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DICK'S Sporting Goods, Inc. NYSE:DKS

FQ3 2023 Earnings Call Transcripts

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Call Participants

EXECUTIVES

Lauren R. Hobart
President, CEO & Director

Nathaniel A. Gilch
Senior Director of Investor Relations

Navdeep Gupta
Executive VP & CFO

ANALYSTS

Adrienne Eugenia Yih-Tennant
Barclays Bank PLC, Research Division

Christopher Michael Horvers
JPMorgan Chase & Co, Research Division

Daniel Robert Imbro
Stephens Inc., Research Division

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

John David Kernan
Cowen and Company, LLC, Research Division

Joseph Isaac Feldman
Telsey Advisory Group LLC

Justin E. Kleber
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Katharine Amanda McShane
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Michael Lasser
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Michael Allen Baker
D.A. Davidson & Co., Research Division

Paul Lawrence Lejuez
Citigroup Inc., Research Division

Robert Frederick Ohmes
BofA Securities, Research Division

Samuel Marc Poser
Williams Trading, LLC, Research Division

Seth Mckain Basham
Wedbush Securities Inc., Research Division

Simeon Ari Gutman
Morgan Stanley, Research Division

Steven Paul Forbes
Guggenheim Securities, LLC, Research Division

Unknown Analyst
Oppenheimer & Co. Inc., Research Division

Warren Cheng
Evercore ISI Institutional Equities, Research Division

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Presentation

Operator

Hello, everyone, and welcome to the Q3 2022 DICK'S Sporting Goods, Inc. Earnings Conference Call. My name is Emily, and I'll be your operator for today's call. [Operator Instructions]

I will now turn the call over to our host, Nate Gilch, Senior Director of Investor Relations. Please go ahead, Nate.

Nathaniel A. Gilch
Senior Director of Investor Relations

Good morning, everyone, and thank you for joining us to discuss our third quarter 2022 results. On today's call will be Lauren Hobart, our President and Chief Executive Officer; Navdeep Gupta, our Chief Financial Officer. A playback of today's call will be archived in our Investor Relations website located at investors.dicks.com for approximately 12 months.

As a reminder, we will be making forward-looking statements 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.

During this morning's call, we will discuss earnings per diluted share on a non-GAAP basis, which eliminates the impact of certain items related to our convertible senior notes issued in Q1 2020. For additional details on this or to find a reconciliation of any non-GAAP financial measures referenced on today's call. Please refer to our Investor Relations website. And finally, for your future scheduling purposes, we are tentatively planning to publish our fourth quarter 2022 earnings results on March 7, 2023.

So with that, I'll now turn the call over to Lauren.

Lauren R. Hobart
President, CEO & Director

Thank you, Nate, and good morning, everyone. As we announced earlier this morning, we delivered an exceptionally strong quarter. Our Q3 results demonstrate the continued success and strength of our business based on our transformational journey and the foundational improvements we've made over the past 5 years. Our strategies are working and are clearly resonating with our athletes.

While consumers continue to face macroeconomic uncertainties, our athletes have held up very well as we continue to offer them a compelling and differentiated assortment as well as a best-in-class omnichannel experience. In fact, during the quarter, we saw three important consumer trends.

More athletes purchased from us, they purchased more frequently and they spent more each trip compared to the same period last year. Our industry has strong momentum given a lasting shift in consumer behavior and our differentiated assortment, elevated service standards and best-in-class omnichannel athlete experience are setting us apart in the marketplace.

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This Q3, we achieved record sales of $2.96 billion and our comps increased 6.5%, driven by increases in both transactions and average ticket. This strong comp was on top of a 13% comp last year, a 23% comp in 2020 and a 6% comp in 2019. As you've heard us say many times, DICK'S is a growth company, and our Q3 results are powerful evidence of our sustainable growth story.

As we indicated on our last call, at the end of Q2, our inventory position was strong, and we were back in stock in key items. This enabled us to deliver a very strong back-to-school season and meet robust consumer demand. Additionally, we also mentioned that we have pockets of apparel inventory to address and we have addressed much of that overage this quarter. As a result, and as expected, we saw a merchandise margin decline of 438 basis points versus last year.

Importantly, our merchandise margin remained elevated compared to 2019. And looking ahead, we continue to be very confident that our merchandise margin will remain meaningfully higher than pre-COVID levels on an annual basis.

We achieved double-digit EBT margin of 10.3% in the quarter, over 3x our 2019 rate on a non-GAAP basis. This was driven by our structurally higher sales, expanded merchandise margins and greater operating efficiency. In total, we delivered non-GAAP earnings per diluted share of $2.60, significantly ahead of any pre-COVID third quarter in our history.

Looking ahead, our inventory is healthy and well-positioned, and we're excited about the assortment that we have in place for the holiday season. Because of our continued strong performance, quality of inventory and the confidence we have in our business, we're raising our full year outlook. We now expect comparable store sales for the year to be in the range of negative 3% to negative 1.5% and non-GAAP earnings per diluted share to be in the range of $11.50 to $12.10.

In closing, I'm very pleased with our strong third quarter results and remain 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 helped make this performance possible and for their upcoming efforts during the holiday season.

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

Navdeep Gupta
Executive VP & CFO

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

We are excited to report a consolidated sales increase of 7.7% to $2.96 billion. As Lauren noted, comparable store sales increased 6.5% on top of a 12.8% increase in the same period last year, a 23.2% increase in Q3 of 2020 and a 6% increase in Q3 of 2019. Our strong comps were driven by a 3.7% increase in transactions and a 2.8% increase in average ticket.

Within our portfolio, the back-to-school categories did very well, driven by our differentiated assortment across footwear, apparel and team sports. When compared to 2019, sales increased 51%. This reflects a significant sequential acceleration in our sales trends versus 2019 from recent quarters.

Gross profit in the third quarter was $1.01 billion or 34.22% of net sales and declined 423 basis points versus last year. However, it increased 463 basis points over Q3 of 2019. As expected, the year-over-year decline was driven by merchandise margin rate decline of 438 basis points.

During the quarter, we focused on cleaning up some targeted inventory overages due to late arriving spring products. We moved excess apparel inventory to our value chain concept and have been very successful in liquidating much of

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this product. We intend to continue addressing this overage in Q4 in order to start 2023 clean.

Our Q4 merchandise margin expectations are appropriately reflected within our annual outlook. Compared to 2019, our merchandise margin rate is 141 basis points higher driven by a differentiated assortment, combined with our sophisticated and disciplined pricing strategies and a favorable product mix. Because of these structural drivers, we continue to expect our merchandise margin rate to remain meaningfully higher than pre-COVID levels on an annual basis.

SG&A expenses were $679.7 million or 22.97% of net sales and leveraged 3 basis points compared to last year on the increase in net sales. The $48 million increase in SG&A dollars was driven by investments in hourly wage rates, talent and technology to support our growth strategies.

Interest expense was $26.1 million, an increase of $20.1 million on a non-GAAP basis compared to the same period last year. This increase was primarily due to $13.8 million of interest expense related to our $1.5 billion senior notes issued during Q4 of 2021. The current quarter also included $8.8 million of inducement charges related to our exchange of approximately $221 million of outstanding principal of our convertible senior notes.

Driven by a structurally higher sales, expanded margins and operating efficiency compared to pre-COVID levels, EBT was $304.1 million or 10.28% of net sales. This compares to a non-GAAP EBT of $59.9 million or 3.05% of net sales in 2019 and an increase of $244.2 million or 723 basis points as a percentage of net sales.

In total, we delivered non-GAAP earnings per diluted share of $2.60. This compares to a non-GAAP earnings per diluted share of $3.19 last year and represents a 400% increase over 2019's non-GAAP earnings per diluted share of $0.52.

Now looking to our balance sheet. We ended Q3 with approximately $1.4 billion of cash and cash equivalents and no borrowings on our $1.6 billion unsecured credit facility. Our quarter end inventory levels increased 35% compared to Q3 of last year. As a reminder, we were chasing inventory last year amidst industry-wide supply chain disruptions. Therefore, the better comparison is against Q3 of 2019. And compared to Q3 2019, our 51% increase in sales was well ahead of our 31% increase in inventory. Our inventory is healthy and well positioned.

Now turning to our third quarter capital allocation. Net capital expenditures were approximately $100 million and we paid $41 million in quarterly dividends. During the quarter, we exchanged approximately $221 million of outstanding principal of our convertible senior notes for cash and unwound the corresponding portion of the convertible note hedge and warrants or 4.3 million shares of our common stock. After completing this exchange, we have taken out approximately $421 million with approximately $154 million in aggregate principal of the convertible notes still outstanding.

Beyond retiring nearly 3/4 of our convertible notes, year-to-date, we have returned $485 million to shareholders through dividends and share repurchases while continuing to invest in the profitable growth of our business.

So let me wrap up with our outlook for 2022. As a result of our strong Q3 performance and the quality of our assortment for the holiday season, we are raising our 2022 guidance. Importantly, our updated outlook continues to incorporate an appropriate level of caution given the uncertain macroeconomic backdrop. For the year, we now expect comparable store sales in the range of negative 3% to negative 1.5% compared to our prior expectation of negative 6% to negative 2%.

In addition, we now expect non-GAAP earnings per diluted share in the range of $11.50 to $12.10 compared to our prior expectation of $10 and $12. EBT margin is now expected to be approximately 11.4% at the midpoint, more than double our 2019 rate. Our earnings guidance assumes an effective tax rate of about 25% and is based on approximately 88 million average diluted shares outstanding.

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In closing, we are very pleased with our Q3 results, and we remain very enthusiastic about the future of DICK'S. This concludes our prepared comments. Thank you for your interest in DICK'S Sporting Goods. Operator, you may now open the line for questions.

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Question and Answer

Operator

[Operator Instructions] Our first question today comes from Simeon Gutman with Morgan Stanley.

Simeon Ari Gutman
Morgan Stanley, Research Division

My first question is on merch margin or gross margin. I think you've been saying that we expect to retain, I think, a majority of the COVID gains. I wanted to ask if that's still the case. And I guess the fact that you're getting through this period relatively well where your vendors have excess inventory, does that build your confidence around that forecast of being able to retain a majority of this gross margin?

Lauren R. Hobart
President, CEO & Director

Simeon, thank you. Yes, we still believe that we will be able to retain a significant amount of our merch margin gains. This particular quarter, if you look back at Q2, we had indicated that we had gotten a lot of late receipts in from spring that came in on top of our back-to-school inventory, and we were heavy in apparel, and we aggressively took care of that this quarter to clean up our inventory so that we could maintain -- so we've taken holiday merchandise and start 2023 clean.

So we absolutely believe in the structural changes in our overall margin. I would point to the fact that our EBT margin, even with that investment that we made to clean up apparel, it was 10.3%. So over 3x what it was pre-2019, we have tremendous confidence in the long-term sustainability of our profitability.

Simeon Ari Gutman
Morgan Stanley, Research Division

And then my follow-up is on sales. Some of the categories or the overall business, either normalizing at a higher level or just performing better than maybe the market would have thought, if you look back a couple of years. You're prepared to talk about '23, but can you just talk about some of the categories where there's been some reversion. Has that stabilized and rebounded? Does the business digest or can the business keep growing next year?

Lauren R. Hobart
President, CEO & Director

Yes. So the categories in Q3 that our core categories are the ones that we are the most focused on. So team sports, apparel, footwear, all key back-to-school categories and our top categories, and they performed extremely well. If you look across every single one of our key categories, everything except hunt, which is not a key category anymore, we have meaningfully rebaselined versus pre-COVID levels. We see no reason why long term, we should not be able to continue to grow from this level.

Operator

Our next question comes from Adrienne Yih with Barclays.

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Adrienne Eugenia Yih-Tennant
Barclays Bank PLC, Research Division

Congratulations to the team on this stellar execution as always. So Lauren, I guess my first question is going to be on the promo environment. Is it only apparel? It sounds like you've actually made your way through that. Are you seeing any kind of spillage -- spill over into safe footwear? And how much vendor support are you getting for those promos? How long do you think that lasts? And then for Navdeep, clearly, you're buying for spring of next year. So you had that buildup of safety stock in transit, whatever you want to call it, but how are you thinking about unit buys, excluding, right, outside of that in-transit inventory.

Lauren R. Hobart
President, CEO & Director

Thanks, Adrienne. So we work very closely with our vendor partners, as always, to make sure that the inventory in the marketplace is at the levels that we all want it to be. We continue to move product when it needs to be moved, and that's in every category. Apparel was an issue this past quarter, and we will be aggressive to clean up whatever needs to be cleaned up in Q4 in partnership with our vendor partners. Our main priority right now is to start 2023 clean, and we're really thrilled that we have in stock for Q4 inventory for the first time in a few years that's going to be robust and that people will be able to find exactly what they're looking for with great holiday gifts. Navdeep?

Navdeep Gupta
Executive VP & CFO

Yes, Adrienne, thanks. For 2023, I'm not going to be able to provide any early guidance. But as Lauren indicated, we are very confident about the core aspects of the business as you think about apparel, footwear, team sports and even the outdoor category. So we are appropriately being cautious about -- with the macroeconomic outlook. But overall, we are very confident about the sales expectations on a long-term basis. And we'll provide our 2023 outlook as part of our fourth quarter earnings release.

Operator

Our next question comes from Robby Ohmes with Bank of America.

Robert Frederick Ohmes
BofA Securities, Research Division

My question is on the basket uplift that you guys saw in the third quarter, do you -- should we look for that to continue into the fourth quarter? Maybe more color on what is driving the increase in the average transaction size? Is it better in-stock levels and the high ticket items? Or is it because you were out of stock last year? Like more of the dynamic on what's driving that would be helpful.

Lauren R. Hobart
President, CEO & Director

Yes. So our comps this year -- this quarter was really strong, driven by more than -- 50% was driven by transactions and the rest by basket. And within the basket, there was some impact of inflation and passing some costs along to consumers, some of which we absorbed ourselves. But there was also a shift in terms of the mix that we provide to consumers and some premiumization of what people are buying. Consumers are absolutely signaling that a healthy active outdoor lifestyle is important to them, and they are buying what they're considering discretionary items to keep that lifestyle going. So it was really across the entire basket. Things were improved.

Navdeep Gupta

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Executive VP & CFO

Yes, Robby, maybe I'll add one more comment. Each of our, the consumer income demographic that we have within our store, did really, really well in third quarter. And what we saw was that highly engaged and loyal athletes that we have in our gold customer. Those customers actually did even better. And so we continue to be really optimistic when we look at the core aspects of the business about the fourth quarter. We are balancing that against the macroeconomic constraints that we see right now. But overall, we were very pleased with the results that we saw in Q3.

Robert Frederick Ohmes
BofA Securities, Research Division

And maybe just a quick follow-up. Can you remind us how holiday played out last year in terms of pull-forward of spending and how you're planning against that this year for the fourth quarter?

Navdeep Gupta
Executive VP & CFO

Yes. We probably, Robby, saw a little bit pretty much like every retailer that there was a little bit of early start to the season, both last year and if you look in 2020 as well because of the overall constrained inventory levels that were existing. And -- but however, as we look to the business, we look at it as the overall holiday season. So not too focused on the first few weeks or late October.

Operator

The next question comes from the line of Kate McShane with Goldman Sachs.

Katharine Amanda McShane
Goldman Sachs Group, Inc., Research Division

I'm just trying to reconcile what one of your vendors said with regards to the amount of inventory that they had in transit. And I wondered if there was any risk of further late deliveries over the next quarter or two that you might have to manage as a result?

Lauren R. Hobart
President, CEO & Director

Kate, thank you. Yes, we are working very closely with our vendor partners. We've got a great flow of product right now, and everything has been factored into our guidance, which we're feeling really, really good about.

Operator

Our next question comes from Paul Lejuez with Citi.

Paul Lawrence Lejuez
Citigroup Inc., Research Division

Maybe you could frame for us the amount of excess inventory that you had to clear through in 3Q, how that compares to what you think you have to clear through in 4Q. Any help you can provide on the merchandise margin side. And I guess just related to the clearance, I'm curious if as you picked up the promotional cadence, if you saw a lift in sales? Was it a traffic and sales driver during the quarter?

Navdeep Gupta

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Executive VP & CFO

Paul, I think there are two questions there. In terms of the quantification of the clearance inventory, I would say it was not a material portion of our driver of the sales in the third quarter. What we saw and like Lauren alluded to, we saw the gain in our comp sales come more from the transaction growth and the AUR increase. And AUR increase also came from kind of the high heat and the highly allocated assortment that we have.

In terms of the potential markdown risk for fourth quarter, much of the inventory that had been moved into clearance was activated and quickly moved through in third quarter. There is some pockets of inventory here in fourth quarter, which we will continue to address. However, all of that has been contemplated in our fourth quarter guidance. And with this guidance that we have given, we are very confident that we'll be able to maintain a meaningful gain in our merch margins compared to 2019.

Operator

Our next question comes from Christopher Horvers with JPMorgan.

Christopher Michael Horvers
JPMorgan Chase & Co, Research Division

Can you dig in a little bit on the gross margin side? The 438 basis points, does that include the mix benefit if footwear and apparel did really well relative to other categories? And then as you think about the freight line, how are you thinking about freight costs? Were they still a pressure year-over-year? Is there any sort of capitalized inventory costs that will flow through on a delayed basis as we look over the coming quarters?

Navdeep Gupta
Executive VP & CFO

Yes, Chris, in terms of the mix, there was probably a small benefit, but it wasn't material to call that out, and that's the reason it was not included. In terms of the freight costs, yes, we are seeing that the freight costs have continued to come down and have come down since the beginning of this year, but still not down versus -- when you compare it to 2019.

In terms of the flow of the product, yes, it will take some time that cost will -- or the benefit of this reduced cost will be realized into 2023.

Christopher Michael Horvers
JPMorgan Chase & Co, Research Division

And then as a follow-up, you mentioned trying to be prudent and conservative around the guidance in the fourth quarter. You are degrading your sort of 3-year CAGR growth relative to 2019. I guess, can you talk about what informs that point of view? I know there's some normalized and seasonality that's occurring as we speak sort of end of October through November, are you extrapolating the sort of the current trend of the business to arrive at the implied 4Q comp? Or are you -- is there -- what degree of conservatism is baked in?

Lauren R. Hobart
President, CEO & Director

Chris, we feel incredibly good about the momentum in our business coming out of a very strong Q3. I would point out, we had three really strong months in Q3. And coming into Q4, we see absolutely no signs of any degradation. We're very enthusiastic about Q4. We are being appropriately cautious just because of the uncertain macroeconomic environment and the fact that the consumer is going through a lot right now, but our confidence is as high as it's been.

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Operator

Our next question comes from Mike Baker with D.A. Davidson.

Michael Allen Baker
D.A. Davidson & Co., Research Division

So just a follow-up on a previous question on how much inventory is left to clear. The -- I think your fourth quarter EBT margin guidance is down 260 basis points. That would be the smallest decline over the year and better than what you saw in the third quarter. Is that because you're now mostly through the markdowns? Or if not, why is the EBT margins decline expected to be better in the fourth quarter than the previous quarters?

Navdeep Gupta
Executive VP & CFO

Yes, Mike, I won't guide specifically to fourth quarter, I'm sure you can back into it. I would say there are structurally things are expected to improve as we go into the fourth quarter. Like we said, much of the clearance activity that we were activating in third quarter is behind us. So that's one reason. The other reason is just because we feel confident about our ability to manage our expenses as well as drive higher productivity.

Michael Allen Baker
D.A. Davidson & Co., Research Division

Makes sense. If I could ask one more follow-up, a mundane question, but the interest expense and everything that's going in that line with all the converted stuff, it's been about $25 million, $26 million each of the three quarters this year. On a non-GAAP basis, can you just help us any reason why that should be different? I know there's a lot of moving pieces with the convert there. So just wondering if you can help us with that line.

Navdeep Gupta
Executive VP & CFO

Yes. You are spot on in terms of the onetime costs associated with the convert, it's over $20 million when you look at it on a year-to-date basis. So if you do decide to execute another tranche of the convertible note transaction in fourth quarter, that headwind was not contemplated in our guidance. But we will continue to look on the convert and take that out in fourth quarter on an opportunistic basis.

Operator

Our next question is from Warren Cheng with Evercore ISI.

Warren Cheng
Evercore ISI Institutional Equities, Research Division

Great execution this quarter. Sorry to keep hammering on this merchandise margin question, but I think it's just really important to understand the dynamics here. So if I just look relative to 2019 levels, it looks like the merchandise margins degraded about 300 basis points from second quarter to third. Can you just give us a little bit better sense of how much of that came from that apparel clearance maybe so we can understand what merchandise margin would look like excluding this issue with the late spring receipts.

Navdeep Gupta
Executive VP & CFO

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Warren, the vast majority of the decline that we saw here in third quarter came from the activation that we had around the apparel overages that Lauren indicated at the end of Q2.

Warren Cheng
Evercore ISI Institutional Equities, Research Division

Got it. Okay. And my follow-up is just any color on the process of clearing these inventories. I know a lot more is running through your own clearance concepts, your own value chain concepts. Can you just give us a sense of the margin uplift when it runs through your own content versus the old way through your own mainline stores?

Lauren R. Hobart
President, CEO & Director

Yes. We've had great success with our value chain concepts, both ongoing on and our warehouse stores. We do see that we can optimize our margin on our clearance better. We also have great success when we clear products online, but it also enables us to bring product -- fresh product into the DICK'S stores, which also helps us drive margin. Navdeep, I don't think we're going to answer specifically.

Navdeep Gupta
Executive VP & CFO

Yes. Warren, I would say that we are very pleased with the strategy that we have of leveraging the Going, Going, Gone! concept as well as the warehouse locations. Like Lauren indicated the recovery on this on this product from a clearance perspective is significantly better than what we used to have in 2019. And we have called out that as one of the key structural drivers of our confidence of us being able to maintain a meaningful portion of the margin gains compared to 2019.

Operator

The next question today comes from Michael Lasser with UBS.

Michael Lasser
UBS Investment Bank, Research Division

So the message that you're offering this morning is that the margin degradation that you experienced in the third quarter is transitory in nature because it's associated with having excess inventory that presumably will be cleared out by the end of the fourth quarter, and you will now have this moving into next year. Now next year, you might experience a softer overall demand environment such that you will have to increase your promotional activity to work harder to driving customers and this will offset some of the benefit next year that you'll have from cleaner inventory. Is that the right way to think about it?

Lauren R. Hobart
President, CEO & Director

Partly, Michael, but not all. No. The margin degradation, we expect to be clean going into next year. So correct that these were investments that we made to get our inventory clean and we'll continue to do that. We're not guiding to next year, but I would just point to the fact that we've had significant athlete growth. We've had growth in the number of athletes, over 16.5 million new athletes in the last 2 years and this year-to-date, 4.5 million new athletes joining, and they are driving transactions and our gold customers are growing. So I would not say that we're expecting at this point in time, any sort of an overall demand change that would require a heavy promotional environment.

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Navdeep Gupta
Executive VP & CFO

Yes, Michael, and I'll add one more you have called out. One of the -- yes. One of the structural drivers that we have talked about in merch margin continuing to remain significantly elevated is the assortment that we now have in our stores. And that assortment is highly allocated, high heat and typically not impacted by the promotional activity that might be happening. So that's another factor that gives us tremendous amount of confidence as we look to 2023.

Michael Lasser
UBS Investment Bank, Research Division

My follow-up question is objectively, DICK's is going to put up one of the strongest results across retail and within sporting this retail in the quarter. Presumably, some of that is related to the unique content that DICK'S has, where it's got a great assortment of footwear, there's a footwear cycle going on. And that's drawing in a lot of the traffic. This is happening at a time where back-to-school was good in part because kids hadn't been in school or known to be -- weren't going to know to be in school ahead of time for the last few years. So is there anything unique given those set of circumstances that is -- you would hold responsible for driving demand that may not persist into next year, especially at a time where the overall consumer environment is likely going to soften.

Lauren R. Hobart
President, CEO & Director

Michael, you have essentially just laid out what I would say is our transformational journey over the past few years where we have really changed the allocation of products that we have, what we're offering to consumers. We've got higher heat and more differentiated products. And at the same time, we've been working on our omnichannel athlete experience of elevating service in the stores, elevating our digital experience, elevating -- having a product available close to the consumer when and where they want it. So there's nothing unique about how we drove demand that won't persist into next year.

The back-to-school season happens to be a showcase of our very strongest categories in footwear, apparel and team sports. But nothing unique about this quarter that shouldn't persist.

Operator

Our next question comes from John Kernan with Cowen.

John David Kernan
Cowen and Company, LLC, Research Division

Congrats on nice quarter. Just on inventory. $3.3 billion on the balance sheet in Q3. Some of that's obviously just from higher cost, but how should we think about the growth of inventory year-over-year in Q4 where you think you might finish? And what you think inventory levels look like in the spring of '23?

Navdeep Gupta
Executive VP & CFO

John, just let's deep -- go a little bit deeper into the Q3 results in terms of the inventory. And as we called out, it's much better to look at inventory growth versus 2019 as we were chasing our inventory all of last year, including fourth quarter with plenty of product remaining in transit as we were getting ready for the holiday season. So when you look at the growth in our inventory in third quarter, our sales grew versus 2019, 51% and our inventory grew 31%. And we'll continue to manage the inventory the same way. We want to make sure that there is right availability and in-stock available for the athletes for the important holiday season. And there are pockets of inventory, like we have said, we will

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actively work on that in the fourth quarter. Overall, we feel our inventory is healthy and is very well-positioned for the holiday season.

John David Kernan
Cowen and Company, LLC, Research Division

Got it. And then maybe one quick follow-up as it relates to supply chain costs. Obviously everybody can see that some of the inbound freight costs have come down pretty significantly. How do we think about some of the domestic freight and shipping costs as we go into Q4 and next year?

Navdeep Gupta
Executive VP & CFO

You meant Q4 of this year?

John David Kernan
Cowen and Company, LLC, Research Division

Yes.

Navdeep Gupta
Executive VP & CFO

Okay.

John David Kernan
Cowen and Company, LLC, Research Division

How do we think about -- I think.

Navdeep Gupta
Executive VP & CFO

No, that's helpful. No, we agree with you on the international freight side that definitely there is a continued lowering of the costs that we have seen, probably I would call it from third quarter onwards. And however, the domestic side still continues to be volatile, and we are working very closely with our vendor partners as well as our supply chain team works very closely with the domestic partners as well. That still continues to be volatile. We are playing close attention to it. But right now, our focus is to make sure that the inventory is available in stores and available for athlete to buy as they are looking for good opportunities here for the holiday season.

Operator

Our next question comes from Brian Nagel with Oppenheimer.

Unknown Analyst

This is William Dawson on for Brian Nagel. Congrats on a nice quarter. So our question is actually just on product mix over time, how you're balancing between your national accounts and your vertical brands? And can you provide an update on the performance in the quarter for your private label brands and how this customer is behaving?

Lauren R. Hobart

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President, CEO & Director

Yes. Our vertical brands continue to do very well and outperformed for this year in Q3. The DSG brand, in particular, has done incredibly well. It's a high fashion, high-function product at a very attractive price point. It's perfect for the consumer right now. And at the same time, CALIA and VRST are filling white space in our assortment and really leaning toward that athletic male, athletic female and more of a performance and lifestyle brands. So we're very, very pleased with the vertical brands.

The last time we gave an update that we do it annually, and it was 14% was our vertical brand penetration. So we'll update that again at the end of this year. Yes.

Unknown Analyst

Okay. I appreciate that. And just a follow-up, do you see any variability across geographies and across other product spectrums?

Lauren R. Hobart
President, CEO & Director

Nothing meaningful in the quarter. No.

Operator

The next question today comes from Sam Poser with Williams Trading.

Samuel Marc Poser
Williams Trading, LLC, Research Division

A bunch of them have been answered, but I have a few more. What was your -- or your e-commerce penetration or e-commerce sales for the quarter?

Navdeep Gupta
Executive VP & CFO

Sam, we no longer break that out. As we think about the athlete, we look at the athlete on an omnichannel basis because the athlete is making the channel agnostic decision, and that's the way we want to operate our business. So we no longer are giving that breakout. Actually, that's been going on since the beginning of this year.

Samuel Marc Poser
Williams Trading, LLC, Research Division

Okay. I missed that...

Navdeep Gupta
Executive VP & CFO

Maybe I'll add that. We were very, very happy with the overall performance that we saw across both channels.

Samuel Marc Poser
Williams Trading, LLC, Research Division

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So let me just follow up. Okay. So back to inventory, what is your forward weeks of supply -- optimum forward weeks of supply with what you're seeing right now or optimum annual turn target that would be -- because it's up from pre-COVID. It's turning a little slower than pre-COVID. But what's -- so how should we think about sort of what it should be on an optimum basis? Should you be having like 14 or 15 forward weeks of supply or you -- should you be running at 17 or 18?

Navdeep Gupta
Executive VP & CFO

Yes, Sam, we haven't given that level of guidance, but the way to think about this is as we are comparing our inventory growth and sales growth compared to 2019 because that is probably the last time we had some normalized level of inventory. So probably that's the easiest and the best comparison right now you could do.

Samuel Marc Poser
Williams Trading, LLC, Research Division

Okay. And then the loyalty members make up how much of your business these days?

Lauren R. Hobart
President, CEO & Director

It's over 70% of our business. But importantly, we've got over 25 million loyalty members, over 32 million active members, both outside of our loyalty and within and then over 150 million athletes who are in our database overall. So they comprise a...

Samuel Marc Poser
Williams Trading, LLC, Research Division

Okay. And then lastly, there's a lot of questions asked about the macro. But my question for you is about what you guys have done and about the long-term growth of the business. Where are you in the continuum of improving the levels of engagement, the personalization process and so on to overcome the macro because I wouldn't call it necessarily a direct competitor, but another athletic retailer reported, you put up significantly better numbers. We're going to hear from somebody else next week. Can you talk about your -- the use of your CRM and how everything is evolving and sort of the reason why from the perspective of what you're doing that the business is rebasing over and can grow from here?

Lauren R. Hobart
President, CEO & Director

Great question. Yes, it's a great question because our database and our knowledge of our athletes is at an all-time high, and we continue to have, what I would say, is the best data set in sports, and I'm not the only person saying that. We have an amazing data set. We are more personalized than ever before. We're driving engagement, both online and also, I would say, in our stores in terms of how we serve athletes, so we're very focused on the athlete experience. But at the same time, I would say we're in early innings. So I think we've got a long way to go with personalization. We continue to gain new athletes. We're very focused on -- using that CRM database to provide people with the best experience for them. And that's, I think, early innings still for a lot of this despite how far along we've come.

Operator

Our next question is from Steven Forbes with Guggenheim.

Steven Paul Forbes
Guggenheim Securities, LLC, Research Division

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I wanted to revisit the acceleration in transaction trends, really, if we look at it on a 3-year basis, it was a meaningful sequential improvement. So curious if you could just expand on what drove that, if it had anything to do with new athletes that were acquired. You mentioned $4 million, but is that $4 million more heavily weighted to the third quarter. Really just trying to get any insight on the sustainability of the step-up in transactions on a multiyear trend.

Lauren R. Hobart
President, CEO & Director

Yes, Steven, thank you for the question. So we -- our growth in transaction came from several important trends. First of all, we did have new athletes come in. So I mentioned 4.5 million year-to-date, 1.5 million of those were in the past quarter. So it's been fairly consistent throughout the year. But they are also driving increased transactions and increased dollars per transaction.

And I think it's important to dive into how our consumers are doing and how they're responding to our industry in our stores. But every single one of our income demographic levels has grown meaningfully in the past quarter. So it's clear that we are providing something for everybody in terms of -- so we can meet their needs and still deliver that outdoor lifestyle. We are not seeing people trade down. So between our athlete database growing, our increased personalization efforts, which will continue into next year, we expect that, that will be a key driver for us going forward.

Steven Paul Forbes
Guggenheim Securities, LLC, Research Division

Maybe just a quick follow-up on Navdeep, obviously, right, you sort of a net share issuer with the settlement and unwind of the convertible note hedges and so forth. So would love to just maybe if you can expand on the decision to pause the repurchase activity last quarter. Any current updates on capital allocation as we look forward here over the NTM?

Navdeep Gupta
Executive VP & CFO

Yes. No, let me start with your second question first. So as we think about capital allocation, we continue to have a really strong balance sheet with more -- with $1.4 billion of cash and cash equivalents. In addition to that, maintaining the investment grade is an important part of the criteria as we think about the capital structure. And then we are continuing to invest aggressively in our business and the growth opportunities that we have.

To your question on a year-to-date basis, we have returned $485 million of excess cash on the balance sheet between the share repurchases, which we guided at the beginning of the year, a minimum of 300. We have already eclipsed that. And in this quarter, we focused on taking out the converts. So we took out $221 million of convert, how deep the convert is in the money, it trades pretty much like an equity. And like you said, it's -- we are taking that potential future dilution as the stock price continues to rise by taking the convert out right now.

So overall, we'll continue to be flexible in our capital allocation in terms of buying more shares back and we'll be opportunistic as we look to the share buyback for the balance of this year.

Operator

Our next question comes from Joe Feldman with Telsey Advisory Group.

Joseph Isaac Feldman
Telsey Advisory Group LLC

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I wanted to ask about the layout in the store, at least a couple of local stores around me, it feels like you've done some things to adjust the layout. Maybe emphasizing private brands a bit more, the vertical brands, I should say, more front and center and in fact, even replacing where you used to keep the big brands, the national brands. And I'm just curious if that's something you're testing and what you're learning from that test? And is that something we should expect to see in more stores in the future?

Lauren R. Hobart
President, CEO & Director

Joe, I think what you're picking up on is that we have adopted a very flexible approach to how we lay out products based on in-stocks, based on what's hot with the consumer at the moment. And so -- no longer are the days where you're going to walk into a DICK'S store and see everything laid out the same way. We are constantly optimizing. We do space optimization frequently and move things around as needed.

Joseph Isaac Feldman
Telsey Advisory Group LLC

Got it. Okay. And then just wanted to get an update on maybe House of Sport and Public Lands, just latest learnings and expansion plans for those two concepts?

Lauren R. Hobart
President, CEO & Director

House of Sport has been absolutely tremendous, both in terms of how the locations themselves are doing. They far exceeded our expectations. But also in terms of what we're able to take from House of Sport and bring down to the rest of our chain in terms of service levels and products and even -- we have some new products that have launched there that have done really well the rest of the chain. So really, really excited about House of Sport.

Public Lands also equally really excited about. We have just launched, I think, five new Public Lands stores about in the past month. They are meant to tap into a very broad outdoor consumer, and they are doing an incredible job serving those explorers very well. So we're very excited. Public Lands, still in test phase. House of Sport support definitely a key part of our roll forward strategies.

Operator

The next question comes from Seth Basham with Wedbush Securities.

Seth Mckain Basham
Wedbush Securities Inc., Research Division

I'm sorry to parse words, and maybe this is just a nuance, but regarding the merchandise margin improvement that you've seen since 2019, you're indicating now that you expect to retain a significant amount or a meaningful amount of it versus previously expecting to retain a majority of it. Is that accurate?

Navdeep Gupta
Executive VP & CFO

Seth, I would say we are still guiding that we will maintain a meaningful portion of that margin gain. So again, maybe I'll recap some of the structural reasons that we are seeing, and we have that confidence. If you look at Q3, the performance that we saw in Q3 from the highly-allocated product is what drove a significant amount of our success in third quarter. And to me, that's kind of a go-forward strategy, and that will be a continued benefit that we will keep.

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The tools that we have, whether it is Going, Going, Gone! or the promotional and the pricing capabilities that we have delivered is something that is really, really strong compared to where it was in 2019. And that, again, gives us a tremendous amount of confidence.

And then the product mix, I know there was a question on vertical brands. The vertical brands have 600 to 800 basis points of higher margin. And these brands, again, resonated really well in third quarter. And the hunt penetration, that used to have almost about 1,700 basis points lower margin, and that has become a meaningfully small piece of our business. When you look back at all of these structural drivers, and you look at the performance that we delivered in Q3, that's what gives us the tremendous amount of confidence that we can maintain a meaningful portion of these gains versus 2019.

Seth Mckain Basham
Wedbush Securities Inc., Research Division

That's helpful. But just to clarify, you don't expect to necessarily maintain majority anymore, just a meaningful amount?

Navdeep Gupta
Executive VP & CFO

Yes. Yes, you can parse the words, but we are very confident that we'll maintain a meaningful portion of those gains versus 2019.

Lauren R. Hobart
President, CEO & Director

I think -- just to add on this, it's important to look at our full year results. We've been talking about full year and we absolutely expect to maintain a significantly meaningful amount of our margin improvements.

Seth Mckain Basham
Wedbush Securities Inc., Research Division

Wonderful. And just as a follow-up question regarding the promotional environment outside of apparel, how would you characterize that relative to pre-pandemic levels and your expectations into the holiday season?

Lauren R. Hobart
President, CEO & Director

Yes. Our approach to the holiday season is very different from how it was prepandemic. We are being much more surgical. We're making sure we have great gifts for people at great value but no longer are we doing whole household sites on sale, that sort of a sledgehammer approach to promotion. We're being much more targeted, much more item focused and much more surgical. We're really excited about the in-stock levels that we have and that our approach to holiday is going to be very well-received by athletes.

Operator

The next question comes from Justin Kleber with Baird.

Justin E. Kleber
Robert W. Baird & Co. Incorporated, Research Division

Just wanted to ask a follow-up on merch margins. Given your comments on largely working through the apparel

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inventory here in 3Q, do you expect your merchandise margin declines to moderate in 4Q based on the guidance?

Navdeep Gupta
Executive VP & CFO

Yes. Justin, I would say it's been implied in our annual outlook. When you look at the merch margin, there are a couple of factors you have to keep in mind. Comparing to 2019, we definitely feel very confident that we'll maintain a meaningful portion of those gains as we go into the fourth quarter. And then you have to look into the commentary that we gave in fourth quarter around the promotional landscape last year compared to where our expectation that Lauren just laid out.

Overall, on an annual basis, like we have said, we'll maintain a meaningful portion of the gains versus 2019.

Justin E. Kleber
Robert W. Baird & Co. Incorporated, Research Division

Okay. Maybe a follow-up, Navdeep, on just SG&A flexibility. Your sales based on the guidance are going to be up to 38.5% at the midpoint. Looks like SG&A will have leveraged maybe around 150 basis points versus '19. So clearly, you've been reinvesting some of the top line upside into SG&A in the past few years, whether that's marketing or wages. I guess my question is in the event demand does soften, how much flexibility do you have within your SG&A structure to maintain EBT margins at this level without of course sacrificing service levels in the store?

Navdeep Gupta
Executive VP & CFO

Yes. Justin, I think that you've read the SG&A profile really well. We agree that we are investing in the long-term growth strategies of the company. In addition, the wage pressures continue to remain elevated compared to 2019. So those are the big areas of investment in SG&A as you look to this year.

In terms of the forward-looking view, first of all, the variable expense is always flexible sales. So if the sales are volatile for whatever reason, we believe that our variable expenses will definitely reflect. In addition, we have flexibility in our fixed as well as the discretionary expenses as well. And as you called out, we will balance these actions with what is the right thing to do for the long-term aspect of the business versus keeping the company in really healthy conditions. And we could look also at our growth strategies and the investments required. So internally, we feel really confident that we will be able to navigate macroeconomic conditions really well and drive the long-term sales growth and the profitability growth of the company.

Operator

The next question comes from Jim Duffy with Stifel.

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

I have a few questions about the warehouse store strategy. We have about 50 locations. So it looks like temporary locations. Is that how you think about this? Or is that a permanent part of the strategy? And I'm curious how that fits with the Going, Going, Gone! concepts?

Lauren R. Hobart
President, CEO & Director

Yes. Great question, Jim. The way we're thinking about the value change in general, is that we have a try before you

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buy strategy where we do a pop up, and that's what you're seeing at the DICK's warehouse stores. See how the consumer reacts, see how we like the real estate and then a portion of those are converted into a Going, Going, Gone! permanent location. So that will be our ongoing strategy. We find a great deal of success trying before we actually sign a long-term lease.

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

Got it. And then a question around the inventory in those stores, the footprints for the ones I've seen are large. Are you opportunistically buying to populate these stores? Or is there inventory in these stores simply accessed from regular way business. And I'm also curious, is that inventory in the outlet store strategy, is that visible and shoppable online? Or are those kind of brick-and-mortar silos?

Lauren R. Hobart
President, CEO & Director

Yes. They are shoppable online. In fact, they really help us by consolidating all of the clearance inventory into one location. We can easily find it and light it up online, not worrying about safety stocks and things like that. So that's a key part of it.

We do buy a little bit opportunistically for the Going, Going, Gone! and warehouse stores. But by and large, they are primarily clearance channels for DICK'S Sporting Goods. Our main goal is to clear that product so that we can bring fresh new receipts into DICK'S.

Operator

Our last question today comes from Daniel Imbro with Stephens Inc.

Daniel Robert Imbro
Stephens Inc., Research Division

I wanted to ask one, Lauren, on the consumer. It doesn't sound like you're seeing any trade down yet. But just as the consumer weakens, are there levers you can pull other than price to kind of increase the value offering DICK'S has to retain that customer? And then just as you think about the box, what categories would you expect to slow first? Or where would be the times of weakness you're looking for to get a sense of the health of the consumer?

Lauren R. Hobart
President, CEO & Director

Daniel, the way we approach the assortment is that we want to have something for everyone. We are not seeing people trade down, but we do offer a range of opening price points, fantastic apparel and gear all the way up to the most premium. So I mean, sort of there's levers we can pull. Our scorecard engagement is really high. That's a great tool for us. It enables us to get personalized message out to our athletes. But across the board, we're not seeing -- I can't predict because I don't see any slowdown in any of our key categories. They're all healthy.

Daniel Robert Imbro
Stephens Inc., Research Division

That's helpful. And then I think just to dig in on the inventory a little more detail or asked a different way. Is your inventory equally strong or healthy across maybe vertical brands and national brands? Or are you more exposed? Just thinking about if there was a trade down, could you get stuck with more national brand inventory that maybe the consumer is opting out of? Or how is your inventory held across the different kind of subsets of inventory?

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Navdeep Gupta
Executive VP & CFO

Yes. Overall, I would say our inventory is very healthy and very well-positioned for the holiday season. The only lump that we called out was on the athletic apparel side and we are -- much of that has been already activated here in third quarter, and we'll continue to work through that. But overall, like I said, we feel really strong about our in-stock levels going into this important holiday season.

Operator

Those are all the questions we have for today. So I will now turn the call back to Lauren Hobart, President and CEO, for concluding remarks.

Lauren R. Hobart
President, CEO & Director

Thanks, everybody, for your interest in DICK'S Sporting Goods. I hope you have a happy, healthy and safe holiday. Bye-bye.

Operator

Thank you, everyone, for joining us today. This concludes our call, and you may now disconnect your lines.

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