -- that can move the needle or can be helpful to the athletes that we serve. So we're constantly looking at that.

Operator

The next question is from Adrienne Yih with Barclays.

Adrienne Eugenia Yih-Tennant
Barclays Bank PLC, Research Division

Let me add my congratulations. Ed, my first question is on the strength that you saw in apparel. Obviously, one of your competitors talked about that as an area of weakness. Wondering what you're doing there specifically that allows for that to continue.

And then secondly, on inventory, if we can go back to that for a sec, what does that look like in units? And are you making higher price point investments that is causing the mix to go up? And when should we see that sort of normalize?

Edward W. Stack
Chairman & CEO

As far as the apparel business that -- what we're doing different, we've really spent a lot of time over the last couple of years trying to differentiate our assortment from what else is out there in the marketplace. So we've got a better -- which kind of will answer both of your questions, we've got some better product out there that is differentiated in the marketplace. And we've also focused more, like we did several years ago, on that enthusiast athlete, which has tended to raise our AURs.

So our AURs are up a little bit and the athlete, the consumer, has responded and has driven the business. We don't really see -- some of the conversation out there around promotion, we don't see a real promotional pressure on our business because, as I said, we've done a really -- our team has done a great job over the last couple of years of differentiating our assortment versus some others in the marketplace.

Adrienne Eugenia Yih-Tennant
Barclays Bank PLC, Research Division

Great. And then with regard to the inventory, when should we see normalization? Can you remind us?

Edward W. Stack
Chairman & CEO

Well, I think it's going to -- as Lee said, it's going to be up -- yes, it's going to be up a little bit toward the first half of next year although much -- in a much lower rate. And then we expect it to level off starting in the third quarter/fourth quarter of next year. But these inventory investments have made a really big difference in our -- have made a big difference in our business.

Adrienne Eugenia Yih-Tennant
Barclays Bank PLC, Research Division

Yes. And then, Lee, for you, 2 quick ones. On the brick-and-mortar, the return to the positive comp, sounds like there's an AUR driver there, but can you talk about traffic and AUR components? And then what was the drag of Field & Stream for the year?

Lee J. Belitsky
Executive VP & CFO

Well, Field & Stream is very minor because there are only 7 stores remaining separately in that Field & Stream chain, so it's really kind of inconsequential. And we haven't split out the traffic for in-store versus online. So yes, we probably won't be doing that today either. But thanks very much for your call.

Operator

The next question is from Jim Duffy with Stifel.

James Vincent Duffy
Stifel, Nicolaus & Company, Incorporated, Research Division

Lauren, very interesting is this notion of improved service standards and better in-stocks combined to help conversion and that being a virtuous cycle of improvement. Can you just share some thoughts on where you think you stand in this progression? How much room for further improvement in service standards? And is there a way to itemize the kind of the benefit between service levels and the inventory investments?

Lauren R. Hobart
President & Director

So there is no way to itemize because it's all contributing to just a better experience overall. But I would say we're still in relatively early innings in terms of our service transformation. We rolled out our major new initiative in April of this year. A massive cultural change takes a while. The stores are very engaged, very excited. So I do think that it will continue to be opportunity for next year.

James Vincent Duffy
Stifel, Nicolaus & Company, Incorporated, Research Division

Great. Do you have any metrics to share on just customer satisfaction improvement or anything like that, that suggests that this is a leading indicator on building traffic in coming periods?

Lauren R. Hobart
President & Director

Yes. Generally speaking, we're liking the metrics that are coming out of the stores in ways that are improving, things like CSAT and things like that. So generally speaking, yes, the metrics are stronger resulting in a stronger sales.

James Vincent Duffy
Stifel, Nicolaus & Company, Incorporated, Research Division

Okay. Then last one for me. The improvement in average ticket, I'm curious to what extent that's driven by lower markdowns versus investment in enthusiast-level products in the merchandising assortment.

Edward W. Stack
Chairman & CEO

I don't think it's driven by lower markdowns. We've taken our markdowns where needed to be. It's driven by -- the margin rate is driven by being in stock on those key products, those strike points that we've talked about. And it's not from postponing markdowns, if you will.

Operator

The next question is from Brian Nagel with Oppenheimer.

Brian William Nagel
Oppenheimer & Co. Inc., Research Division

First off, I'd like to add my congratulations on a really nice quarter.

Edward W. Stack
Chairman & CEO

Thanks, Brian.

Lee J. Belitsky
Executive VP & CFO

Thank you.

Brian William Nagel
Oppenheimer & Co. Inc., Research Division

So I want to -- there's been a number of questions already just on the inflection higher in sales. A nice way to look at the quarter, you also had a significant inflection higher in gross margin on a single multiyear basis. Can you help me understand better what factors help to drive that, the much improved gross margin that you saw in the Q3? And then just overall, the sustainability -- or your thoughts on sustainability of that trend maybe as we go through the balance of this year and into next year.

Lee J. Belitsky
Executive VP & CFO

Well, I think there were 3 main items that drove gross margin: 2 are in the merchandise margin side, 1 being mix, a favorable mix, and I think the favorable mix will continue because we're deemphasizing the hunt business, and that's going to continue and we're replacing it with higher-margin categories.

The second item within merch margins is the actual merch margin itself due to lower promotions, and we'll have to let that play out through the fourth quarter and see how that goes. It's going to be driven by weather, it's going to be driven by competitors and so on. So it's a little bit harder to get our arms around that, and that's one of the reasons for the variation in the guidance that we have going forward.

And the third big item that we have in there is the occupancy leverage that we've got, and that's really going to be driven by how our comp sales unfold for the quarter. And obviously, we had significant comp leverage with a 6% comp increase in the third quarter. And we expect to have some smaller amount of leverage in the fourth quarter as well if we get within the sales guidance range that we've got for the quarter.

Brian William Nagel
Oppenheimer & Co. Inc., Research Division

Got it. That's helpful. Then the second question that I had or a follow-up, in your press release, you talk about -- and I think on the prepared comments, you mentioned it too -- the ongoing investments being made to support the online business and the fulfillment centers, the enhanced website functionality. As we look at that, the growth of 13% here in Q3, is that reflective of these investments? Or should we expect that these investments, so to say, kick in more in subsequent quarters?

Lauren R. Hobart
President & Director

I think the 13% growth, as Ed alluded to earlier, was a very intentional decision on our part to pull back promotion on the site. So our experience is improving, our load times are faster, all of the kind of core conversion drivers are improving, and we're managing the business as we see appropriate going forward. So there will be continued impact, positive impact as we get into next year, but it's been slow and steady improvement throughout this year as well.

Operator

The next question is from Tom Nikic with Wells Fargo.

Tom Nikic
Wells Fargo Securities, LLC, Research Division

I wanted to ask about the improvement in transactions that you see in the last couple of quarters. Do you think it's a function of traffic to your stores and your site improving? Or do you think it's a function of the investments that you've made in the in-store and online experience driving higher conversion rates?

Edward W. Stack
Chairman & CEO

I think it's a combination of both. As -- again, as I said earlier, there's not a silver bullet here. We've done some -- there's some great things that we've done from a -- from our online experience. There's -- our marketing is better driving traffic into the store. The athletes come into the store, they are finding what they want based on the inventory investment that we've had and what a great job our merchants have done buying the right product, the allocation of products that we've gotten from the support of the brands and the relationships we have with them.

It's a combination of things that is driving this. And as I said, we can't just sit here and say there is one silver bullet, which is why, as I say, we're enthusiastic about our business because it's -- there's a number of things that are running well right now that are driving this improvement.

Tom Nikic
Wells Fargo Securities, LLC, Research Division

That's helpful. And Lee, a quick follow-up for you. I think you mentioned that the SG&A growth in Q3 was partially inflated by some incentive comp. Yes, I'm not sure if you can quantify that at all. Or if we look out to Q4, should we assume that the SG&A growth looks more like Q2's mid-single-digit growth rather than Q3's plus 10-ish?

Lee J. Belitsky
Executive VP & CFO

I would say Q3 is a bit of an outlier. It's primarily driven by incentive comp, and we have a bit of a catch-up from the first 2 quarters of the year that we had to book in Q3 based upon how it look -- it appears the full year is coming out. So I think Q4 will be more normalized from a SG&A growth rate and not like Q3.

Operator

The next question is from Scot Ciccarelli with RBC.

Gustavo Arturo Gonzalez

RBC Capital Markets, Research Division

This is Gustavo Gonzalez on for Scot. First of all, congrats on the quarter. Just one more question on the inventory. You guys are saying it's helping you guys during the quarter, it's comp, 6% up. And last year, it was running kind of lean. I was wondering if you guys can quantify what the negative impact was last year. And then maybe in terms of inventory to payables ratio, what kind of [indiscernible] going forward, if that helps?

Edward W. Stack
Chairman & CEO

Well, last year, we were kind of underinventoried across the board. We just let the inventory run a little bit lean. Our inventory in running footwear, our inventory in baseball product, we didn't -- we weren't really catering to that enthusiast athlete. We had gotten a bit too mid-price point, if you will. And so beginning this year, we started to see the benefits beginning this year.

We started this last year with our buy and our plans that we would focus again on that enthusiast athlete that we used to focus on that we'd kind of lost and we've made those investments. And you can see, in the second quarter, with comps up 3.2%, comps up 6% in the third quarter that, that athlete is coming back to shop at DICK'S Sporting Goods.

Operator

The next question is from Chris Svezia with Wedbush.

Christopher Svezia
Wedbush Securities Inc., Research Division

My congratulations as well on the quarter. A couple of questions. Number one, Ed, if you want to answer this, but what was the cadence of comps as you went through the quarter? Was it consistent? Did you see an acceleration? Or any color you can provide about that. That's my first question.

Edward W. Stack
Chairman & CEO

Yes, we've never really guided on a month-by-month basis. We think that the overall quarter is the best way to look at this. And with comps at 6%, we were really, really quite pleased with the quarter.

Christopher Svezia
Wedbush Securities Inc., Research Division

Okay. Okay. Lee, for you, just on the -- I know earlier, you made a comment that you anticipated to continue to make investments in the business, eCommerce last year, fulfillment this year. I guess the question is, are there offsets? I think there's $30 million in offset or thereabouts on the SG&A side within the operations that -- or act as offsets to a degree to some of the investments? Are those capabilities -- or is that possibly still within the business model to act as offsets? Or are you nearing the end of finding those cost savings to offset some of that investment?

Lee J. Belitsky
Executive VP & CFO

No, there are more cost offsets available that we're actively going after for next year. So I can't say it's going to 100% offset some of the investments that we'll be making, but we are going to continue to aggressively chase some of the cost offset opportunities.

Christopher Svezia
Wedbush Securities Inc., Research Division

Okay. Final question, just on, I guess, Ed, when you think about Q4 and Q3 for a moment. In Q3 last year, you did benefit a little bit from an early start to cold weather to the comp this year. For all intents and purposes, it was a little bit -- it was warmer, but you referenced there was no real material impact to your business. If you think about Q4, weather is important, but there's a lot of individual drivers to the business, the service model, the in-stock, the Gold member rewards, private label. How really -- how important, I guess, what I'm trying to get, is the weather turning for you guys to hit your implied, call it, 2% to 3% comp? I'm just trying to gauge that because it seems like it wasn't that much material impact for Q3 given all the initiatives that are going on at the company.

Edward W. Stack
Chairman & CEO

Well, Q3, the weather isn't as impactful in general year-over-year as it is in Q4. We've -- we're hoping for a cold winter. We'd like to see some snow in the ground and some cold weather and that will be helpful. And when you get that in the fourth quarter, also has an impact on the business. So whether we like it or not, weather is impactful. We've done our very best to try to offset some of those if we don't get the weather, but weather is still impactful. And if we have a really cold winter and it comes at the right time, our team's done a great job, we've got the right product and I think we've got the right value proposition for, our business will be very good.

We've kind of baked in the high and the low of it. If the weather is normal, it will be great. If it's extremely warm, there's some risk. If it's extremely cold, there's some upside. So we've tried to kind of lay this in the middle of the road the best we can under the circumstances, but we're pretty excited about the business.

Operator

The next question is from Matthew McClintock with Raymond James.

Matthew J. McClintock
Raymond James & Associates, Inc., Research Division

Congrats on the quarter. Ed, I was wondering if we could just talk about DSG. You said it's going to be the largest private label brand next year. You've had some pretty successful private label brands before in the past, but this would probably make it the largest private label brand in your history.

And given that it's probably replacing something that was a lot smaller, can you help us think about how the growth will be achieved? Are you just going to continue to give more space to the product over the next year? Are you going to go into new product categories? Just help us conceptualize how you're going to achieve that growth.

Edward W. Stack
Chairman & CEO

Sure. Well, the -- it's really broad-based. It's not just an apparel brand. We've got athletic apparel in here. We'll have some fleece pieces in here also. We've got hardlines, basketball. We've got baseball. We've got -- it's a really broad-based brand, and we're very pleased with how it's come out of the box. And we do think it will be the largest -- our largest private brand by the end of next year. And you're right, it will be the largest in our history, and we're really enthusiastic about it.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Ed Stack, for any closing remarks.

Edward W. Stack
Chairman & CEO

I'd like to thank everyone for joining us on our third quarter conference call, and we look forward to talking to everybody again in March. All have a great Thanksgiving and a happy holiday. Thank you.

OperatorThe conference has now concluded. Thank you for attending today's presentation. You may now disconnect.