THOMSON REUTERS

EDITED TRANSCRIPT

Q1 2019 Sportsmans Warehouse Holdings Inc Earnings Call

EVENT DATE/TIME: MAY 30, 2019 / 12:30PM GMT

CORPORATE PARTICIPANTS

Jon Barker *Sportsman's Warehouse Holdings, Inc. - President, CEO & Director*
Robert K. Julian *Sportsman's Warehouse Holdings, Inc. - CFO*
Rachel Schacter *ICR, LLC - SVP*

CONFERENCE CALL PARTICIPANTS

Daniel Harry Hofkin *William Blair & Company L.L.C., Research Division - Analyst*
Peter Jacob Keith *Piper Jaffray Companies, Research Division - Principal and Senior Research Analyst*
Peter Sloan Benedict *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*
Ronald Cunningham Bookbinder *IFS Securities, Inc., Research Division - Analyst*

PRESENTATION

Operator

Greetings, and welcome to the Sportsman's Warehouse First Quarter 2019 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

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

Rachel Schacter ***ICR, LLC - SVP***

Thank you. Good morning, everyone. With me on the call is Jon Barker, Chief Executive Officer; and Robert Julian, Chief Financial Officer.

Before we get started, I would like to remind you of the company's safe harbor language. The statements we make today will contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, which includes statements regarding our expectations about our future results of operations, demand for our products and growth of our industry.

Actual future results may differ materially from those suggested in such statements due to a number of risks and uncertainties, including those described under the caption Risk Factors in the company's 10-K for the year ended February 2, 2019, and the company's other filings made with the SEC.

We will also disclose non-GAAP financial measures during today's call. Definitions of such non-GAAP measures as well as reconciliations to the most directly comparable GAAP financial measures are provided as supplemental financial information in our press release included as Exhibit 99.1 to the Form 8-K we furnished to the SEC today, which is also available on the Investor Relations section of our website at investors.sportsmanswarehouse.com.

Now I'd like to turn the call over to Jon Barker, Chief Executive Officer of Sportsman's Warehouse.

Jon Barker ***Sportsman's Warehouse Holdings, Inc. - President, CEO & Director***

Thank you, Rachel. Good morning, everyone, and thank you for joining us today. I'll begin by reviewing the highlights of our first quarter performance and then discuss the progress on our strategic initiatives and thoughts on the coming fiscal year. Robert will then go over our financial results in more detail and review our outlook, after which we will open up the call to your questions.

Our first quarter results were in line with expectations on the top line and $0.01 below expectations on bottom line.

For the quarter, net sales declined 3.4% to $174 million. Comparable sales decreased by 0.7%, which was modestly below our outlook, driven by weaker-than-expected firearm and ammunition sales, primarily due to a difficult event-driven year ago comparison.

Gross margins were up 27 basis points for the quarter due to favorable mix and rate variance, partially offset by higher transportation costs. Operating expenses increased $300,000 for the quarter primarily driven by increased rent expense. We reported adjusted diluted loss per share of $0.12 for the quarter.

Drilling down on the composition of our first quarter comparable sales results. Firearm units across the company performed better than the adjusted NICS data nationwide and within our states. This is reflective of our continued market share gains as we strengthened our dominant positioning within the industry given our breadth of firearm offerings combined with unique value-added services that are driving further customer engagement.

For the quarter, firearm units decreased 8.1% versus an 11% decline in the adjusted NICS data. Firearms and ammunition sales together decreased 14% in Q1 2019. This decline was primarily due to the difficult event-driven comparisons for these categories in Q1 of last year.

For our nonhunting categories, as expected, weather had a negative impact on our fishing and camping categories, with both decreasing 2.5%.

Our soft good categories performed well with an increase of 3.5% in apparel and an increase of 10.3% in footwear.

Shifting gears to our operational performance. I'm pleased to report we made progress on our strategic initiatives. Our strategic priorities are focused around leveraging our growing omni-channel capabilities to gain market share; customer acquisition and engagement; a differentiated merchandising assortment.

Beginning with our omni-channel strategy. As planned, we are on track to open 3 standard format stores or 2.4% square footage growth this year. The reduced store opening pace allows us to focus on paying down debt while expanding our e-commerce capabilities. We're excited about the opening of our store in Lansing, Michigan, which will have its grand opening tomorrow, and our Murfreesboro, Tennessee and Fort Wayne, Indiana stores, which are scheduled to open this summer.

As previously discussed, in addition to these standard format stores, we are on schedule to test our first small-format concept shop in the fourth quarter as we focus on capitalizing on the white space opportunity we see for Sportsman's Warehouse in the highly fragmented outdoor sporting goods industry.

As a reminder, this much smaller store format will focus on hunting and shooting sports, but will also showcase a curated, localized assortment of outdoor gear. This test store reflects our commitment to these core categories that are important to our customer and our focus on maximizing the lifetime value of a long-term consumer relationship.

We look forward to generating learnings from this smaller format store and leveraging our expertise, everyday low pricing and expansive assortment in underserved markets that are more difficult for national players to profitably operate.

Turning to e-commerce. We are very pleased with the performance of our e-commerce platform. Our new website, sportsmans.com, has now been up and running for 5 months and customer response have been very positive, including strong reception to features such as real-time inventory visibility and buy online, pick up in store, which is now available across all categories. Buy online, pick up in store has driven thousands of customers into our store to fulfill their immediate needs and at their convenience, while providing Sportsman's Warehouse with additional opportunities to engage the customer across all categories and services.

For the first quarter, buy online, pick up in store orders increased approximately 75% versus the prior year. As we continue to invest in our e-commerce capabilities and drive higher e-commerce generated sales penetration, we will focus on improving the overall online shopping experience through database tools, user functionality enhancements and digital marketing initiatives.

Looking at our strategies around customer acquisition and engagement. As we discussed on our Q4 call, we launched The Gunsmith Center at Sportsman's Warehouse, providing nationwide repair and personalization services for firearms. On a limited scale, we are now buying, accepting trade-in and selling used firearms, which are eligible for support from our existing services that provide peace of mind on firearm purchases. Providing customers options like these is yet another valuable service. It provides us the opportunities to strengthen the relationship with our core customer, drive engagement, loyalty and ultimately, lifetime customer value.

As part of our increased focus on customer acquisition and nationwide expansion of our brand, we are excited to announce that customers outside Sportsman's Warehouse geographical footprint are now able to shop and buy the largest assortment of firearms of any national retailer through sportsmans.com. We are partnering with select licensed firearm dealers across the nation to expand our reach, providing the -- providing customers the option to take delivery of firearms purchased on sportsmans.com across the nation in a safe and compliant manner.

Value-added services such as these allow us to strengthen the relationship with our existing customers while also drawing new customers to our brand.

Our loyalty program continue to grow -- continues to grow as well with over 1.9 million members driving 51.9% of our revenue during Q1. We're excited to announce the next pillar in that program. As part of our focus on driving customer engagement, loyalty and strengthening our value proposition, we've identified a new partner, Comenity Bank, to launch an entirely new Sportsman's Warehouse Visa credit card program, which provides best-in-class benefits such as industry-leading points accumulation, better access to credit and a variety of financing offers. We believe this will ultimately drive customer retention and increase lifetime value. Pending FDIC approval, we plan to roll this program out in Q4 of 2019.

With regards to merchandising, we see opportunities to selectively expand our exclusive product offering in certain categories as we look to provide a strong value proposition for our customers across categories and price points. In the first quarter, we expanded our exclusive product offering into kayaks, which has been performing above our expectations. We will continue to increase our exclusive product penetration into other categories as we move throughout the year, including optic packs and firearm categories.

We recently announced the addition of Scott Walker as our new Senior Vice President of Merchandising. Scott's previous experience serving in various merchandising roles at outdoor retail -- sporting retailers such as the Sports Authority and Bass Pro, just to name a few, complements the talent of our existing team. His breadth of experience across multiple categories make him a great new addition. We are very excited to have him on board and look forward to benefiting from his expertise.

The -- this announcement comes on the heels of Robert's appointment as Chief Financial Officer. Both of these important additions position the business well for continued success.

In summary, we are making good progress on our strategic priorities. As we look to the remainder of the year, we will continue to invest in key areas across our omni-channel business to strengthen our competitive positioning and fuel market share gains as we focus on deepening our relationship with existing consumers, while attracting new consumers.

In terms of our outlook, Robert will discuss our updated guidance, though we have trimmed the high end of our sales outlook for the year and updated our EPS guidance.

Finally, as it relates to the recent announcement around tariffs. We are working with our vendor base to better understand the impact and identify the most effective ways to offset the tariffs where possible. These actions will include: vendor negotiations; sourcing action; and where necessary, an appropriate pricing action. Ultimately, an extended tariff period and expanded list of products and increasing tariff levels will eventually impact all retail customers, including ours. Like other retailers, we are hopeful for a timely resolution that minimizes the impact on the end consumer.

Before turning the call over to Robert, I want to thank all of our team members for their tireless work and dedication to executing with discipline every single day. They are the reason our customers enjoy shopping in our stores and reward us with their loyalty.

With that, I'll turn the call over to Robert to discuss our financials.

Robert K. Julian ***Sportsman's Warehouse Holdings, Inc. - CFO***

Thank you, Jon, and good morning, everyone. Let me begin by saying how pleased I am to be on the call with you today. I'm very excited about joining the Sportsman's Warehouse organization. It's been a real pleasure getting to know the Sportsman's team since coming onboard in mid-April. From the corporate staff, to our operations people, to our retail sales associates. I look forward to working with Jon and the entire Sportsman's Warehouse team and contributing to our profitable growth and driving long-term shareholder value.

Now turning to the numbers. I'll begin my remarks with a review of our first quarter results and then discuss our outlook for the second quarter and fiscal year 2019. Most of the financial figures discussed on today's call are reported on a U.S. GAAP basis. In the instances where we report non-GAAP financial measures, we have reconciled the non-GAAP measures to the corresponding GAAP measures in our earnings press release, which was issued earlier today.

First quarter 2019 net sales came in at $174 million compared to $180 million in the first quarter of fiscal year 2018, a decline of $6 million or 3.4%.

Same-store sales decreased 5.7%, which was slightly under the low end of our expectations and guidance. The decline was primarily driven by weaker-than-expected firearm and ammunition sales due to difficult comparisons from event-driven actions taken by competitors in Q1 of last year. However, we did see nice year-over-year growth in our footwear and clothing categories as well as continued improvement in our e-commerce driven sales.

We ended the quarter with 92 stores operating in 23 states. Total square footage growth was 2.9% this year versus the first quarter of fiscal year 2018.

Q1 2019 gross profit was $54.2 million compared to $55.6 million in the first quarter of fiscal year 2018, a decrease of $1.4 million or 2.5%.

Gross margin increased 27 basis points to 31.1% versus 30.9% in the prior year period.

Product margins improved approximately 50 basis points as a result of positive rate variances and favorable mix due to lower firearms and ammunition sales. This was partially offset by higher transportation costs, negatively impacting margins by approximately 20 basis points.

SG&A expense was $59.5 million for Q1 2019, and an increase of $0.3 million or 0.5% compared to the first quarter of fiscal year 2018.

Rent expense increased $1.2 million primarily due to a change in lease accounting practice and the addition of new stores.

Other miscellaneous operating expenses increased $0.2 million. These cost increases were partially offset by lower payroll expense of $0.7 million and lower preopening expense of $0.4 million.

As a percentage of net sales, SG&A increased approximately 130 basis points from 32.9% to 34.2% primarily due to deleveraging of fixed cost on the lower revenue. Excluding executive transition cost, SG&A expense would have been $59.2 million or 34.0% of net sales for the quarter.

Loss from operations in Q1 2019 was $5.4 million as it compared to a loss of $3.7 million in the first quarter of fiscal year 2018. Again, excluding the executive transition cost, Q1 adjusted operating loss would have been $5.2 million for the quarter.

Our interest expense in Q1 2019 was $2.1 million compared to $3.6 million in Q1 of prior year, a reduction of $1.5 million. This improvement is the result of our amended credit facility that lowered the interest rate on our term loan and also shifted a significant portion of the balance on the prior term loan to the new line of credit, which bears a lower interest rate.

We reported an income tax benefit of $2.0 million in Q1 2019 compared to $1.4 million last year.

Net loss for the quarter was $5.5 million or $0.13 per diluted share based on a diluted weighted average share count of 43.0 million shares as compared to a net loss of $5.8 million or $0.14 per share based on a diluted weighted average share count of 42.7 million shares last year.

Adjusted net loss was $5.2 million or a loss of $0.12 per diluted share in the first quarter of 2019 compared to an adjusted net loss of $3.6 million or $0.08 per diluted share in the first quarter of last year. Adjusted EBITDA for the first quarter of 2019 was $0.4 million compared to $4.8 million in the prior year period.

Turning to the balance sheet. Q1 2019 ending inventory was $291 million as compared to $306 million at the end of first quarter of last year, a reduction of $15 million.

On a per-store basis, inventory was down 9% compared to last year. This success is a result of investments in the team; better analysis and visibility into the data; and greater focus on inventory management by the entire organization.

We had $3.4 million of capital expenditures during the first quarter of 2019 compared to $4.5 million in the prior year period.

Q1 2019 operating cash flow was $3.4 million positive versus $9 million negative in Q1 2018. The improvement is primarily due to the progress we have made in managing inventory.

Our liquidity remains strong as we ended the quarter with $140 million -- $142 million in outstanding borrowings and $39.3 million of availability under revolving line of credit.

Turning to the outlook. As you saw in our press release, we are revising our full year guidance to reflect our Q1 top line results, which came in at the low end of our guided range as well as some margin headwinds and other economic uncertainties. Our current outlook includes the following items that were previously discussed on our last call.

We continue to make key investments in our team for the long-term success of the organization. In addition to minimum wage increases, we are investing increased resources in new hires and improved benefits for our team members. We continue to expect the combined investment in our team will be just under $5 million, which we believe will make Sportsman's Warehouse a more competitive retailer as we continue to execute our growth plans.

We invested approximately $3 million in 2018 into our e-commerce platform, and we will continue to invest in the platform and the modernization of our systems this year. We expect this investment to be approximately $1 million in 2019.

We expect to incur additional expenses related to being a public company of approximately $0.7 million, including the additional costs associated with Section 404(b) compliance with Sarbanes-Oxley as we prepare to exit emerging growth company status at the end of the fiscal year.

Given the implementation on new lease accounting standards, we no longer amortize the deferred gain from our 2012 sale leaseback transaction. We expect our occupancy expense to increase approximately $1.4 million for the year, resulting in an EPS reduction of approximately $0.02 per share for fiscal year 2019.

We continue to implement inventory initiatives this year that will allow us to improve the leverage of our working capital through increased inventory turnover. We continue to assume approximately $10 million of interest expense for 2019 as we realize the benefits of our new debt structure and our debt reduction strategies.

We now expect net sales of $860 million to $884 million in fiscal year 2019 and same-sale stores change in the range of down 1% to up 1.5% compared to fiscal year 2018. We expect 2019 adjusted earnings per diluted share of $0.48 to $0.60 on approximately 43.2 million weighted average common shares outstanding.

Our outlook for the second quarter is as follows: net sales in the range of $205 million to $211 million; same-store sales change in the range of down 0.5% to up 1.5% compared to the second quarter of fiscal year 2018; net income in the range of $4.5 million to $5.9 million; projected diluted earnings per share of $0.10 to $0.14 on approximately 43.2 million weighted average common shares outstanding.

We continue to expect net capital expenditures of approximately $16 million to $20 million in fiscal year 2019, with approximately $28 million to $33 million in total capital expenditures, offset by $12 million to $13 million in landlord incentives and sale leaseback transactions.

With that, I will now turn the call back over to the operator for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Peter Keith with Piper Jaffray.

Peter Jacob Keith ***Piper Jaffray Companies, Research Division - Principal and Senior Research Analyst***

What -- just to want to dig into the slightly revised down guidance outlook and just to understand the -- what's driving that. Is that basically baking in kind of what happened with Q1? And/or, I guess, does it factor in any current trends or any change to your outlook looking at Q2 to Q4? And I was hoping you can address that both from a sales and expense standpoint.

Robert K. Julian ***Sportsman's Warehouse Holdings, Inc. - CFO***

Yes, Peter. So it does certainly bake in what happened in Q1. As we mentioned earlier, we missed our revenue by about $6 million on the top end of our previous guide. We hit exactly the low end of the guide in revenue. So we did bake in that on the top end, we lowered our guidance for full year by that same amount. We did have some results that were less than expected even in terms of margin and SG&A as a percent of revenue on the lower revenue. And so that is reflected in the full year guidance.

In terms of revenue, we did see a little bit of a slower start to the Q2 than we were hoping for, although it's picked up more recently. And so we have considered that as well into Q2 guidance and that just sort of rolls through the end of the year.

I -- Jon, I don't know if you want to add anything to that.

Jon Barker ***Sportsman's Warehouse Holdings, Inc. - President, CEO & Director***

No. I think that's accurate, Robert. On the EPS revision, Peter, we did lower that range which reflects Q1 performance. But also some of the freight headwinds that we experienced in Q1 are likely to continue. We also are, like all retailers, very focused on this tariff uncertainty and how that may flow through.

At this point, we don't have a clear understanding of exactly what is going to happen with tariffs from a timing and the lift. We're working with our vendors, and we'll be negotiating to try to offset those increases. So there's some tariff uncertainty built into our EPS as part of this.

Peter Jacob Keith ***Piper Jaffray Companies, Research Division - Principal and Senior Research Analyst***

Okay. That is helpful. And I always hate to harp on weather, but it does seem like that's been a point of discussion with investors because of some of the precipitation dynamics so far this year. So you guys have gone from most of your Western stores from a very dry year last year to now very wet year this year. Could you help us frame up how you're thinking about weather is -- in terms of maybe helping or hurting your business if we look to Q2, Q3?

Jon Barker ***Sportsman's Warehouse Holdings, Inc. - President, CEO & Director***

Great question, Peter. Weather -- and you're exactly right last year, mid-summer was very challenging for the West with the drought and ultimately a series of fires through many of our states. This year, we've started out with an extreme snowpack in most of the Rockies, Uinta and the Wasatch front. And that's continued through, even today, with rain and moisture. So our start to camping and fishing, Memorial Day was off. The rivers, many of them are still blown out and most of the high camping areas are under multiple feet of snow as we sit here today.

We're still skiing in parts of Utah and I assume they're still skiing in Colorado. We will -- the next couple of weeks will be telling for how that manifests itself for the rest of camping and fishing. Now we're hopeful for a turn, more normalized temperatures and a reduction to a normal amount of precipitation over the next couple of weeks, it's going to be important for us to get back on track with camping and fishing for the remainder of the year.

Peter Jacob Keith ***Piper Jaffray Companies, Research Division - Principal and Senior Research Analyst***

Okay. That's helpful. And one last question for me. So the inventory management was quite impressive at down 9% on a per-store basis. Is that a trend that we should expect to continue? Or was there certainly something unique to Q1, particularly, with some of the decline in comp dynamic?

Jon Barker ***Sportsman's Warehouse Holdings, Inc. - President, CEO & Director***

Peter, we discussed a little bit in the fall of last year bringing on a new inventory planning leader. And he's done just a fantastic job of building the structure, the analytics and the rigor around our processes. And we expect to continue to have similar results in our inventory flow through the rest of this year, making sure that we balance our inventory turns with our in-stock and our fill rates. So we're very impressed by his performance so far. And we believe there's -- will be continued progress on that front for the remainder of 2019.

Operator

Our next question comes from the line of Daniel Hofkin with William Blair.

Daniel Harry Hofkin ***William Blair & Company L.L.C., Research Division - Analyst***

Just wanted to clarify the point regarding the first quarter and the comparison in firearms and ammo. Obviously, the comparison aspect of it was already known, so I'm just trying to understand a little bit when you say that the comps coming in below the low end of the plan reflected the top prior year comparison.

Maybe you could explain that a little bit? Or was there some aspect of this year's performance that was weaker in those categories? And what drove that? Was that affected by the -- some of the same weather things that affected camping, for example? And then kind of what are you seeing real time in terms of trends in your hunting and shooting business as we speak? That's my first question.

Jon Barker ***Sportsman's Warehouse Holdings, Inc. - President, CEO & Director***

Great, Dan. Thanks for the question. Let's -- let me parse this out a little bit. On ammunition, the biggest driver of the comp down was actually in reloading and gun parts, which are the magazines which had a very large growth in Q1 of last year as there was discussion of regulation changes. That comp was greater than we expected. We missed a little -- slightly on that comp around reloading and gun parts.

On the firearms, we actually saw a little bit of a change in trend during April. We were in good shape to forecast in the last couple of weeks of April. We're a little farther down than we expect in actual firearm units.

That was directly related to the comparison of 2018. We've seen that start to normalize the last couple of weeks. As I said on the last call, we expected kind of late May, early June to see a more normalized comp pattern. And that has started to flow through on the firearm side.

Ammunition still continues to be a little down year-over-year. I think that the consumer hasn't necessarily gotten back on track with their ammunition sales as quickly as we would have hoped. But firearms are starting to normalize.

Robert K. Julian ***Sportsman's Warehouse Holdings, Inc. - CFO***

Yes. I would say also just to answer your question directly. I -- we would not attribute it to weather, and we would not attribute it to market share. In fact, you could -- based on the NICS data, it suggests that we're gaining share. It was just a lower result on those comps than expected, I think, across the industry.

Daniel Harry Hofkin ***William Blair & Company L.L.C., Research Division - Analyst***

Yes. No, I was trying to clarify the at lower-than-expected part because the expectations -- seemingly, you would've had -- you would've known what happened last year. But maybe there's some aspect of that that's tough to forecast off of.

But anyway, the other question was as it relates to tariffs, maybe you could comment on what sort of an impact you've seen, thus far, from the 10% tariffs that have been in place for a while. And is it reasonable to think about some kind of multiplier effect on going from 10% to 25% on the same set of goods? And if that were to broaden to potentially the other -- the part of goods that are not currently tariffed, what might that look like?

Robert K. Julian ***Sportsman's Warehouse Holdings, Inc. - CFO***

Yes. So I'll start. The 10% tariff was contemplated and built into our expectations and our guidance. And we haven't seen any change versus expectations in that regard. We've not seen any real impact currently in our results for the new tranche of tariffs or the increase from 10% to 25% based on inventory that's in the stores and what's on the water that might not have been impacted by that. If we were to see an impact, it would be in the second half of the year, and it's really unclear in terms of how that's going to impact us.

We source very little goods directly from China. But indirectly, many of our products in camping and fishing and other categories do come from China and have a potential to impact, and then Jon talked a little bit about the mitigating strategies that we're trying to apply. But at the moment, it's really hard to know what that overall impact might be in the second half of the year. We're -- frankly, we're hoping that it gets resolved in a positive way that doesn't impact consumers at the end of the day.

It also is -- it's probably worth noting that these tariffs do not impact guns or ammunition as most of those do not come out of China. They're coming out of the U.S. and Russia and other places. So a large portion of our business will not be impacted by the tariffs at all.

Daniel Harry Hofkin ***William Blair & Company L.L.C., Research Division - Analyst***

And just to be clear, when you say -- I guess I was thinking like, perhaps, you had a sense for how much -- even though it's been factored into your numbers and then to your expectations, what sort of impact the 10% tariffs have had to date versus prior to when they went into effect?

Robert K. Julian ***Sportsman's Warehouse Holdings, Inc. - CFO***

Yes. I'm not sure that's it's been very significant. I think it's been relatively insignificant through actions taken by the suppliers and other mitigating strategies. I wouldn't say that it was a material impact so far.

Operator

(Operator Instructions) Our next question comes from the line of Peter Benedict from Robert W. Baird.

Peter Sloan Benedict ***Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst***

A quick one on -- just on the firearms and ammo discussion. Jon, you mentioned kind of more normalized trendsetting in here, ammo's still down a bit. Just curious how you guys are planning those categories within this guidance over the balance of the year. I mean is -- are positive comps implied for firearms in 2Q or in the second half? Or how should we think about your approach there? That's my first question.

Jon Barker ***Sportsman's Warehouse Holdings, Inc. - President, CEO & Director***

On firearms, Peter, on the firearm side, we are assuming a slight increase on same-store per unit and dollars on firearms and a flat to slightly down in ammunition for Q2 in the back half.

Peter Sloan Benedict ***Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst***

Okay. That's helpful. And was the 14% decline in firearms then, was that a comp number for the first quarter?

Jon Barker ***Sportsman's Warehouse Holdings, Inc. - President, CEO & Director***

Yes. Comp number.

Peter Sloan Benedict ***Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst***

Okay. Turning to the margin outlook, I mean for 2Q, the EBIT margins implied down here. Just curious if you can tease out a little bit the gross margin view in the second quarter. It seems to be implied down a bit. Just what the pressure points are, how should we be thinking about gross margin? I'm understanding inventory's in very good shape.

Robert K. Julian ***Sportsman's Warehouse Holdings, Inc. - CFO***

Yes. So we saw a little bit of pressure on transportation cost in Q1 that we've sort of reflected in our guidance in the Q1 experience generally. I do think we're going to see a mix impact continue. We saw a little bit of product margin improvement in some of our categories, clothing and so on. But mostly, the impact has been mix related and then some freight pressures. Frankly, the inventory management also has some impact on margins in the short term as we clean that up. But that's generally what's in -- built into the guidance for Q2 in the year.

Peter Sloan Benedict ***Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst***

Okay. And in terms of SG&A, I mean the pace of the growth when you ex out of some of the items, it seems to be growing maybe at a mid-single-digit pace, call it 5%. Is that the way we should be thinking about the growth rate in SG&A here? I mean I know there's a few items you've called out that have been part of the guidance.

But as we think about just the underlying growth in the expense structure, is 5% to 6%, is that the right way to think about it? Or are there other factors that we need to think about as we look through the balance of the year?

Robert K. Julian ***Sportsman's Warehouse Holdings, Inc. - CFO***

Well, there's a bit of a step-function increase in SG&A going from Q1 to Q2. And actually, we did a really nice job of controlling costs in Q1, very marginal increase in absolute dollars from prior year despite wage increases and some benefit changes and so on. You do see a little bit of a step-function increase in SG&A in our projections starting in Q2, and then it flattens out for the remainder of the year. And I wouldn't expect it to continue to grow. It's fairly consistent, the SG&A spend, across the last 3 quarters of the year.

Peter Sloan Benedict ***Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst***

Okay. That's super helpful. My last question. Just on this partnership with the dealers in non-Sportman's markets, I guess. Can you just give a little more color on maybe the scale of that? Or the -- and I was a little unclear on the timing. But just maybe expand a little bit on that? It sounds like an interesting initiative here.

Jon Barker ***Sportsman's Warehouse Holdings, Inc. - President, CEO & Director***

Yes. And Peter, I really should have connected the dots as I -- as we think about firearm units growing in the remainder of the year as a comp of both dollars and units. It includes the additional reach through the dealer network as well as used firearms and the gunsmithing. All of that combined is included in our internal modeling on the growth.

The website is already live. So if you go to the website today, choose a firearm, put it in your cart or just go to put it in cart, you can choose a firearms dealer in your area. And to be clear, that has just started in the last few weeks. So the network is not completely built out.

We are going to be very specific about dealers we will let in our network. They will have to be reputable dealers that are storefronts compliant, regulatory and outside the Sportsman's Warehouse reach as partners, not necessarily within the reach. But we have, call it, an additional 25% of U.S. population can now purchase our firearms and have it delivered to a local dealer within 45 minutes of their home in the first few weeks. So over time, you'll see that expand to most areas of the 48 states.

Operator

Our final question comes from the line of Ronald Bookbinder with IFS Securities.

Ronald Cunningham Bookbinder ***IFS Securities, Inc., Research Division - Analyst***

On the inventory, you're doing a terrific job of bringing that down and driving cash flow out of it. But are there any certain areas that it's especially down in? And is the reduction in inventory also benefiting from your sort of shift to include drop-shipping?

Jon Barker ***Sportsman's Warehouse Holdings, Inc. - President, CEO & Director***

Yes. Ron, it's Jon. The -- there's a combination of things working together here, Ron. The drop-ship component on firearms absolutely is helpful. The buy online, pick up in store component of the new e-comm platform is immensely helpful because now someone in -- again, I'll slide -- using Slidell.

You walk into the Slidell store, Ron, you can't find the particular caliber you're looking for. Very good chance that we have it in one of our 93 stores. The systems are now allowing us to fulfill your needs in Slidell from any one of those 93 stores with the existing inventory, where in the past, we might have had to special order that item for you, going against our inventory turns.

So those categories, especially around firearms, the buy online, pick up in store is helping with our inventory turns and reduction.

When it comes to other areas, I think apparel's a place that we will continue to be focused as an organization on ensuring that our assortment strategies are accurate for the local markets that we're within. And we have good plans to move through that inventory seasonally and keep our health of that inventory up. So apparel is the area that we're heavily focused on currently.

Ronald Cunningham Bookbinder ***IFS Securities, Inc., Research Division - Analyst***

And so that -- on the apparel side, that would really help drive gross margin because you'll have less to clear and that would give you some benefit to help offset the increase in freight, correct?

Jon Barker ***Sportsman's Warehouse Holdings, Inc. - President, CEO & Director***

That's correct. Ron, to be clear though, we aren't in the shape we want to be in all categories. So let's say, we have some apparel to move through to get everything lined up with our inventory commitments and rigor for the future. So that will take a little time to get into the spot where we expect it to be.

Ronald Cunningham Bookbinder ***IFS Securities, Inc., Research Division - Analyst***

And on footwear. Impressive comp on the footwear. What is driving footwear this past quarter?

Jon Barker ***Sportsman's Warehouse Holdings, Inc. - President, CEO & Director***

So Ron, the weather, again, I hate to choose weather as a good and bad. But the weather helped us immensely from a comp in the last quarter. If you remember, we had very, very low moisture in Q1 of 2018. The snowpack was very limited. This year, our snowpack boots, snowshoes and related activity -- related products in the West did very, very well given our snow accumulation. The weather helped us there.

Ronald Cunningham Bookbinder ***IFS Securities, Inc., Research Division - Analyst***

Okay. And well, yes, weather's always going to impact outdoor sporting. So gun services, how has that been ramping up? And how has that been accepted by the communities?

Jon Barker ***Sportsman's Warehouse Holdings, Inc. - President, CEO & Director***

It's on track, Ron, with expectations. We started slow in our marketing plans to make sure that we had all the processes down, all of the technology in place and the staff. So we're very pleased with its progress. Over time, we see that being a very strong pillar in lifetime value engagement with the consumer.

Ronald Cunningham Bookbinder ***IFS Securities, Inc., Research Division - Analyst***

Have you seen any new loyalty members coming in because of the services you now offer?

Jon Barker ***Sportsman's Warehouse Holdings, Inc. - President, CEO & Director***

I don't know that I can specifically speak to those new services driving loyalty members. But I can tell you that the loyalty program continues to grow as we've indicated, not only in count, but also in revenue percentage. And as we think about using our new e-commerce capabilities for customer engagement, the e-mails we're capturing as part of that loyalty program are paying off very nicely for us in reengagement and future transactions.

Operator

There are no further questions at this time. I would like to turn the call back over to management for any closing remarks.

Jon Barker ***Sportsman's Warehouse Holdings, Inc. - President, CEO & Director***

As I wrap up today, I want to thank all of our team members, over 5,000 employees in 93 stores, distribution center, corporate office and our care center that support our consumers on a daily basis. Their passion is what keep our loyal customers coming back to Sportsman's Warehouse. We look forward to building on our progress and further strengthening our market position.

Thank you, again, for joining our earnings call today.

Operator

Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation, and have a wonderful day.