Ulta Beauty (ULTA) Earnings Report: Q1 2016 Conference Call Transcript

The following Ulta Beauty conference call took place on May 26, 2016, 05:00 PM ET. This is a transcript of that earnings call:

Company Participants

- Laurel Lefebvre; Ulta Salon Cosmetics and Fragrance Inc. ; Investor Relations
- Mary Dillon; Ulta Salon Cosmetics and Fragrance Inc. ; CEO
- Scott Settersten; Ulta Salon Cosmetics and Fragrance Inc. ; CFO
- Dave Kimbell; Ulta Salon Cosmetics and Fragrance Inc. ; Chief Merchandisng and Marketing Officer

Other Participants

- Chris Horvers; JPMorgan; Analyst
- Joe Altobello; Raymond James & Associates, Inc.; Analyst
- Brian Tunick; RBC Capital Markets; Analyst
- Jason Gere; KeyBanc Capital Markets; Analyst
- Ike Boruchow; Wells Fargo Securities; Analyst
- Mark Altschwager; Robert W. Baird & Company, Inc.; Analyst
- Simeon Gutman; Morgan Stanley; Analyst
- Daniel Hofkin; William Blair & Company; Analyst
- Adrienne Yih; Wolfe Research; Analyst
- Simeon Siegel; Nomura Securites; Analyst
- Matthew Fassler; Goldman Sachs; Analyst
- Courtney Wilson; Cowen and Company; Analyst
- Rupesh Parikh; Oppenheimer & Co.; Analyst
- Steph Wissink; Piper Jaffray & Co.; Analyst
- Michael Baker; Deutsche Bank; Analyst
- Omar Saad; Evercore ISI; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:

Welcome to the Ulta Beauty first-quarter 2016 earnings results conference call.

(Operator Instructions)

As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Ms. Laurel Lefebvre. Thank you, you may begin.

Laurel Lefebvre (Investor Relations):

Thank you. Good afternoon. Thanks for joining us for Ulta Beauty's first-quarter 2016 conference call. Hosting our call are Mary Dillon, Chief Executive Officer; and Scott Settersten, Chief Financial Officer. Also joining us is Dave Kimbell, Chief Merchandising and Marketing Officer.

Before we begin, I'd like to remind you of the Company's Safe Harbor language. Statements contained in this conference call which are not historical facts may be deemed to constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

Actual future results may differ materially from those projected in such statements due to a number of risks and uncertainties, all of which are described in the Company's filings with the SEC.

During the Q&A session, we'll respectfully request that you please just ask one question, to allow us that time to respond to as many of you as possible during the hour scheduled for this call.

I'll now turn it over to Mary.

Mary Dillon (CEO):

Thank you, Laurel. Good afternoon, everyone.

2016 is off to a phenomenal start, with excellent top and bottom line growth in our first quarter. There are several factors coming together to drive the momentum in our business: healthy consumer demand in the beauty category; Ulta Beauty's unique and relevant format and positioning; and effective collaboration across the enterprise, which is driving strong execution of our growth strategies.

To recap the first-quarter results, we grew the top line 23.7%, and delivered 15.2% comps on top of an 11.4% comp in the first quarter of 2015. This is our best comp growth since 2006. Comp sales were driven primarily by traffic, while ticket also saw healthy increases.

Ongoing strength in cosmetics, both mass and prestige, is the largest contributor to our growth, but other major categories are delivering robust comps as well. E-commerce continues to see rapid sales growth. The salon's top line was solid, even while we reduced the frequency of our promotions.

So with overall revenue growth significantly better than planned, coupled with strong execution of our strategic imperatives, we delivered earnings per share growth of almost 40%, well above our expectations.

I'd like to call out some more specific details on the primary contributors to our performance during the quarter. Growth in our loyalty program continues to fuel our business results. ULTAmate Rewards membership grew to 19.4 million active members, up 25% year over year. This continued acceleration in sign-ups reflects our store associates efforts to convert new members, and strong traffic driven in part by our advertising campaigns.

The number of members shopping increased as well, as our average sales per ticket -- per visit. Loyalty member retention has increased steadily each quarter, and is up almost 200 basis points compared to last year. Using the loyalty program points as currency, our CRM team is working closely with our merchants and our brand partners to continue developing targeted and relevant campaigns that are increasingly resonating with our guests.

Our marketing mix continues to evolve, with great balance across television, radio, digital and social media, as well as our traditional print vehicles. In March, we ran television and radio ads for our signature 21 Days of Beauty event. We complemented this with an aggressive online video campaign, as well as extensions into online radio with Spotify and Pandora.

We elevated our social media and influencer efforts anchored on our spring trends. We surrounded our consumer with current and relevant content, online and in store, as well as activation at high profile events including the Coachella Music Festival.

Our comprehensive campaign for Mother's Day, which was called Pamper Her with Pretty was designed to build awareness of our brand, deepen our connection with our guest, and provide a platform to make Ulta Beauty a top of mind destination for gift giving, especially in fragrance. In addition to the return of the Mother's Day gift guide and fragrance finder, we offered more gifts with purchase and CRM promotions, in conjunction with many exciting new fragrance launches.

The Mother's Day activities also included a social media campaign, with the launch of the special video entitled Mom, the Original Beauty Icon, which invited guests to celebrate mom by sharing what makes their own moms beauty iconic through a post on Facebook , Twitter or Instagram. This campaign was viewed over 4.5 million times. We believe all these marketing efforts contributed to our strong traffic growth during the quarter.

Now to update you on merchandising, the trends from last year continue to drive the business, with Urban Decay, IT Cosmetics, Nyx, Anastasia, Too Faced, Tarte, Clinique, Lancome, Benefit and Ulta Beauty collection among the best-performing brands for the quarter. The pipeline of newness really continues to be quite compelling, translating into strong growth in both mass and prestige cosmetics.

During the quarter, we launched Honest Beauty in 250 stores, rolled out our exclusive Fiona Stiles line in 500 stores, and added Buxom cosmetics to all doors. Anastasia Beverly Hills and Perricone launched new product lines, Clarins was rolled out to additional doors. We introduced Tarte's Double Duty Beauty collection, which is exclusive to Ulta Beauty, and we rolled out Dior mascara to all stores.

More recently, we announced the addition of dpHUE hair care products, and we began to offer Nuxe, a French skin care brand on our website. We also rolled out an assortment of the iconic Drybar hair products and tools in hundreds of stores.

We're enhancing our Ulta Beauty collection through a series of initiatives. We've been updating and elevating the formulas and packaging, as well as in-store graphics, while improving speed to market and on trend product.

Trend categories include contouring, strobing, and multi-dimensional makeup, and we've also added an end cap featuring new spring kits. We've produced compelling training videos, and enhanced our sampling programs. While we've made great progress, we're just getting started with our efforts to evolve Ulta Beauty Collection to continue to represent our brand personality.

Turning to services. Our salon sales rose 14.7% and comped 7.7% with strength in blowouts, hair treatments, and makeup services. We view the services business as a growth opportunity, and we're very focused on our strategy to convert more of our loyalty members to discover our high quality services offering. Our Benefit Brow Bar business continued its strong performance, with brow services now in 738 stores, and we're proud to perform more brow services than anyone else in the US.

Moving on to stores. We opened 13 stores, and closed 1 in the first quarter, well on our way to executing our 2016 program of 100 net new stores. We ended the quarter with 886 stores. New store productivity remains very strong, with all vintages of stores benefiting from the successful execution of our strategic imperatives.

Our growth and development team is now in the process of performing a deep dive analysis to refresh our estimate of the store potential in the US. This analysis includes an updated assessment of the potential for smaller and urban markets, as well as how our small store format will fit into the future store mix. Sharing the outcome of this work is expected to be one of the topics we plan to cover at our next Analyst Day this fall, as well as other updates from our long-term strategic plan that we're now in the process of refreshing as well.

Moving on to Ulta.com. Our e-commerce growth was very strong, up 38.8% and contributing 130 basis points to our total Company comp. The mix of professional hair care and prestige cosmetics continues to grow, helping our e-commerce margin rate. We're also adding brands and products that are available only online, such as J Cat Beauty, StriVectin hair care, Eyeko and ManCave among others.

Our Ulta.com guests remain very interested our beauty bag sampling programs, and beauty break limited time promotions. Mobile is growing rapidly, now representing more than 60% of site traffic.

We released new versions of our iPhone and Android apps in the first quarter. The iPhone app was featured on the Apple Store homepage.

Moving up to a five star rating, this new version now includes features such as Apple Pay checkout, enhanced features displaying ULTAmate Rewards information, and gift with purchase details on product pages. Both app versions have been a big hit with users, garnering enthusiastic user reviews, and an increase in downloads, now reaching well over 2 million between the two.

Finally, our supply chain and IT teams have done a great job managing the ramp up of the Greenwood distribution center, while preparing to open our new distribution center in Dallas, which began success inbounding inventories just last week. The Greenwood DC is now serving about 200 stores, and fulfilling roughly 40% of our e-commerce orders. We're on track to end the year delivering to approximately 240 stores from Greenwood.

Our Dallas facility, a carbon copy of our Greenwood building, is right on track to begin outbound shipments in July as planned. We expect to ramp up this newest DC to serve 125 stores by holiday. As expected, the Greenwood distribution center and systems are producing efficiencies in costs per unit shipped.

On the system side, we have good progress to report here as well. SWIFT, our forecasting replenishment tool, has been rolled out to additional categories including skin care and hair care, and the rest of the categories will be implemented throughout the remainder of the year.

I am particularly proud of the supply chain team and IT teams performance and deep collaboration, as they are balancing execution of several major initiatives and projects, while doing an excellent job improving in-stocks in our stores to support the higher than expected sales trends.

So now I'll turn it over to Scott to discuss the drivers of our first quarter results, and outlook for the second quarter and the year.

Scott Settersten (CFO):

Thanks, Mary. Good afternoon, everyone.

Starting with the income statement. Similar to previous quarters, our top line was driven by a very healthy 15.2% comp and strong new store productivity. The total Company comp was composed of 11% transaction growth and 4.2% average ticket growth.

The retail comp of 14.3% was made up of 10.5% traffic and 3.8% ticket. The salon business comped 7.7% and salon growth was all ticket based. E-commerce growth was almost entirely driven by traffic with modest ticket growth.

Gross profit increased 150 basis points. The improvement was driven by strong leverage on store rent and occupancy expenses, as well as by healthy product margin expansion, offset by planned supply chain deleverage related to investments in new distribution centers and core merchandising systems.

Strong product margin performance was driven in part by significant margin improvement in mass departments, due to changes in our promotional offers, and a mix of higher margin brands, including the Ulta Beauty Collection. We continue to carefully pull back on broad discounting, while placing more reliance on loyalty and our CRM toolkit.

Moving on to SG&A expenses. We deleveraged by 20 basis points, primarily related to investments in headcount and consulting to support our growth initiatives.

Turning to the balance sheet and cash flow. Inventories were up 14.5% on a per store basis, slightly below the comp rate. This growth was driven by investments in inventory to keep up with better than expected top line growth, new brand additions, and the accelerated expansion of prestige boutiques. In-stock levels have improved year over year, but we still expect to make more progress going forward, as we begin to reap the benefits of our new distribution centers and related systems.

Capital expenditures were $54.3 million in the quarter, driven by new store openings, merchandise fixtures for the rollout of prestige brand boutiques, and supply chain and system investments. We ended the quarter with $369 million in cash and short-term investments. We repurchased 158,000 shares at a cost of $27 million under our 10b5-1 plan.

As you know, we entered into a $200 million ASR agreement in March, which settled just last week. During the first quarter, we received 80% of the shares we expected to receive on settlement or about 852,000 shares. A reduction in shares outstanding year over year contributed approximately $0.03 of earnings per share growth in the quarter. Including the entire $200 million paid as part of the ASR agreement, approximately $219 million remained available under the $425 million share repurchase program announced in March.

Turning now to guidance for the second quarter. We anticipate sales to be in the range of $1.041 billion to $1.058 billion, compared to $877 million last year. We expect comparable sales to increase in the range of 11% to 13%, versus 10.1% last year. Online sales growth is expected to be in the 40% range. We plan to open about 25 stores in Q2, compared to 20 stores during the same period last year, and pre-opening expense for the quarter is expected to be about $4.6 million.

Earnings per share are expected to be in the range of $1.32 to $1.37 versus $1.15 for Q2 of 2015. Our supply chain investments, including the new Dallas DC, are expected to weigh on margins the most in the second and third quarter, and we expect earnings per share growth to be higher in the fourth quarter this year. We anticipate a tax rate of 37.6%, and a fully diluted share count of approximately 63 million.

In terms of our outlook for the full year 2016, we are raising our guidance for comparable sales and earnings per share growth to reflect the strong start to the year. Total Company comps are now expected to be approximately 10% to12%, compared to our prior guidance of 8% to 10%. We now expect to grow earnings per share in the low 20s percentage range, versus our prior guidance of 18% to 20% growth. Operating margins are now expected to leverage slightly.

The other elements of our guidance for the year are unchanged. We are on track to open approximately 100 stores, all planned to be our 10,000 square foot prototype. We expect to open about 25 stores in Q2, 50 stores in Q3, and 15 stores in Q4. We are also planning 12 major remodels and two relocations.

We plan to grow e-commerce approximately 40%. We expect CapEx to be about $390 million, driven by slightly higher capital per new store, and the rollout of boutiques.

As a reminder, we've planned about $80 million for boutique expansion and updates, with over 500 Clinique, Lancome and Benefit boutiques, as well as updates to our fragrance fixtures, and the Ulta Beauty Collection. We anticipate that share repurchase activity under our $425 million authorization will contribute about 2 percentage points of earnings per share growth.

I'll now turn the call over to our conference call host for the Q&A session. Operator?

QUESTIONS & ANSWERS

Operator:

(Operator Instructions)

Chris Horvers with JPMorgan .

Chris Horvers (Analyst - JPMorgan):

A great ending to a tough earnings season. Was curious, we heard from lot of retailers talk about an uneven cadence during the quarter, some pull forward demand is earlier in quarter, some weather issues. Was curious, if you had a view, and how that impacted your business during the quarter?

Mary Dillon (CEO):

Thank you, Chris. Well, I guess, first of all, I'd say what we saw was pretty consistent across the quarter, in terms of comps, not a lot of variation. Where we did see variation, it was maybe cadence of promotions that we had planned. So I think at the end of the day, beauty as a category is a great place to be as you know, and it's a healthy category. And it's fairly, we think insulated from some of the factors that are affecting maybe retail at broadly. In particular, what we bring to the marketplace, in terms of the differentiated proposition of categories, various price points, products and services, we think makes us pretty insulated right now. And we're pretty proud of the results.

Chris Horvers (Analyst - JPMorgan):

Understood. And then, as a follow-up, can you just talk about the performance, the comp performance in your mature store base, and how that impacts your view on potential store penetration over the long-term? Thank you.

Scott Settersten (CFO):

Yes. Again, in our store model reflects mature stores five years and older, kind of moderating, comp down to middle, lower single-digit kind of comps over the long-term. With a 15% comp in total, as you can well imagine, Chris, I mean the existing store base, very healthy comps overall, very productive on the [SLB] contribution line, which is huge contributor to the profit increases that we saw year over year. As we look to the future, I mean, that's part of the mix here, with adding the boutiques. That's why we are being so aggressive with the CapEx this year, to get those installed.

We believe that, as long with all of the other great parts of the pipeline that we have coming aboard, loyalty on top of that, some of the marketing and advertising kind of initiatives we have under way -- we think all of those things together, will come together to drive really strong productivity in that exiting store base.

Chris Horvers (Analyst - JPMorgan):

Thanks very much.

Operator:

Joe Altobello with Raymond James.

Joe Altobello (Analyst - Raymond James & Associates, Inc.):

Thanks. Hi, guys. Good afternoon. Great quarter, congratulations. I guess, first question on the ULTAmate Rewards program, obviously hugely successful for you guys. You're now well north of 19 million. First, how high can that number get? I guess, you guys I'm sure have done demographic analysis in terms of the potential size of that. And secondly, if you can remind us what percentage of sales comes from your loyalty club members?

Mary Dillon (CEO):

Thank you, Joe. Well, first of all, I would say we've said it's well over 80%, over 80% of our sales are driven by the loyalty program members. We're really pleased with how that's working for our business. The -- it's really one of the key drivers of the results that we're seeing, is the acceleration in members entering the program, really proud about our store teams being able to convert new traffic and new members into the store and into the program.

How high is up? I mean, certainly we ask ourselves that question as well. As we think about our kind of long term view of the business, it's going to be obviously a very key driver for us as we move forward. And if you step way back, and look at it our share of the market in beauty in the US is still only 3% or so of the total market, right? So we know there's a lot of growth ahead, and we're very focused on understanding what it is about the loyalty program that drives the appeal, and continue to make sure that we fine-tune it going forward. So we think there's more growth there certainly, and I think our results are showing that.

Joe Altobello (Analyst - Raymond James & Associates, Inc.):

Okay, understood. And then, just moving on, I guess, one for Scott. The guide for Q2, you mentioned, looks like earnings per share down sequentially. That's seasonally fairly unusual. You mentioned some of the costs related to Dallas hitting you in 2Q and 3Q. You had the Greenwood facility around the same time last year, and yet you had sequential earnings improvement in 2Q. So I'm just curious, is Dallas bigger in terms of the impact, or is the timing a little bit moved forward relative to Greenwood? Thanks.

Scott Settersten (CFO):

No, I would say it's probably more along the lines of a couple new factors this year. So again, I think we've talked about the DCs, and the lapping effect there year over year, so not a huge change there within the sequence. We do have accelerated depreciation from this boutique acceleration that we talked about. So again, you guys can't really model that very accurately, but that's a little bit lumpy. And it's kind of first half of the year kind of weighted, I would say. And then, we also have some store payroll implications related to the same boutique strategy, right?

So I think we explained back in the fourth quarter, that it takes a while for those boutiques to ramp up, right? So they're being installed now, and we got some payroll investment there in the early days. Which again, over time moderates and plays very well, at least from a profitability standpoint. So it's really the payroll piece of that, and some of the depreciation that's related there, that's causing that.

Joe Altobello (Analyst - Raymond James & Associates, Inc.):

Got it. Helpful, thank you.

Operator:

Brian Tunick with the Royal Bank of Canada.

Brian Tunick (Analyst - RBC Capital Markets):

Thanks, good afternoon. I'll add my congrats as well. So excited to hear you guys are having an Analyst Day in the fall. Sounds like the footage and smaller stores you'll be updating us on, but I guess, I was curious about the mid teen operating margin that you have been talking about?

I guess, you look at these double-digit comps you've been running, I guess, the question is, can you get to a mid teen operating margin target faster? Or is there anything impairing you from getting to a high teens operating margin over the next couple of years? So curious on that.

And then from a market share perspective, when we all look at the department store numbers they've been putting up the last couple of quarters, can you maybe talk how that affects the brand conversations? So are there still major hold outs regarding brands that you'd like to be offering your guests, that might be still looking at the department stores as one of their key channels of distribution? Thanks very much.

Mary Dillon (CEO):

Okay. Thank you, Brian. On your first question, while I'm not going to provide the guidance today, nice try though, but it's really fair question. I'd say this, we're very confident -- first of all, we're thrilled with the progress of the business. I mean, I think that should be pretty clear, and confident that we understand the drivers, and we see plenty of growth ahead.

We're confident in the mid teen operating margin target that we've stated previously. I think what you'll see as we, we're looking to refresh our view, but feel good about where we are. I wouldn't expect to change our outlook materially. We believe we can continue to drive top line and invest in the business for the long-term, as well as drive efficiencies with the investments that we're making today. And while we're thrilled about the top line momentum, I think all of us would say, consumer expectations in the future will continue to evolve. And so, we need to be prepared to be able to respond in some areas, lead in some areas. So that makes us cautious about getting more aggressive about the operating margin target.

Dave Kimbell (Chief Merchandisng and Marketing Officer):

Great. And Brian, it's Dave Kimbell on your second question around adding new brands in this environment. I'd start with saying, that we're really focused on growing our business with our existing brands, and that's working very well for us. And we've got a great portfolio of brands across all categories, and that's been very successful, and will continue to drive success for us going forward.

Having said that, Mary mentioned some of the brands that we've added just in the last quarter. You've heard that we've added well over 100 over the last several years, so we're always looking at new brands. And as our growth continues, I think we're an attractive partner for brands. So we'll continue to be having discussions and exploring new opportunities. But right now, we're really focused on continuing to drive behind the success that we've been having.

Brian Tunick (Analyst - RBC Capital Markets):

Super. Thanks very much.

Operator:

Jason Gere with KeyBanc Capital Markets.

Jason Gere (Analyst - KeyBanc Capital Markets):

Thanks, and congratulations on a great quarter. I guess, I wanted to go back to talking about maybe the omnichannel customer. And I know you talked about e-com was up almost 40%, a lot of that was traffic-driven. So I was just wondering, as you're learning more with the loyalty card and CRM and the personalization, how are you getting that transaction size of that omnichannel customer to kind of increase? And any updated outlook, in terms of how big that customer could actually become as a part of your subscriber base? Thanks.

Mary Dillon (CEO):

Well, I'll start, and maybe, David if there's additional color you want to add. We're thrilled with the growth that we're seeing in e-commerce. Of course, it's still a pretty small percentage of our sales, just under 6%. So and what's interesting is that, as we look at that omnichannel shopper, I guess, multi-channel shopper, we love that guest because they're really our best guest in many ways. So the person whose shopping both in store and online is driving 2.5 times the sales, as somebody whose only shopping in the store. So what that says to us, is it's quite incremental. There's not a lot of replenishment type activity happening.

We talked about this, we focus on this beauty enthusiast whose really focused on trend and newness. And actually as when we get her e-mail address, the ability to give her e-mail, spark her imagination and curiosity about other products that maybe she didn't see in the store, seems to be driving. Whether it's that, or beauty breaks, or samples, they're really responding. So over time, we'd certainly see that expanding in terms of percentage of sales. It's a small percentage of our sales today, in terms of the multi-channel shopper. But it's a very healthy place for us to continue look at driving growth.

Dave Kimbell (Chief Merchandisng and Marketing Officer):

Yes, the only thing I'd add to that is what we see is the omnichannel guest, most of them pretty quickly, if they come in through e-commerce, pretty quickly move into retail. And that's what we would like to see. We want her experiencing the entire Ulta Beauty experience, both online and in store. We're investing heavily in various, both enablers of omnichannel around our inventory and our understanding of our guest, as well as guest-facing experiences. We've talked in the past, we've got beacons in our stores now that allow us to, will allow us over time to identify our guests. We've got I think same-day shipping with -- in partnership with Google . We've -- Mary mentioned some of the app improvements which will make it easier for her to buy any where, at any time she wants. So it's a big focus for us, and we see lots of upside going forward in that.

Jason Gere (Analyst - KeyBanc Capital Markets):

Okay. And then the other one. I was just going to squeeze in. So I know you talk about Greenwood and Dallas in terms of the DCs. Just given that, the last few years, you've made some key investments. And obviously, you guys have really been doing a terrific job in terms of top line and bottom line. How does it make you think about the older DCs? Like as you continue to really drive strong growth now, is now the time to maybe think about retrofitting some of the older DCs, that eventually you might have to do, just to obviously keep it best-in-class? So I'm just wondering if that's something that you guys internally talk about, or you're happy the way things are with the older DCs; and down the road maybe you'll just deal with it?

Mary Dillon (CEO):

No, I mean it's part of the whole supply network is part of our -- we've got a road map built, right, five years into the future, showing us different things we're going to address at different points in time. So yes, you're right on, Jason, we're thinking about the rest of the network in those buildings. We would like to have everyone on one platform, right, best-in-class platform at one point in time. So those decisions are a little bit yet out in front of us, but I would say, definitely that would be a focus of ours over the long-term.

Jason Gere (Analyst - KeyBanc Capital Markets):

Okay, great. Thanks, Scott. Thanks a lot guys.

Operator:

Ike Boruchow with Wells Fargo .

Ike Boruchow (Analyst - Wells Fargo Securities):

Hi, good afternoon, everyone, and congrats on a great quarter. Scott, just for you I guess. I'm sorry if I missed this, but on the gross margin, great, very impressive expansion this quarter. Can you just elaborate how much of that was merchandise, core merchandise margin versus fixed cost leverage? And then of the 4% pricing in the quarter, maybe just how do we think about that in terms of product mix and then just higher like-for-like pricing due to the pull back in couponing?

Scott Settersten (CFO):

Well, let me take a crack at that. So gross margin overall, we're not going to break down all of the basis points pluses and minuses here, puts and takes. But I could, just directionally talk, and I know sometimes people -- it may not be clear because this is a multi-variable equation that we're solving for here at Ulta, when we talk about promotions, right? So there's a couple of major buckets, I guess I would call them, merchants discounts, right? So what are we -- what are the offers in the mag -- magazines that we distribute, or the tabs that we put in the newspapers. Whether it's two-or-one, or is it buy one get one 50% off, is there a GWP with it, right? So that's one bucket.

Then there is the marketing discount bucket, right, which is the coupon, right, $3.50 off $10, 20% off one item, 20% off the entire order kind of thing, with the postcard offers that we've described in the past. And then, there's the loyalty, right, so would be the third leg of the stool. So again, we approached this very carefully, and we're testing and learning constantly. But if we look at the first quarter, for example, we talked about the mass area, right?

So mass has been generating really healthy comps for us. We've kind of learned over the course of the last year, that the merchandise discounts don't need to be as broad, maybe as what we've had done in the past. So this year we narrowed it down. Instead of two, you buy two, get one across the whole brand, maybe it's a narrower set of SKUs. So that would be one example of something that we executed very well in the first quarter.

And then there's just another -- a set of other, just what I'd call smart merchandising marketing decisions, continuing to tweak our coupon offers, and the circulation that we have on our marketing offers. Both the beauty collection, private label, super high margin part of our business was especially strong in the first quarter this year. E-commerce, we called out again, product mix there is being very helpful to us. So we've got a lot of good things happening in the merch margin bucket, I would say. And then you layer on top of that, a 15% comp, right, that helps a lot on the fixed store cost line. We called that out in our comments.

And then we had some offset, some deleverage on supply chain which was planned and which was expected. So that's kind of it, I guess, I'd say in a nutshell, on the explanation of the variation year over year. When we think about the comp breakout and the ticket bifurcation, units were pretty flat year over year. So most of it was on average selling price.

Ike Boruchow (Analyst - Wells Fargo Securities):

Got it. Thanks so much, Scott.

Scott Settersten (CFO):

You're welcome.

Operator:

Mark Altschwager with Robert W. Baird.

Mark Altschwager (Analyst - Robert W. Baird & Company, Inc.):

Good afternoon, and congratulations to the team. Scott, thanks for all of that detail on gross margin. I guess, I wanted to follow-up quickly on SG&A. Spending was up 25% in the quarter, which is presumably more than you initially planned when you built your plan for the quarter and for the year. So I guess, can you break out just how much of that was pull forward, and some of the accelerated depreciation you referred to, that would potentially allow greater leverage later in the year? And then, to the extent you've had more dollars to spend, given the top line growth, what are the areas where you've chosen to really intensify investment?

Scott Settersten (CFO):

Yes. So we're really trying to stay focused, and not break it out in too much detail, kind of the variations; and I know you guys would love to have that. But again, directionally the store payroll, there's some investment there, as we ramp up the boutiques. There was accelerated depreciation in the first quarter. It's going to be heavy again in the second quarter as we look -- compare against last year. I would say, that there is some cost of doing business things that are in there. You guys read all these stories about credit card fraud, and the whole EMV thing that all of retail is kind of struggling with. So we aren't immune to that, right.

We had some of that in the first quarter. Now lucky for us, our EMV rollout is complete now. So that, we've mitigated that risk as we look out across the rest of the year. I would also say that we're, like we've done in the past, we've looked to optimize the business, right? So there's some additional investments, I guess, I would call in the short-term around some test and learn things, around levers, future levers to drive growth that we think we can move up here, and accelerate a little bit into 2016. Again those aren't huge things, but there's a little bit here and a little bit there. So again, we're doing it in a very disciplined manner, making sure we have the right balance for both short-term and long term financial results of the business.

Mark Altschwager (Analyst - Robert W. Baird & Company, Inc.):

That's great. Thank you.

Operator:

Simeon Gutman with Morgan Stanley .

Simeon Gutman (Analyst - Morgan Stanley):

Hi, good afternoon. Nice results. Mary, you mentioned, I think 3% you said market share. I don't know if that was including or excluding services, but my question is, do you have a sense of the share of the beauty spend among your best customers, what percent of their wallet are you getting? And then, based on what you carry -- I know this is a moving target because that will change over time -- but based on what you carry how much of that wallet is attainable?

Mary Dillon (CEO):

Well, the 3% number that I mentioned is, if you take all of beauty product and services in the US, and that -- a very macro view of it which kind of where we start. And then if you look at really just the dollars that are spent even among the target that we focus on, the beauty enthusiast and the beauty enthusiast on a budget, certainly is higher. We have 5% of their share of wallet. Of the people that are in a loyalty program, well, clearly it's higher than that. But I'll tell you what, there's a lot of upside to that as well. We believe even when we look at our best guest, if you step back, there are -- I don't know -- I'm going to make, 50,000 places you can buy beauty in the US, right?

So between grocery, mass, drug, department store, specialty retailers, online there's a lot of places you could buy beauty. So there's a lot of sources of volume and share gain. The whole idea for us, and our guests seem to be resonating with this, is the more she spends with the loyalty program, right, the more benefit she gets by consolidating her spend at Ulta. So we have not tapped that out, either in terms of the number of the relevant, the addressable market in terms of folks that could be in our loyalty program. As well as, we'll never have a 100% of anybody's wallet I think -- that's kind of in any category, think about grocery for example, people buy food probably in two or three or four different types of retail outlets. It's probably going to be always a little bit like that with beauty. But we feel good about where it is, and there's still a lot of potential for that growth.

Simeon Gutman (Analyst - Morgan Stanley):

Okay, thank you.

Operator:

Daniel Hofkin with William Blair.

Daniel Hofkin (Analyst - William Blair & Company):

Good afternoon. Congrats as well. Two quick questions, one on the comp, further uptick, anything you could point to either in terms of brand, marketing, et cetera that led to the further acceleration in the first quarter? Second question, is just on the labor cost outlook? Was some of it -- what's going on in the retail broadly, and some of the recent legislation, or Department of Labor rulings -- any impact on you guys in the next couple of years? Thanks.

Mary Dillon (CEO):

Thank you, Dan. In terms of the drivers, honestly, it's really a combination of a lot of factors. It really, I guess, that you could point most directly to the acceleration in the growth in the member file. So the 25% increase in the members in the ULTAmate reward program, that clearly, we can point to as a major driver. So more guests in the program, and guests spending more often, reactivation of guests, better retention. Now that doesn't happen on accident, right? So it's really a combination of I would say, everything we're doing. I mentioned at the top, I mean, it's great to be in a category that's growing in beauty. We believe what we have is a very compelling proposition, relative to a large segment of the market, right?

So what we offer them is relevant. And as we look out into the future, of that future consumer and millennials, I think even more so relevant. But then in addition, right, we have to be driving awareness and traffic, so I feel great about what I would call our demand creation tools. So wouldn't have an increase in the members, if we didn't have new people aware of and coming to Ulta, and the traffic shows that. Then in addition, of course, it's about what we sell in the store, and the service that we give, and the services and the guest experience. So I talked a lot about the merchandise assortment. So I feel good about we're really doing business smartly with our brand partners. So I guess, in total, it's a lot of things coming together effectively for us to drive members into loyalty program, and have a relative proposition to drive their growth.

On the second part, you asked about was on, yes, there's a lot obviously happening, and as it relates to wages and whatnot. In particular, the overtime pay, a thing that just passed, we are -- we've already factored that into our forecast. There's some impact to us this year. It's pretty, it's immaterial I would say. Most of our managers are typically paid above the threshold, and our co-managers are affected. And as we look out into future years, we'll continue to obviously be cognizant of factoring wage and other pay factors.

Daniel Hofkin (Analyst - William Blair & Company):

Thanks very much.

Operator:

Adrienne Yih with Wolfe Research.

Adrienne Yih (Analyst - Wolfe Research):

Thank you. Good afternoon. Let me add my congratulations as well. Two quick, very quick questions. Mary, what is the overall forecast that you're using for beauty and services segment growth? And then secondarily, as you build or as do your brand awareness studies, where are you finding, which demographic do you have the highest brand awareness with? Thanks very much.

Mary Dillon (CEO):

I would say that, we would just look at the current growth factors for the industry that you guys can see as well, which is the industry is up, what 4% -- which is great. And obviously, prestige up more than mass, color cosmetics up a lot. So we look at the published forecast or the published data that's out there, as well as just do our own kind of work, that's both qualitative and quantitative, thinking about future sources of growth. So we don't have a great -- we don't have any other crystal ball than anybody else. But we, we're I think pretty darn good at understanding consumer segments, understanding and projecting where their demand might go in the future, and use that to try to figure out what we think the category growth will be. The second question was?

Dave Kimbell (Chief Merchandisng and Marketing Officer):

Awareness.

Mary Dillon (CEO):

Yes, let me give that one to Dave. Thank you.

Dave Kimbell (Chief Merchandisng and Marketing Officer):

Yes. So on brand awareness, overall, we see -- we don't see huge swings by any demographic group. It's really pretty broad-based and we're seeing growth across all demographic, all age ranges, ethnicities. But I would say Hispanic women do have a bit higher, in general across-the-board, and that's the strength we're continuing to grow with.

Adrienne Yih (Analyst - Wolfe Research):

Okay, great. Any quantification of that?

Dave Kimbell (Chief Merchandisng and Marketing Officer):

No. I guess, we won't share any of that detail. But yes, we're going to give you our total awareness, and we've shared that in the past. So our total awareness increased 5 points in Q1 versus Q1 of last year to

84% on a native basis, and was up 2 points on a non-native basis to 40%. So continued strong growth of that, behind the marketing efforts, and we expect to continue to drive that going forward.

Adrienne Yih (Analyst - Wolfe Research):

Okay, great, thanks everyone. Best of luck, thank you.

Dave Kimbell (Chief Merchandisng and Marketing Officer):

Thank you.

Operator:

Our next call question comes from Simeon Siegel with Nomura Securities.

Simeon Siegel (Analyst - Nomura Securites):

Thanks. Hi, guys and congrats. Did you say, or how many prestige brand boutiques do you currently have? I think, Scott, did you say you expect to open 500 this year? And then, can you share any color on the comp lift and maturity curve you tend to see in those stores when added? Thanks.

Dave Kimbell (Chief Merchandisng and Marketing Officer):

We, I think we shared this last time; so we started the year, with we talked about in the couple hundred range of Clinique and Lancome. And this year, yes, 500 -- in the approximately 500 new boutiques across Clinique, Lancome and Benefit, those three brands. We will see growth over the year.

We're just getting those new ones opened. So while it had some impact on Q1, it wasn't -- was not the big driver of Q1. And frankly, it will be a contributor, but there's a lot of other parts of our business that are driving growth, a lot of the brands in prestige space, with mass, and hair care, skincare. So it will continue to drive growth, but we're not counting on that being the primary driver of growth throughout the rest of the year.

Simeon Siegel (Analyst - Nomura Securites):

Great, thanks. And then did you say with the Ulta Beauty Collection penetration was at this point? I mean, do you see that business grow in mix, as the overall brand awareness grows, do you actively look to grow that penetration? Any thoughts there?

Dave Kimbell (Chief Merchandisng and Marketing Officer):

Yes, Mary, gave a few of the highlights of some of the things that we're doing to build that. And frankly, I think we are on -- at the beginning of a really reinvention of that business, and we're seeing the impact of that already; strong growth. Scott talked about high margins, so all the reasons we'd want to grow that.

When we look at the exclusive Ulta Beauty Collection and exclusive brands combined, like including brands, like gift brushes for Ulta, it's about 6% of our business, and we'll see that growing over time. We've got new innovation. We'll continue to drive that business behind, and we'll as you mentioned, as our brand grows, as our recognition grows, and then we improve its presentation and quality of the product, and just overall merchandising strategy, marketing strategy, we'll see that grow as well.

Simeon Siegel (Analyst - Nomura Securites):

Great, thanks. Best of luck for the rest of the year.

Mary Dillon (CEO):

Thanks.

Operator:

Matthew Fassler with Goldman Sachs .

Matthew Fassler (Analyst - Goldman Sachs):

Good afternoon. A couple of follow-ups. In terms of demographics, you spoke a bit about Hispanic customers, you talked to millennials. If you think about the market share opportunity you have, and where you're getting incremental traction, it would be interesting to talk a bit more about age, and also new versus exiting markets? What cohorts you feel you're uncovering, and kind of awakening to the vitality of the concept at this point, as the marketing has exploded here.

Mary Dillon (CEO):

Let me just say, I think more of this we'll talk about in the fall, as we do the Analyst Day. Because it's, kind of as we think about the future, that's obviously we're sort of in the insights and mulling machine, about kind of where the world is going, and how to think about those dynamics for Ulta. I'll let Dave add some color.

But I will tell you, I think we all feel personally very optimistic about that, that as we think about the way of the world, it is with the world today, sort of the influences are really converging nicely, as it relates to beauty as a category, as well as shopping and the way that we offer. To be able to come in with a point of view, and see, already have a curated idea in mind, but to get some help as well. So maybe you could add a little more to that. But more on this topic, I'd say is the best way to think about it.

Dave Kimbell (Chief Merchandisng and Marketing Officer):

Yes, the only thing I'd say is our growth, we're excited to see in our growth, as I mentioned earlier, it isn't concentrated on any specific age range or demographic profile. It's really this beauty enthusiast, and she's all ages. She looks all across the country. So we're seeing strength with teenagers. There's been reports out that from other third-parties about Ulta continuing to gain strength and presence with teenagers, certainly millennials. But through all the way through ages, and of course, a great part of beauty is, it's not age dependent. Needs might change, but the desire to be part of a beauty category continues. So we're seeing that across-the-board right now.

Matthew Fassler (Analyst - Goldman Sachs):

Thank you for that. My second follow-up. So it sounds like the boutiques while they are rolling in, are only about, or only starting to really impact the business. If you think about your historical experience, and the kind of pop that, that can give the business, relative to the double-digit same-store sales you've been posting without that catalyst, is the input or the additional volume from those boutiques material in that context? Or is it something that should just be absorbed, by the strong growth that you've got these days?

Scott Settersten (CFO):

Yes, I think in the short-term, it's absorbed. So again, back to Dave's earlier point here. It's going to be additive. It takes awhile for those boutiques to ramp up, much similar to our store maturation curve overall. We've seen that demonstrated over a long period of time. So again, over the longer term, yes. We think that it's a significant add to the box overall, and will help productivity significantly over the long-term.

Matthew Fassler (Analyst - Goldman Sachs):

Great. Thank you so much guys.

Operator:

Oliver Chen with Cowen and Company.

Courtney Wilson (Analyst - Cowen and Company):

Hi, this is Courtney Wilson in for Oliver tonight. Thanks for taking our question and congrats on the impressive results. We just had a question, in terms of the consumer dynamics of the mass consumer versus the prestige consumer. Which segment is experiencing higher rates of new customer acquisition, and is there an increasing amount of cross-shopping between the two customer segments? Thanks very much.

Mary Dillon (CEO):

Thank you, Courtney. Yes, you know what the great thing is, there's not really separate mass versus prestige consumer at our store, which is kind of cool. Our guests, there's bit of a tendency to come in -- I think we've talked about this, right, on maybe more of the mass side and prestige and migrate over time. Typically, our guest has a mixture though. There's really very few people, I think that are just completely one versus another type category. And that's part of the beauty of what we offer, that makes it super relevant for our guest. And I think as well for our brand partners.

Courtney Wilson (Analyst - Cowen and Company):

Great, thank you. Best of luck.

Mary Dillon (CEO):

Thank you.

Operator:

Rupesh Parikh with Oppenheimer.

Rupesh Parikh (Analyst - Oppenheimer & Co.):

Congrats on a great quarter. So I have two quick questions. First, are you guys seeing any significant differences between the performance or traffic at your mall locations versus non-mall locations? And then, second on new products. Clearly, from your Q1 remarks, it sounds like there's a significant amount of newness and innovation in Q1. As we look out for the balance of the year, what can we expect in terms of brand product additions?

Mary Dillon (CEO):

Okay. So we'll tag team this again, Dave? I'll start on the mall piece, malls are about what, 10% or so of our store base, and we're not really, we're not seeing much of the difference. We're seeing positive traffic. I would say, when we're in malls, we pick those spots pretty carefully, both in terms of the market, it being a great place to shop in a given market, as well as our locations tend be on the exterior of the malls. So we feel good about how they're performing.

Dave Kimbell (Chief Merchandisng and Marketing Officer):

Yes, and on new brands, nothing else to report specifically here. But I will say as has been our trend of late, we'll continue to add new brands. But I'd say, well, that is a big contributor. We're also -- I mentioned this earlier, we're really focused on driving growth with our existing brands. We had a lot of new products coming in, and growth with existing products within our portfolio, across many of the brands that Mary mentioned in her remarks. And so, it will be a mix, continue to drive with the strength of our big brands like Urban Decay and Redken, and Bare, and Too Faced and Nyx, but then we'll certainly complement it, with that with new brands throughout the year.

Rupesh Parikh (Analyst - Oppenheimer & Co.):

Thank you, and congrats again.

Mary Dillon (CEO):

Thank you.

Operator:

Steph Wissink with Piper Jaffrey.

Steph Wissink (Analyst - Piper Jaffray & Co.):

Thanks, I'll add my congratulations. I just have one question on the brand boutiques. I'm wondering if you can give us a little bit more information on the return on invested capital, or some of the productivity goals that you have within that floor space? And just given the $80 million investment that you talked about so far, can you talk to us about what the brands are committing to, whether it's capital, exclusive product, or marketing? Thank you.

Scott Settersten (CFO):

Yes, let me start there. So as far as the $80 million is concerned, I mean that's all on Ulta, right. So we're stepping up with the CapEx investment. And again, that $80 million, partly it's not just a boutique drop-in, right. So again, there's 500, roughly 500 individual boutique drop-ins across the chain. But we're going to take the opportunity, when we're in those stores, to also refresh our fragrance fixtures in those stores, and Ulta Beauty Collection fixturing as well. As well as other miscellaneous things, like you're in a store, touching it up and causing some chaos, you're going to take the opportunity to do what you think is best for the guest long-term. So that's how we're deploying the $80 million.

Again, each vendor, we have a different set of economic terms with them. So I think by and large, it's kind of a payroll share kind of model, right? So again, they're trained, they're our associates, they're on our payroll. The vendors provide, our vendor partners provide excellent training for them. We kind of share the payroll model on a go-forward basis, and it takes awhile. Again, we install the boutiques up front, and it takes awhile for those to reach maturity, right? So again, as we go over time, we add more payroll resources there to make them more productive. So I think that's it in a nutshell.

Steph Wissink (Analyst - Piper Jaffray & Co.):

Thank you.

Operator:

Mike Baker with Deutsche Bank.

Michael Baker (Analyst - Deutsche Bank):

Thank you. So I just wanted to ask about the loyalty card increased membership? Is a lot of that, or is there any way to break out how much is coming from people who already were shopping in your store, but weren't loyalty cards, and now you're sort of upgrading them to loyalty members? Or versus what percent is coming from customers who were new to the brand, and they're coming in, and then they're signing up?

Dave Kimbell (Chief Merchandisng and Marketing Officer):

Well, we've shared, I think a couple of quarters ago, that we've seen an increase in -- I guess what we'd call reactivation, which were lapsed customers. And so, we've seen a healthy increase with that, but I won't get into sharing that every quarter, but that is part of it. So customers that might have shopped with us two years ago would not be considered a current customer. But we have a record of them, they come back in, they reactivate their account, and then they would move into our active, move back into our active member profile. So that's a chunk of it.

But the biggest part of it is new to Ulta customers. And that is exactly as you described -- customers coming in, and shopping at Ulta, and starting that experience not a customer, and when they get up and interact with one of our associates, become a customer during their visit there. And a key part of our success has been our store associates really doing an excellent job, converting non-members into members in the store. And we've seen a strong increase in that, so that is the primary driver of our new member growth.

Michael Baker (Analyst - Deutsche Bank):

Okay, great. That's helpful. While I have you, one more, maybe more mundane question. But we've heard from a couple other retailers, that the real estate opportunities are very strong out there, very much a buyer's market. Can you talk about what you're seeing in some of your new stores, in terms of rents and those types of metrics?

Scott Settersten (CFO):

I guess, we could echo those comments that you've heard from others. We have -- there's no shortage of great real estate sites that we're seeing, as we look at proposals across the country. Again our stores, we have a typical, I guess, best-in-class kind of set of co-tenants that we would like to operate with. But we have proven and demonstrated over time, Ulta stores work on a wide variety of real estate locations and types.

So feel very confident about our current pace of 100 stores a year, right, that we've talked about here, as our medium term target. We just came back, I guess, from ICSC here in the last day or so. And again, we've -- the landlords, the relationships that we have are very strong. We know Ulta is being sought out as a tenant of choice. We're proven traffic drivers to centers in the beauty category is something that many landlords, that's a piece of that offering, retail offering that they'd love to add to the mix overall.

Michael Baker (Analyst - Deutsche Bank):

So I guess the punch line there, is that materially changing your new store economic model? And is that something that you would address at your Analyst Day in the fall?

Scott Settersten (CFO):

Yes, I mean, I don't -- we haven't, we're always very competitive, when we get into the rent structures and the economic terms of our deals. I mean, I think Ulta probably best-in-class, when you look at our operating model overall. So it's not like we're seeing some big step decreases in rent terms or anything like that, at least not at this stage. Now a lot of these liquidation events are kind of in process, I guess, I would say right now. So I guess, that's yet to be seen. And we don't -- it's not causing us to rethink the number of stores that we open every year, right? A 100 a year, again there's no magic around that, but that's been a comfortable pace for us, with the number of new associates we need to add to the mix overall, and that time of year that those stores usually get opened. All-in, when we think about that, a 100 is a kind of a good pace.

Michael Baker (Analyst - Deutsche Bank):

Okay, thank you. Thanks for all of the color.

Operator:

Our final question comes from Omar Saad with Evercore ISI.

Omar Saad (Analyst - Evercore ISI):

Thanks for taking my question. Was wondering if you could elaborate a little bit on the comment you made earlier around urban stores, and doing some more thought process around that? If you have anything in fleet now that resembles an urban location, and how it does, and how those locations may do in more densely populated urban type areas? Seems like it could be a great fit. Obviously, the real estate costs are a bit different, but would love to hear more about it?

Scott Settersten (CFO):

Yes, no problem, Omar. I guess, what I would say, is that yes, we have several urban, I guess, you'd call them stores in the fleet, and they do fine. As we're thinking about the future, I wouldn't say we've ever had a concerted urban strategy, right? So we don't have a lot of them. Our main strategy has been really in suburbs and in power centers, and lifestyle centers. We've talked about, we feel good about this 10,000 square foot store format, and the ability to hit at least 1,200, at least of that format. But when I reference that, we're also looking at what's the opportunity in smaller markets? And then also, what's the opportunity in places where the parcels of real estate would by definition be smaller.

So whether it's urban centers or the downtown, maybe shopping area of high end suburbs, right? So we've got [two] with 2,500 -- two 5,000 square foot stores right now, that we're operating to learn about the dynamics of the different size box, and they're doing well. They're also learning a lot about the best way to operate that. And as we look at refreshing our view of store growth, urban is a question we're asking ourselves, and we'll look at. As you said obviously, the economics are different, but as we drive brand awareness across the country with our marketing efforts, we know that -- where will we go now. People know more about us than I think they would have in the past, right. So that's a good way or place to start. So more to come on that.

Omar Saad (Analyst - Evercore ISI):

Thanks, that's helpful. And then, can I ask one follow-up on the loyalty? Have you thought about ever partnering with a financial services firm, and maybe adding a private label credit element to that? Or are you happy as a standalone loyalty program?

Mary Dillon (CEO):

Well, we're very happy with the loyalty program today, it's really a key asset for us. And it's a fair question, I mean, that's something that could be a good asset in the long run, right? Nothing to announce on that certainly, but it's certainly has a history in retail that's been successful for many retailers, no doubt.

Omar Saad (Analyst - Evercore ISI):

Thanks so much, great job.

Mary Dillon (CEO):

Okay, thank you.

Operator:

I'd now like to turn the call back over to management for closing remarks.

Mary Dillon (CEO):

Thank you. I'd just like to close by thanking our 26,000 associates for an incredible start to the year, and I look forward to speaking with all of you again soon. Thank you.

Operator:

This concludes today's teleconference.