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SCSS - Q2 2017 Select Comfort Corp Earnings Call

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OVERVIEW:

Co. reported 2Q17 net sales of $285m and loss per diluted share of $0.02. Expects 2017 EPS to be $1.25-1.50.

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PRESENTATION

Operator

Welcome to Select Comfort's Q2 2017 Earnings Conference Call. (Operator Instructions) Today's call is being recorded. (Operator Instructions)

I would like to introduce Dave Schwantes, Vice President of Finance and Investor Relations.

Thank you. You may begin.

David W. Schwantes - *Select Comfort Corporation - Senior Director of FP&A and IR*

Good afternoon, and welcome to the Select Comfort Corporation's Second Quarter 2017 Earnings Conference Call. Thank you for joining us.

I am Dave Schwantes, Vice President of Finance and Investor Relations. With me today are Shelly Ibach, our President and CEO; and David Callen, our Senior Vice President and CFO.

This telephone conference is being recorded and will be available on our website at sleepnumber.com. Please refer to the details in our news release to access the replay. Please also refer to our news release for a reconciliation of certain non-GAAP financial measures and supplemental financial information included in the news release or that may be discussed on this call.

The primary purpose of this call is to discuss the results of the fiscal period just ended. However, our commentary and responses to your questions may include certain forward-looking statements. These forward-looking statements are subject to a number of risks and uncertainties outlined in our earnings news release and discussed in some detail in our annual report on Form 10-K and other periodic filings with the SEC. The company's actual future results may vary materially.

I will now turn the call over to Shelly for her comments.

Shelly R. Ibach - *Select Comfort Corporation - CEO, President & Executive Director*

Good afternoon, and thank you for joining our call today. My SleepIQ score last night was 86.

We are very pleased with consumers' continued demand for our brand and products. Our growth initiatives are producing steady traffic and sales performance. Demand in the second quarter was ahead of our internal expectations and traffic was again consistent throughout the quarter, as it has been all year. We are reaffirming our full year guidance.

While demand has remained strong, our second quarter results reflect a delay in deliveries and shipments with the corresponding shift of sales into the third quarter. Net sales of $285 million were up 3% over the prior year with a $0.02 loss per share. These results include $25 million of delayed shipments that will be delivered in the third quarter. For context, this represents 1 week of customer deliveries that moved from the second to the third quarter due to a shortage of inventory. The reason for this is that production at one of our new suppliers fell short of our demand needs as they scaled and worked through new specifications. We now have the necessary inventory levels to fulfill the outstanding second quarter deliveries. Our suppliers' weekly production is also now exceeding our forecasted sales needs for the third quarter and beyond. The issue is resolved and we don't expect a shortage in the future.

Taking a wider view, this supplier change was an important one for us to make to achieve our innovation plans and financial goals. So although it resulted in some challenges in the quarter, it will have no impact on our ability to deliver our plans for the year.

We have taken numerous actions to reduce the impact on our customers. Our gross margins in the quarter include these costs, yet are still slightly ahead of our expectations due to our ongoing margin expansion initiatives. I will now provide an update on the 4 growth catalysts for our brand. Our execution of these initiatives again resulted in increased traffic, conversion and product mix results.

First, we are excited about bringing the revolutionary Sleep Number 360 bed to our customers. As planned, all stores were set with the i7 and i10 smart beds by the end of May. We kicked off our new marketing campaign called "The Future of Sleep", which features the 360 smart bed in the second week of June. Demand for our 360 smart bed is ahead of our expectations in both units and ARU. Customers and our sleep professionals have both responded strongly to the smart bed's benefits and features, particularly the effortless adjustability, SleepIQ connectivity and foot warming. Our design and pricing strategy contemplated increased attach rates of FlexFit smart adjustable bases and SleepIQ technology, and this is what we are experiencing. Deliveries of the 360 smart bed began in June and the product has received strong reviews. One of our customers in Portland said it best, "I believe it is the best sleep system on the planet." We will continue our phased implementation of additional smart beds over the next 3 quarters. We're confident in our actions to drive demand and achieve our goals for the year.

Our second driver of demand is our loyal customers who are responding to our newest innovation with enthusiasm. Both referrals and repeat sales reached record levels in the quarter. Our centralized database marketing and digital loyalty initiatives are contributing to more effective personalized communications. This is leading to increased sales and higher efficiency from both existing and new customers.

Third, we again delivered increased media efficiency and effectiveness in the second quarter, with year-over-year media leverage of 30 basis points. We held our spending essentially flat to the prior year based on two factors: the efficiency improvements our media buying strategy has garnered this year and the fact that the second quarter is the seasonally lowest sales quarter. We continue to expect 50 basis points of media leverage for the full year.

From a traffic perspective, qualified unique visitors to our website were on plan. We drove higher-quality store traffic with record high conversion rates. We continue to optimize digital actions in real time as we pursue a media mix that connects the customers' digital experience through to the store purchase.

Our final driver of increasing demand is the extraordinary retail experience associated with our direct-to-consumer and exclusive distribution model. Our strategy is driving both positive comps and new store growth over the long term. In the second quarter, new stores contributed 8 points of growth, offset by a negative 4% comp.

We advanced our margin expansion initiatives in the quarter and delivered a gross margin rate of 62% compared with 61.9% in prior year. These initiatives include supplier transitions, lean process improvements and manufacturing cost reductions. We also executed 2 hub relocations and piloted fully assembled beds in our Irmo, South Carolina facility. We will expand this pilot to our Salt Lake City facility in Q3. With these changes, we will deliver nearly 10% of our volume fully assembled this year, which is consistent with our expectations. These advancements are part of a multi-year network reconfiguration that ultimately delivers a more effective and efficient final-mile brand experience.

We continue to expect a record year of operating cash flows in 2017. Year-to-date, we have generated $89 million in cash from operations compared with $47 million the prior year. We reinvested $27 million in capital projects and repurchased $75 million of shares in the first half compared with $70 million in the prior year. Our trailing 12-month ROIC at the end of the first half was 13.6%, well in excess of our weighted average cost of capital. Our 3 cash priorities remain investing in our growth, financial flexibility and share repurchases.

In summary, we expect to deliver accelerated earnings growth, cash generation and returns to shareholders in 2017. The investments we have made in differentiated products, digital, stores, technology and infrastructure are helping us achieve our long-term business goals, and we expect our productivity improvements will drive a mid-teen operating profit flow through rate long term.

This is an important week for us as we host our national retail conference here in Minneapolis. We are all excited about the opportunities we have to take market share with the Sleep Number 360 smart bed. The smart effortless sleep that is enabled by SleepIQ technology is a clear differentiator, and we intend to capitalize on this momentum.

With Sleep Number's leadership of sleep technology, this is an important time to place all of our assets against our powerful Sleep Number brand. To that end, we will change our corporate name to Sleep Number Corporation later this year when we relocate our headquarters to downtown Minneapolis.

I want to offer a heartfelt thank you to our team members for their ongoing dedication to our mission of improving customers' lives by individualizing sleep experiences and their unwavering passion for innovation.

Now David will provide more details about our second quarter performance and our outlook for the remainder of the year.

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

Thank you, Shelly. We continue to advance important profit accelerators across the business to enable delivery of our 2019 EPS target of $2.75. As Shelly detailed, we've continued to improve the effectiveness of our data-driven marketing tools and are seeing strong consumer demand for our revolutionary sleep innovations. We expect to complete the phased rollout of our 360 smart beds over the next three quarters.

In the first phase, we introduced two of our upper-end 360 smart bed models, which make up about 10% of our unit volume. As planned, beginning in our seasonally slowest quarter, gave us room to work through learnings without impacting our performance expectations for 2017. The inventory shortage we had from one of our new suppliers is now resolved. While early customers and team members have embraced our 360 innovations enthusiastically. In addition to our demand drivers, another important evolution underway is of our supply chain. Back in November, at our investor conference, we talked about several facets we'd be addressing to accelerate profits, including design to value and design for manufacturability through our 360 smart bed, evolution of our outbound logistics network and global sourcing for innovation and profitability.

Our operating teams have delivered meaningful efficiencies while successfully piloting in-hub mattress assembly at a new company-operated location. They've also relocated two partner hubs and transitioned more than 20 suppliers. All but one of these vendors ramped production seamlessly. That supplier had productivity challenges that led to temporary inventory shortages for us in Q2. This shifted a week's deliveries worth about $25 million in revenues and $0.12 of EPS from Q2 to Q3. Today, those inventory shortages are resolved and the supplier is consistently producing at volumes that exceed our demand plans the balance of the year.

We are confident in the supply chain advancements we're making and in the partnerships for innovation and profit expansion with our suppliers. They are essential to advance our business and to delivering our full year and long-term guidance.

Second quarter net sales of $285 million increased 3% over the prior year. While our Q2 sales metrics were impacted by the shift noted earlier, we expect to fully realize these sales in Q3. Our ARU and deliveries of company-controlled units each grew 2% year-over-year in Q2. Our net new stores contributed 8% of year-over-year growth. We had 549 stores at the end of Q2, up 8% versus the second quarter of the prior year. Our reported comp store sales declined 4%, including 2 percentage points of lift from online and phone sales, which grew 26% over the prior year.

Our trailing 12-month average comp store sales were $2.3 million flat to the prior year. This metric continues to be a longer-term opportunity for us to grow average sales per store toward our $3 million target while delivering 30% to 40% incremental four-wall profits on the incremental sales.

Our gross margin of 62% in the second quarter improved 10 basis points versus the prior year on operating efficiencies and favorable returns experienced that more than offset margin pressures from supply chain, shipping inefficiencies and closeout sales.

Our business initiatives remain on track, as seen with our Q2 gross margin improvement. For the full year, we continue to expect to improve our gross margin by 30 to 50 basis points on top of the 80 basis point increase in 2016.

Our transition costs in Q2 totaled $4 million or $0.06 per diluted share as expected. Two thirds of these costs landed in COGS and one third fell in operating expenses, primarily in sales and marketing expenses.

We expect transition costs of $3 million to $4 million per quarter in the back half of 2017, as previously communicated. Overall, our operating expenses as reported were in line with our expectations, but delevered 210 basis points in the second quarter with a shift of revenues from Q2 to Q3. For modeling purposes, G&A expenses will be about $34 million per quarter in Q3 and 4.

Our $0.02 loss per diluted share includes $0.03 from favorable tax benefits from the realization of tax credits and the new stock-based compensation accounting rules. As noted earlier, our Q2 results were adversely affected by about $0.12 on a $25 million shift in deliveries that we expect to fully realize in Q3.

Year-to-date, net sales of $679 million are up 8%. Our gross margin improved 190 basis points, reflecting the benefits of our ERP-enabled efficiencies and our lean initiatives. Our net operating profit rate improved 130 basis points in the first half on a 22% incremental profit flow-through rate and our diluted earnings per share of $0.55 are up 83% versus the prior year first half.

Our $70 million of inventories at quarter-end were about $5 million to $8 million lighter than planned but have recovered to service demand. You'll also note a $21 million year-over-year increase in our customer prepayments due primarily to the expected shift of deliveries into Q3 and timing changes of orders. Overall, our balance sheet is healthy and our working capital management initiatives are delivering results.

We generated a record $89 million in cash from operations year-to-date, up 89% versus the first half of the prior year. $27 million has been used to support high-value capital projects and we've repurchased $75 million of our common stock year-to-date.

Our 13.6% trailing 12-month ROIC through June was up 560 basis points from this time last year. The strength of demand we've seen and continued progress against our initiatives gives us confidence to reaffirm our 2017 EPS guidance range of $1.25 to $1.50. Throughout my prepared remarks, I've provided color on our assumptions for growth and shape. Excluding the impacts from the revenue shift, our assumptions for the year are consistent with those provided on our Q1 earnings call. With the first phase of our 360 smart bed launch and our new supplier partners in place, we are well positioned to deliver on our goals. We're advancing our value drivers to deliver $2.75 in earnings per share in 2019. This continues to represent a compelling investment opportunity.

Jivvy, at this point, we'd like to open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is from Peter Keith of Piper Jaffray.

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

I was curious with the supplier issue, two questions on that. Was that specific to the 360 products or was that more broadly across the product line? And then, secondly, would there be any change in the launch timing that you're expecting for the oncoming 360 products later this year?

Shelly R. Ibach - *Select Comfort Corporation - CEO, President & Executive Director*

Great. Hi, Peter. Well, first of all, the inventory issue is resolved and the supplier is meeting our inventory requirements and forecast, and demand is strong. This was across our entire line for the inventory shortage. And then specifically to the question of the 360, we're really excited about the demand that we're seeing from the i7 and the i10. Both product mix and ARU are ahead of expectations. And being in this position, we're confident with the product line-up as we're set today as we execute Q3 and we will continue our phased launches over the next 3 quarters.

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

Okay, good. And maybe, I guess, the change from Q1, as you're probably optimistic around 360 but you didn't really have any idea how it would perform. I guess, now that it is out in the marketplace, do you feel more confident in that $2.75 in earnings or do you feel relatively consistent with where you were earlier this year?

Shelly R. Ibach - *Select Comfort Corporation - CEO, President & Executive Director*

Yes, this first phase with the i7 and i10, we did expect some ARU growth and it's better than we expected. So we're very pleased with the demand that we're seeing in -- it's early, but we see additional efficiencies throughout our supply chain and we'll take this time before the next phase to build on that and also capitalize on the increased mix and ARU that we're getting and we'll see a little more growth in ARU in the back half than we had originally thought. So it will be both from units and ARU, and all this gives us great confidence as we head towards our $2.75.

Operator

Our next question is from Brad Thomas of KeyBanc.

Bradley Bingham Thomas - *KeyBanc Capital Markets Inc., Research Division - Director and Equity Research Analyst*

Yes. Wanted to just follow up on, making sure I'm doing the math right, bridging the comparable brand revenue growth of -- if we went to add back the delay in revenue, it does imply your comparable brand revenue would have been up about 5%. Is that an accurate way of looking at things? And can you talk a little bit about what the trends look like in the quarter and as we've moved into 3Q?

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

Yes, Brad, your math is spot on. And I'll have Shelly talk about the trends during the quarter.

Shelly R. Ibach - *Select Comfort Corporation - CEO, President & Executive Director*

Brad, we've seen steady performance all year since January week 1 regarding traffic and sales. So we're very pleased with that in Q2 as well.

Bradley Bingham Thomas - *KeyBanc Capital Markets Inc., Research Division - Director and Equity Research Analyst*

Great. And then a question in terms of modeling the back half year. Will there be any specific costs that you all will incur with respect to the delays that will hit sales here in 3Q? And then, David, if I heard you right, did you say G&A is going to be $34 million in each 3Q and 4Q? And if that's right, why is that the case?

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

Yes, Brad. The -- in terms of the transition costs, I highlighted those in my prepared remarks, as being $3 million to $4 million in each of the quarters of the back half. Those would capture any supplier-related transition costs as onetime items. We're very cautious and careful about including only those types of items that are one-time in nature in those buckets when we call those out. In terms of the G&A color, we saw favorability in Q2 and overall for the year. I've provided that guidance just to help you with your modeling but, overall, I think, it's directionally consistent with what we've provided before.

Operator

Our next question is from John Baugh of Stifel.

John Allen Baugh - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

The first one is, if I did the math right, the incremental flow for the $25 million you missed is about 30%. That seems a little higher than what you've done in the past, so could you just comment on that, please?

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

Yes, John. It's -- you're right, the math is about 30% on that business and you know that incremental sales have that impact. We talked about incremental sales on the four-wall profit side being 30% to 40%. Same thing goes with our model on the incremental sales that we're talking about in this regard and you know that we've already spent the media dollars, marketing dollars, to deliver those -- or get those orders on the books.

Shelly R. Ibach - *Select Comfort Corporation - CEO, President & Executive Director*

So John, on media, we did leverage 30 basis points in the quarter. But with the shift of the $25 million, if you put that back into the quarter, our leverage would have been over 100 basis points in media.

John Allen Baugh - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Okay. And then, you're telling us you're "caught up" and with the $25 million. So -- and I realized that Labor Day is the intensive period. But is it fair to say that, because it works out weekly, roughly that you'd have $30 million a week in shipments. But I understand that would be weighted more to Labor Day. But -- so are we looking at like the first two weeks of July where your sales are $25 million a week and then another $25 million spread over those 2 weeks? Or are we catching up later? Or is there some impact to the July business to date from what transpired in the June quarter?

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

John, we expect to be fully caught up and back to normalized lead times of -- by -- before Labor Day.

John Allen Baugh - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Got it. And then my last question is, I don't think you've given us the exact timing of the 360 launch and don't expect you to, but is there a change from your internal plan as it relates to Labor Day? You might have to push something back a little bit or you're trying to say no everything is on the exact same schedule we had. And I guess my concern would just be, would you have to change any of the marketing or promotional stuff around the key Labor Day event?

Shelly R. Ibach - *Select Comfort Corporation - CEO, President & Executive Director*

Yes, John. We approached this as a phased launch so that we could benefit from flexibility. And as we went into it -- our first launch was executed as scheduled. We had anticipated looking potentially at a second phase here in the third quarter and, instead, based on two things. One, the demand that we're seeing from the i7 and the i10 has been so strong and it's been driving the incremental mix in ARU that we want to continue to benefit from that and we have great confidence in where we are with our product line-up as we execute Q3. And we also have efficiency opportunities throughout the vertical business model that we see in this first phase that we want to capitalize on before we launch the next phase. So we intend to do that and we have confidence on where we are from both a demand and efficiency as we move into the balance of the year.

Operator

Our next question is from Keith Hughes of SunTrust.

Keith Brian Hughes - *SunTrust Robinson Humphrey, Inc., Research Division - MD*

So the sales have been pushed forward. Is that of the i7 360 and the i10 360? Is that where the problems arose?

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

We saw inventory delays across the entire product offering.

Keith Brian Hughes - *SunTrust Robinson Humphrey, Inc., Research Division - MD*

Across it. Including the historic ones that are going to be going away. Is that correct?

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

That's correct.

Keith Brian Hughes - *SunTrust Robinson Humphrey, Inc., Research Division - MD*

So then I'm confused. I thought this was, given the new construction of the new bed, the supplier associated with that. Is that not the case?

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

You know, when we identified the supplier, we went to them because of their partnership on the innovation side and their willingness to work with us on the profitability goals that we have. In conjunction with that whole process, we gave them the opportunity to take more of the product line, the entire product line.

Keith Brian Hughes - *SunTrust Robinson Humphrey, Inc., Research Division - MD*

Okay. So they were going to be supplying for the new construction and that's where the shortfalls came or just on their entire offering?

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

On the entire offering.

Keith Brian Hughes - *SunTrust Robinson Humphrey, Inc., Research Division - MD*

Entire offering. Okay. So when -- how -- in terms of the first two 360s, they're going to be rolled out. I believe you said that earlier. Is that already started in retail stores and it's not coming on the website?

Shelly R. Ibach - *Select Comfort Corporation - CEO, President & Executive Director*

Yes, and it absolutely should be on the website. The 360 smart bed is there. And we were set in all stores by the end of May and we launched our marketing campaign to support that the second week in June.

Keith Brian Hughes - *SunTrust Robinson Humphrey, Inc., Research Division - MD*

And is it called -- I was on the impression you were going to be having all the models with another name plus 360 at the end. Has that changed?

Shelly R. Ibach - *Select Comfort Corporation - CEO, President & Executive Director*

It has not changed. We've intended to and are calling it the 360 smart bed, Sleep Number 360 smart bed. And we will, through a phased execution, change over our entire product line to the 360 smart beds.

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

However, the model name, for example, the i10, is still the i10. The -- what was the m7 is now the i7.

Keith Brian Hughes - *SunTrust Robinson Humphrey, Inc., Research Division - MD*

M7 is the i7. So -- but it kind of say like i7 360. I thought that was the whole marketing pitch around it.

Shelly R. Ibach - *Select Comfort Corporation - CEO, President & Executive Director*

Yes. The Sleep Number 360 smart bed. Yes.

Keith Brian Hughes - *SunTrust Robinson Humphrey, Inc., Research Division - MD*

So it'll be the i7 360 smart bed. Is that correct?

Shelly R. Ibach - *Select Comfort Corporation - CEO, President & Executive Director*

360 smart bed i7 model.

Keith Brian Hughes - *SunTrust Robinson Humphrey, Inc., Research Division - MD*

I7 model. Okay, all right. I see. I was confused. Sorry about that. And I guess, also, you're running discounts now on the old beds. How long will that last? And has that been factored into the $3 million to $4 million per quarter of transition costs that you referred to earlier on the call?

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

In regards to the transition costs, it doesn't have any discounting included in that number. Those are purely one-off types of costs that we'd be incurring in conjunction with 360, our supply chain evolution and our network -- our logistics network evolution.

Keith Brian Hughes - *SunTrust Robinson Humphrey, Inc., Research Division - MD*

Okay. So with -- as the shape of gross margins in the second half of the year on a year-over-year basis, would we see more of a gain or a better number in the fourth as that transition runs its way through?

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

We're expecting 30 to 50 basis points of gross margin improvement for the full year. That's how we're guiding. That's based on all the puts and takes that we're seeing across the business.

Keith Brian Hughes - *SunTrust Robinson Humphrey, Inc., Research Division - MD*

Okay, final question, just on the pace of business. I know you've had some demand get pushed forward into the third quarter. But if you were to think about that, has there been any change over the last seven months, either up or down, in terms of your weekly pace of business?

Shelly R. Ibach - *Select Comfort Corporation - CEO, President & Executive Director*

Yes, Keith. This is where we've seen steady performance on an ongoing basis since January week 1 consistent with our plans.

Operator

Our next question is from Seth Basham of Wedbush.

Seth Mckain Basham - *Wedbush Securities Inc., Research Division - SVP of Equity Research*

My first question is on store traffic. If you could comment on trends and comp store traffic relative to your expectations, it seems like there wasn't much improvement in comp store traffic even when you add back in the sales that shifted forward.

Shelly R. Ibach - *Select Comfort Corporation - CEO, President & Executive Director*

Yes. We're happy with our demand here in the second quarter as we were the first quarter, the steadiness, the consistency of traffic and sales. We intentionally went into the second quarter holding our marketing or our media spend flat to prior year based on it being a seasonally low quarter and also knowing that we had been experiencing efficiency gains on our initiatives. And we again advanced those initiatives in the second quarter, and pleased especially with the quality traffic that we've been able to generate.

Seth Mckain Basham - *Wedbush Securities Inc., Research Division - SVP of Equity Research*

Got it. As you look forward, given the strength of new products that you see, would you expect comp store traffic growth to accelerate for the back half of the year?

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

Seth, we're planning for low single-digit comp growth for the year.

Shelly R. Ibach - *Select Comfort Corporation - CEO, President & Executive Director*

And then from an overall growth in the back half, mid- to a high single-digit growth.

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

Yes, excluding the shift of the $25 million.

Seth Mckain Basham - *Wedbush Securities Inc., Research Division - SVP of Equity Research*

Got it. As you see more of your sales migrate to the online channel, do you think that will potentially lead to more limited ability to sale attachments? Or are you encouraged by that trend?

Shelly R. Ibach - *Select Comfort Corporation - CEO, President & Executive Director*

Yes. We -- we're very encouraged, excited about being a direct-to-consumer brand at this particular time. We've been executing against this strategy for a few years now, strengthening our competitive advantages, of proprietary products, exclusive distribution and lifelong relationships with our customers. And this is where we'll really see it play out, especially in the overall retail environment. And we have an extraordinary experience in our stores. We know that absolutely generates a higher ARU overall when our customers get the full experience. But the website actions that we're building and taking work in an integrated way with our store experience, the two go hand-in-hand. And we've always looked at them as a complete customer experience because the customer interacts at different times with the site as well as the store. And they're seamless and they're meant to fuel and support one another, and that's what we're seeing in our ability to track the digital actions from the customer and being able to see that pull through to store purchase. And specifically, yes, the site does have a lower ARU than our stores and we've taken that into consideration for our longer-term guidance as well.

Seth Mckain Basham - *Wedbush Securities Inc., Research Division - SVP of Equity Research*

Got it, understood. My last question is just around upcoming changes in terms of suppliers. Do you have any other significant changes, such as the one that you called out, that caused this transition issue recently?

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Shelly R. Ibach - *Select Comfort Corporation - CEO, President & Executive Director*

No, we don't. That we've made significant changes in the second quarter with the first phase and we're set in executing against this plan as we head into the back half.

Seth Mckain Basham - *Wedbush Securities Inc., Research Division - SVP of Equity Research*

Got it. Okay. If you have that degree of confidence, and I guess the ultimate question I have is with your guidance for the year. You still have relatively wide range of EPS guided for the year. What are the considerations that could keep the guidance range wide at this point in time?

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

Seth, we raised our guidance on the last call and we feel confident with the elements that we've got in front of us and the things that we've put in place, the initiatives that we have made progress against. We feel like the $1.25 to $1.50 is a good solid range for us to deliver against.

Operator

Our next question is from Budd Bugatch of Raymond James Financial.

Beryl Bugatch - *Raymond James & Associates, Inc., Research Division - MD and Director of Furnishings Research*

If I did my math right, it looks like 5,800 or so beds were delayed, is that correct? And is the ARU of what, the $25 million, the same as the ARU of the average $4,300 or so?

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

That's directionally fine, Budd.

Beryl Bugatch - *Raymond James & Associates, Inc., Research Division - MD and Director of Furnishings Research*

Hopefully, it's a little bit more than directionally, David. Is it -- I mean, is it -- I think directionally we'll get there. I'm just trying to understand, that's about 11 beds per store that you kind of disappointed customers. And have you lost any of those sales? Or what have you had to do to keep those sales?

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

Budd, there's a little bit higher ARU, as Shelly highlighted. And we've had active outreach, working with customers that have been affected by the inventory delays. That included some appeasements, et cetera. But those have already been baked into both our Q2 results and our thinking for the balance of the year.

Beryl Bugatch - *Raymond James & Associates, Inc., Research Division - MD and Director of Furnishings Research*

Okay. And can you talk -- can you give us a little bit more detail of what happened with the supplier? How can that -- how did it become a surprise? When during the quarter did it get to be a surprise?

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

Budd, we transitioned more than 20 suppliers and we had one that had some productivity challenges. And we continued to work with them during the quarter to get productivity where it needed to be. They've since done that. We're really glad to see how much this vendor has been a strong business partner and has been leaning in with the business. And they're producing now at a level that's more than we need for our demand for the balance of the year.

Beryl Bugatch - *Raymond James & Associates, Inc., Research Division - MD and Director of Furnishings Research*

So I'm curious as to why the big change in supplier base. I guess I must have missed that, because I didn't think you were dissatisfied with 20 suppliers.

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

That's -- it's part of our overall plan that we talked about at the November Investor Day, that we would be looking for suppliers that are working with us, both on the innovation side and those in support of our profitability objectives.

Shelly R. Ibach - *Select Comfort Corporation - CEO, President & Executive Director*

And Budd, it was a combination. The 360 bed is a very different product than our current one, and it did require additional suppliers. So it -- and we cast the broader net on supplier changes to keep pace with the margin expansion goals that we have over the next number of years as well as the innovation.

Beryl Bugatch - *Raymond James & Associates, Inc., Research Division - MD and Director of Furnishings Research*

So maybe -- I don't have any problem with that. It's when you told us it was a wider array of issues affecting a wider number of beds. That was the legacy beds as well that, that kind of that what you just said doesn't kind of make intuitive sense to me, maybe I'm just too dense to get it. But when it affects other beds, those are things that we're operating well. And you already have enough of them. We had enough issues with ERP that we don't need to repeat any of those. What am I missing in that equation?

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

Yes, Budd, all of the products were new to this vendor. And taking on the Sleep Number bed line as well as the 360 smart bed line, they had some productivity challenges. And glad to say that was contained to 1 week's worth of deliveries at the end of the quarter and that it's fully -- the inventory challenges that we had are fully resolved and we're moving forward.

Beryl Bugatch - *Raymond James & Associates, Inc., Research Division - MD and Director of Furnishings Research*

So are you saying then it occurred toward the end of the quarter? Or -- but I thought it was -- how about just the $25 million is -- equates to 1 week. It didn't -- I didn't -- I thought it would happen.

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

Yes. All I'm saying to you that, at the end of the quarter, we had an additional week's worth of deliveries that didn't get shipped out compared to what we expected.

Beryl Bugatch - *Raymond James & Associates, Inc., Research Division - MD and Director of Furnishings Research*

And forgive my memory, I'm an aging guy. My memory is a little faulty. But I thought all the 360s are supposed to be -- if done this year, I thought it was towards a phased launch, but it was all this year. Am I not mistaken on that? And now that's going to look like the first quarter of 2018.

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

Last quarter, we talked about it being a 9- to 12-month effort, which would have taken us to Q -- early part of '18.

Beryl Bugatch - *Raymond James & Associates, Inc., Research Division - MD and Director of Furnishings Research*

So is it still the early part of '18 or now through the full -- first full quarter of '18?

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

Well, it's -- I'm implying the same. Yes, three quarters, the next -- over the next three quarters.

Beryl Bugatch - *Raymond James & Associates, Inc., Research Division - MD and Director of Furnishings Research*

Over the next three quarters. Okay. And David, what happened with tax? I know that the loss was small, but the tax rate therefore becomes a big item. You probably had some discrete items in there that affected tax. What's the tax guidance for the full year?

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

So for the balance of the year, I think it's the part that matters, is 34.5% is what you should be using in your modeling. What happened in Q2 is we had some tax credits related to the acquisition of the BAM Labs that we were able to realize. That was about $0.02, and then we had $0.01 related to the new accounting rules for equity compensation.

Beryl Bugatch - *Raymond James & Associates, Inc., Research Division - MD and Director of Furnishings Research*

And that was a positive or a negative?

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

Those are both favorable.

Beryl Bugatch - *Raymond James & Associates, Inc., Research Division - MD and Director of Furnishings Research*

Favorable. And so if we are at a 34.5% for the balance of the year, that gets to about a 31% and change for the full year. Is that in the right ballpark, as you would say, directionally correct?

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

Yes, yes, that's directionally correct.

Operator

(Operator Instructions) Our next question on queue is from Michael Lasser from UBS.

Michael Lasser - *UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines*

On the delayed $25 million, did that only impact the retail same-store sales because your retail comp went from up 2% last quarter to down 6% this quarter, whereas you're online and phone comp went from -- growth went from 18% to up 26%.

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

Michael, yes. The reported comp for the quarter was down 4%. And adjusting for that $25 million, yes, it would have largely all been comp growth, on an adjusted basis, would have been a plus 5%.

Michael Lasser - *UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines*

But I guess, my question was that it only affected the retail comp and not the online channel.

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

Yes, for the most. Our order comp store growth number includes both.

Michael Lasser - *UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines*

Okay. And as you look forward to the third quarter, the $0.12 that were impacted by the inventory shortage, are you going to get all of that back in the third quarter?

David R. C. Callen - *Select Comfort Corporation - Senior VP & CFO*

Yes.

Michael Lasser - *UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines*

And that -- and so how are you going to be able to offset the -- that you referred to earlier?

Shelly R. Ibach - *Select Comfort Corporation - CEO, President & Executive Director*

How are we going to offset the appeasements? We did in the second quarter and we will in the third quarter and back half due to our margin expansion initiatives and the pace that they're on.

Michael Lasser - *UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines*

Got it. And then my last question is, it looks like the i7 is currently $300 off from the website. The i10 is $500 off on the website. Was it part of your plan to discount those products so early in their tenure?

Shelly R. Ibach - *Select Comfort Corporation - CEO, President & Executive Director*

Yes. We utilize dollars off in the close of the sale. So it's not an attract for us. We utilize benefits for the attract, but the dollars off or financing helps us with close.

Michael Lasser - *UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines*

Okay, even though the iLE bed is not being discounted?

Shelly R. Ibach - *Select Comfort Corporation - CEO, President & Executive Director*

Right. The -- well, the iLE is in, generally, in market during a large market share event.

Michael Lasser - *UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines*

Okay. And Shelly, I think you didn't necessarily comment on traffic earlier in response to a question. You said it was steady, but...

Shelly R. Ibach - *Select Comfort Corporation - CEO, President & Executive Director*

Yes.

Michael Lasser - *UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines*

You also mentioned that conversion rate was off. So it would suggest that traffic is down. Is that right?

Shelly R. Ibach - *Select Comfort Corporation - CEO, President & Executive Director*

Yes. When we look at traffic, and one of our key measurements is the qualified unique visitors, again, it exceeded our expectations. And we've been focused on quality traffic with our digital actions. And yes, that is driving a higher conversion, but it was knocked down.

Michael Lasser - *UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines*

It was knocked down.

Operator

We show no further questions on queue at this time. Now let me turn the call over back to Select Comfort.

David W. Schwantes - *Select Comfort Corporation - Senior Director of FP&A and IR*

Thank you for joining us today. We look forward to discussing our third quarter performance with you in October. Sleep well and dream big.

Operator

That concludes today's conference. Thank you for your participation. You may now disconnect.