

Company Name: Container Store Group  
Company Ticker: TCS US  
Date: 2014-07-08  
Event Description: Q1 2014 Earnings Call

Market Cap: 1,298.68  
Current PX: 27.07  
YTD Change(\$): -19.54  
YTD Change(%): -41.922

Bloomberg Estimates - EPS  
Current Quarter: 0.141  
Current Year: 0.571  
Bloomberg Estimates - Sales  
Current Quarter: 202.857  
Current Year: 830.375

## Q1 2014 Earnings Call

### Company Participants

- Anne Rakunas
- William Arthur Tindell
- Melissa Meyer Reiff
- Jodi Lynn Taylor
- Jodi Taylor
- William Tindell

### Other Participants

- Gary Balter
- John Heinbockel
- Patrick O'Brien
- Dan Binder

## MANAGEMENT DISCUSSION SECTION

### Operator

Greetings and welcome to The Container Store First Quarter 2014 Earnings Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

I would now like to turn the conference over to Ms. Anne Rakunas of ICR. Thank you Ms. Rakunas, you may begin.

### Anne Rakunas

Thank you, operator. Good afternoon, everyone, and thanks for joining us today for The Container Store's first quarter fiscal year 2014 earnings call. On today's call are Kip Tindell, Chairman and Chief Executive Officer; Melissa Reiff, President and Chief Operating Officer; and Jodi Taylor, Chief Financial Officer. After Kip, Melissa and Jodi have made their formal remarks, we'll open up the call to take question.

I need to remind you that certain comments made during this call may constitute forward-looking statements, and are made pursuant to and within the meaning of the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements are subject to both known and unknown risks and uncertainties that could cause actual results to differ materially from such statements. Those risks and uncertainties are referred to in The Container Store's press release issued today. The forward-looking statements made today are as of the date of this call and The Container Store does not undertake any obligation to update their forward-looking statements.

Finally, the speakers may refer to certain adjusted or non-GAAP financial measures on this call. A reconciliation schedule showing the GAAP versus non-GAAP financial measures is available in The Container Store's press release issued today. If you do not have a copy of today's press release, you may obtain one by visiting the Investor Relations page of the website at containerstore.com.

I will now turn the call over to, Kip. Kip?

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## William Arthur Tindell

Thanks, Anne. Hello, everyone. Thank you for joining us today to talk about our results for the first quarter of 2014 and I hope everybody had a great 4th of July.

Net sales for the first quarter were \$173.4 million, an increase of 8.6% over first quarter of fiscal 2013. We thought our sluggish sales were all because of weather encounterships in the fourth quarter. Going into this first quarter, we had whatever bug we had, weather encounterships for Christmas that began last November and continued into the spring, but now we've come to realize it's more than just weather encounter, consistent with so many of our fellow retailers, we're experiencing a retail funk, I mean, so many retailers that we talk to are experiencing that. Our comparable store sales declined 0.8% in the first quarter. They declined 0.8% and that's after 15 consecutive quarters of comp store increases.

It's important to remember that historically the first quarter of The Container Store is by far our lowest quarter from both the sales and profitability standpoint. It's a very small seasonality quarter for us, simply could represents less than zero percent of our annual earnings. So, we're disappointed with the first quarter and yes, we're surprised by slightly negative comp store sales increase. For the first quarter, it has very little impact on our full-year earnings results.

We are confident that customer enthusiasm for our brand and employee morale are at all-time highs. I mean, we continue to experience slight traffic declines in this surprisingly tepid retail environment, but we feel like our brand and employee morale are just as good, actually better than they've ever been. And consumer seem to be – as you guys know consumers seem to be buying homes and automobiles and even high-ticket furniture, which has kind of been on the [ph] build room since the Great Recession, but most segments of retail are a little like us seeing more challenging sales suddenly than we had hoped for early in 2014. So we're not alone in this but we will absolutely not rest until we turn these slight traffic declines we've experiencing and the slight traffic increases. We have exciting initiatives that we feel like will take that slight traffic decline and turn it into a slight traffic increase and we have very exciting initiatives and the list will go into shortly at hand that we think will have a terrific impact on average ticket increase, which is what we're most skillful at doing in tough times. We have a long history of having a great deal of success at raising average ticket.

Regarding our second and third quarters, we believe that these two quarters will improve slightly to flat to slightly positive. We're being cautious about taking about those but we do feel there will be some improvement in the second and third quarters. And then we're, like every retailer, I mean we're very much looking forward to the fourth quarter as we comp against the worst weather we've had in our history last year and we believe we'll see – we know we'll see market improvement in our sales trends in the fourth quarter, which is our most important quarter.

I mean one thing we know sure is that chances are very, very, very high that we won't have the worst weather in our 36-year history again this fourth quarter and it was darn unfortunate to have it right after we were public. Historically, over 60% of our profitability has been derived in the fourth quarter. So from a profitability perspective fourth quarter is very, very important for The Container Store. We joke it's like a basketball game. It's really all about the fourth quarter for us, wish it wasn't that way but it's always been that way. We have both our Christmas campaign and our Annual Elfa Sale in the fourth quarter, our two biggest seasons simultaneously. So fourth quarter is 60% of our profitability and this year we expect it to be perhaps even a little more than that total percentage of our total profitability.

We're pleased that during the first quarter in order to preserve our brand and protect gross margin, we did not accelerate promotional levels. We recognize that consumers have a inordinate appetite for promotional levels right now and we recognize that this continues to be an incredibly promotional consumer environment. We're very proud and thrilled with our average ticket growth right now as always and the service that our wonderful employees provide to our customers every day.

As I mentioned, we feel that we really adapted offsetting occasional traffic declines with average ticket growth. I mean, think about it, last year our average ticket increased a robust 5.6%. The previous year average ticket increased 4.2%. All of our employees are so proud of our ability to do this. It's just something that we've always been able to do when traffic levels were not exactly what we wanted. I think it's a huge differentiator for us. So, we can flat out, raise average

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ticket with the very best in our industry because of our great, great sales people.

We won't rest until we turn the traffic slight declines into slight gains. But what we're really anxious to do, what the job before us is to do is to get those average tickets up truly, robustly. And so Melissa how are we going to do that? Tell us how we're going to do that, average ticket thing, let's talk about the traffic thing. But, how you got do this average ticket thing?

## Melissa Meyer Reiff

Okay. Well, we'll talk about it. Thanks Kip and hello everyone. But first, I want to talk about our new stores just for a little bit. We continue to be very pleased with their performance. Our average first year four wall adjusted EBITDA margin on new stores has historically averaged 23% and our invested capital has seen a payback in about two-and-a-half years. I think that's really important to reiterate those two points again.

We opened three new stores in our first fiscal quarter in King of Prussia, Pennsylvania of this past March 8. Our second store in the Seattle area, April 12 and our first store in Rhode Island in the Providence area, May 17. And we just relocated last month our 20-year-old Oak Brook, Illinois store to a beautiful space at the successful Oakbrook Center, which is right across the street from where our old store lies and it's a gorgeous outdoor mall for those of you not familiar with it.

We had a very successful grand opening. We received a glorious welcome from our customers we've had for 20 years as well as new customer. And the remaining stores that we will open this fiscal year are in Los Angeles, California, August 9 at Farmers Market at the Grove and Salt Lake City, Utah at Fashion Place Mall opening October 18; in Chicago in the South Loop area, in what's called the Roosevelt Collection, opening November 15.

And you all may remember that last quarter we announced that we have accelerated our annual square footage growth from 10% to 12% minimum and today well, we are just super pleased to announce that we are also opening our eighth store this fiscal year, at the end of January 2015 in the Phoenix market, Glendale to be specific and that enables us to meet that 12% minimum square footage growth even in this fiscal year.

It normally requires about , I don't know, about eight months to ten months for us to open a new store the way we like to open a store once the lease is signed. So, we've really worked diligently to even add that additional store in this current fiscal year, so that's really terrific. So, four more stores to open this year, a total of eight grand openings, seven net new stores by the end of fiscal 2014.

Tomorrow is a big day for us, because POP will be available in all of our stores and online. Yes, it's our new customer engagement program POP, Perfectly Organized Perks, our program that rewards customers with special communication, surprise and delight gifts and exclusive offers that will be available in all 67 stores. Customers has simply have to sign up and begin being surprised and delighted by The Container Store. It's so simple, so easy, and if the customers [ph] knock in one of our stores to sign up all they have to do to become a POP! Star is to enroll online at containerstore.com.

So, some of you on the call may remember that we cracked at our POP program to be simple, relevant, emotional engaging and designed specifically to improve customer frequency, traffic, gifts, there is what we're talking about traffic. We launched the program in just our California stores almost one year ago and already we know that the program is increasing POP! Star traffic and what's really wonderful POP! Stars have a higher average ticket than non-POP! Stars. So, of course, we love that too.

Currently, we have around 330,000 POP! Stars, but hey, watch those number of store after all stores and online offer the program beginning tomorrow. In addition, we've expanded the rollout of our ATHOME personalized in-home organization design service beyond just the Texas market, having successfully just launched this service in the Manhattan market with 12 really outstanding organizers. I've met all 12 of them and they're really outstanding. Again this has been our most requested service in all of our 36 years. Our customers don't want DIY. They just want someone they can trust to do-it-for-them, organize every area of their homes, a whole soup to nut to A to Z program which

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makes their time-starved busy lives obviously more efficient and enjoyable and that's exactly what we're giving them.

Our ATHOME organizers go to directly into our customers' home and design solutions for them, organizing every space using, of course, The Container Store products. We're bringing this service to additional markets such as LA and Chicago and Washington D.C. market by the end of this calendar year and into the rest of our stores in 2015. The results so far [indiscernible] with this service are really exciting with the average ticket – average customer ticket in excess of \$2,000 for ATHOME customers. That's incredible we think when our average ticket in our stores is around \$60. We really see this having a significant impact in the coming months as we continue to rollout in more markets and certainly of course in the long-term.

And lastly, as many of you know from our last call, we've been talking about closet domination actually for the past several months. And so we wanted to make sure that we are offering our customers many closet solutions, choices, getting her what she wants, when she wants it, anywhere, anytime and so I bet you probably did wondering exactly what we mean by that. Well, get ready, because we are over the moon delighted to announce today that we will launch a brand new exclusive custom solid drawer and shelving closet solution later this fall. The new product collection will be a higher end offering than our current assortment and will provide our customers with custom-built solutions crafted from the highest quality materials and with a variety of choices in wood grain finishes and extras all the bells and whistles including lighting and storage option for shoes, jewelry and handbags. This new closet collection will be custom and made to order with service from our in-store expert sales people, our ATHOME organizers and of course our installation service.

Our customers are asking for an even more luxurious closet offering as they think about their dream closets, which we know is an area of their home that they want to be a well-appointed, beautifully designed and a reflection of their style, while of course, also remaining functional and efficient. Many customers simply want a more custom-built look. And this new collection is just that quality, custom solutions with again, all the bells and whistles and a superb customer service that our customers expect from us to go along with it.

So as you can hopefully tell we're very enthusiastic and very optimistic about this collection and service because we know it's going to appeal to our loyal customers but also going to attract new customers to our brand. We expect that the average ticket on our new closet collection will be much higher than our over \$2,000 current average ticket that we are experiencing with our ATHOME service. And therefore we believe it will contribute very meaningfully to comp store sales increases in the longer term.

As I said earlier, this new solid drawer and shelving closet collection will rollout late this fall in our seven stores in the Dallas/Fort Worth Metroplex with planned rollout to the rest of our stores beginning in the spring of 2015.

We really do believe this is a game changer for us. It could be our most significant product launch to-date in 36 years. So, how cool is that? So, we can't wait to tell you more about it and hopefully maybe even show it to you very soon.

So, lots happening here at The Container Store. We will continue to focus on our solutions based selling as opposed to items, continue to focus on proprietary products like our new solid drawer and shelving closet collection that I just spoke about. Both of which of course insulate us from the giant internet retailers. It's not – it's just not a factor, because you cannot showroom proprietary exclusive products. And almost no one tries to sell solutions over the internet, it's not easy, but we do it.

So that's it from me today. Thanks for listening. And now Jodi, you're going to review our first quarter financial results and discuss, I believe, our outlook for fiscal 2014.

## Jodi Lynn Taylor

Yes, thank you, Melissa. Good afternoon, everyone. I'd like to begin my remarks with a review of our first quarter results and then discuss our outlook for the year.



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Net sales in the first quarter were \$173.4 million which was up 8.6% from the first quarter of fiscal 2013. Sales in The Container Store retail business were up 8.9% to \$149.7 million, and our third party sales at our Swedish subsidiary, Elfa, were up \$1.5 million, or 7% from the first quarter of 2013. As we discussed on our fourth quarter call, the first quarter [ph] was historically by far our lowest quarter for both sales and profit contribution. We ended the quarter with 66 stores and approximately 1.65 million of gross square footage as compared to 60 stores and approximately 1.5 million of gross square footage at the end of the first quarter of 2013.

Our comparable store sales for the quarter decreased by 0.8% which included a 1.5% increase in average ticket. The weather driven extension of the Elfa sale that we spoke to you in fourth quarter also resulted in a shift of approximately \$4 million in sales at our TCS business into the first quarter, due to more merchandise deliveries being recorded into first quarter this year.

Our comp store sales metric recognizes a sale when the product is purchased, but in the financial statements revenues are recorded when the product is delivered. In the first quarter of fiscal 2014, approximately 26% of Elfa sales were derived from The Container Store, with the balance to [ph] fill primarily derived from Scandinavia. The growth in third-party sales in the quarter was primarily related to a promotional campaign as well as improved market conditions in Scandinavia. We remain cautiously optimistic that these improving trends in Europe will continue.

Consolidated gross margin decreased by 30 basis points to 58.1% from 58.4% in the prior year period. Gross margin in The Container Store retail business decreased 70 basis points to 58.2%, primarily due to the extension of our annual Elfa sale and to a lesser extent the appreciation of this Swedish krona versus the U.S. dollar year-over-year.

The Container Store gross margin decline was partially offset by the increase in Elfa's gross margin of 60 basis points to 40.9% primarily driven by leverage of fixed costs during the quarter. As a percentage of sales, consolidated SG&A increased to 52.6% from 52.3% in the first quarter of fiscal 2013, primarily due to public company cost, which we did not incur last year as well as to a lesser extent due to investments in future growth and strategic initiative.

Our net interest expense in the first quarter of 2013 was \$4.3 million compared to \$5.6 million in the first quarter of fiscal 2012, with the year-over-year decline due to lower interest rates achieved through refinancing of our term loan facility at The Container Store last year. Our tax rate for the quarter was 35% compared to 29.6% in the first quarter of last year.

The increase in the effective tax rate is primarily due to a shift in the mix of projected domestic and foreign earnings as well as fluctuations in the valuation allowance recorded against domestic earnings in the first quarter of fiscal 2013. Our expectation is that our tax rate for full-year 2014 will still be approximately 38.8% as outlined on our fourth quarter conference call.

The net loss for the quarter was \$3.6 million compared with a loss of \$4.8 million in the first quarter of last year and our loss per share was \$0.07 compared with the net loss per share attributable to common shareholders of \$9.25 last year.

Again, our first quarter has historically always been our quarter with lowest sales and net loss due to seasonality of our business. Last year's net loss per share reflects \$22.3 million in preferred distribution. As a remainder, we did retire our preferred stock in connection with the IPO in late fiscal 2013. On an adjusted basis, net loss per share in the first quarter of 2013 was \$0.07.

Turning to our balance sheet, we ended the quarter with \$8.6 million in cash on our balance sheet, \$361.6 million in outstanding borrowing and combined availability with cash on hand of \$68.8 million. We ended the quarter with well managed inventory of \$94.6 million as compared to \$91.2 million at the end of last year's first quarter, up only 3.8% on sales increase of 8.6% with six additional new stores. So we're very proud of that.

Next, I'd like to turn to our outlook. We expect consolidated net sales for the year to be \$820 million to \$830 million, comparable store sales to increase in the 1.5% to 2.5% range and earnings per share to be in the \$0.49 to \$0.54 range based on a weighted average of \$49 million diluted common shares outstanding. Included in this outlook is the expected impact of the additional 8th store opening that Kip discussed, which we are very excited to be able to add this

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year. Since this store will not be opening until January 31 of 2015, it will have limited sales that we can obtain in this fiscal year, but the full amount of pre-opening store cost, which we expect will reduce our 2014 earnings per share by \$0.02.

We are assuming tax rate as I noted of 38.8% and annual interest expense at today's LIBOR rates of approximately \$17.5 million.

A few additional comments that I have regarding the expected comp and SG&A cadence this year. First on comp, our quarterly comp expectations for fiscal 2014 are as follows.

Second quarter and third quarter, flat to slightly positive and fourth quarter mid-single digits again noted due to the extreme weather of last year. Two, we expect the impact of the initiatives that we've outlined that we're very excited about, to really be most beneficial to sales in the later part of this fiscal year. And as noted last quarter the impact of the costs associated with these planned initiative including the rollout of the POP program, the ATHOME rollout into nearly half of our stores and the new custom closet program will be most significant in the first half of the year with some modest impacts still into the third quarter.

As a result, we expect consolidated SG&A as a percentage of sale in the second quarter fiscal 2014 to de-lever from second quarter of last year by approximately 100 basis points from the 46.7% last year to de-lever slightly in third quarter, but to improve considerably as a percentage of sales year-over-year in the fourth quarter.

As we have said before, fourth quarter seasonally our most important quarter and in fiscal 2014 we expect to deliver nearly 70% of our full year earnings per share in the fourth quarter. And third, in fiscal 2014 please remember we will also have the incremental cost including additional payroll and professional fees associated with becoming a public company which is approximately \$1.5 million beyond what was incurred in fiscal 2013.

So with that, I'd like to turn the call back over to the operator, so that we can take your questions. Operator?

## Operator

Thank you. [Operator Instructions] Our first question is from Gary Balter of Credit Suisse. Please go ahead.

**<Q - Gary Balter>:** Thank you.

**<A>:** Hi, Gary.

**<Q - Gary Balter>:** Just on the stuff that you're doing exclusive custom like the higher end that you're going to be introducing in the store. How does the pricing compared to Elfa?

**<A>:** It's – we're introducing a higher end product than Elfa. What we discovered is that customer that really represents 83% of our sales, 30% of customer represent 83% of our sales and she buys everything in the store at around 200% ratio to average. But she buys Elfa at only kind of low-to-mid 100% ratio to average. She is not putting it in the master bedroom closet. She is putting it in the kids room. She is putting it in the laundry room. She is putting it in the guest room. And we believe that she wants a more upper end product for her bedroom particularly that best customer. So, this is our – we refer to it as Lexus added to the Toyota line. I mean, Elfa is the best closet system in the world. But it needs this Lexus added to the Toyota. It is more expensive. It's not going to be branded Elfa, it would be branded The Container Store. It will not be on sale when Elfa is on sale. It's not Elfa, it's The Container Store and we think it will go hand-in-hand with our Toyota that is Elfa and bringing this customer and tempt some of the other customers to go this new – it's hard to describe over the telephone.

You might call it Taxes closet, we joke. It's people have been asking for years and frankly we said no, we want you to buy Elfa and I was saying well, let's let her buy what she wants to buy. If she wants that solid built-in more wooden look rather than that more metal look let's her have that. It's the best quality system we believe ever. We have that good housekeeping seal of approval that is Elfa to compete against the other several people that are doing something somewhat similar. So the same gross margin pretty much we're trying to get and I think we're going to succeed at

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having it be the same very high gross margin we have on Elfa.

So while we don't know what the cannibalization will be, we think it will be like a Lexus Toyota hand in hand, not much cannibalization at all and just kind of allowing us to better dominate as we should all of the closet business in the United States whether she wants solid that look or kind of see through more ventilated Elfa look.

**<A - Melissa Meyer Reiff>**: Yeah, it's about. Hi Gary it's Melissa. It's about getting your choices keep, it's about getting your – as I said earlier, what she wants. And it is going to be more expensive, but I think it's going to be an incredible collection and really round out our assortment.

**<Q>**: And just one follow up, you brought down the guidance for comps in Q2 and Q3. Could you talk about your thoughts behind doing that?

**<A>**: You want me to take that one.

**<A>**: Sure Gary. We're certainly doing everything we think we should and can do to try to both improve traffic and average ticket. But in this sort of more tepid environment that we're in, we really felt as though the appropriate thing to do was to really lower that guidance for the next two quarters particularly in light of the fact that these -- some of these great initiatives we're talking about don't really have much of an impact to the shorter term. So, that was really sort of what drove our thinking, it's just -- we didn't want to unrealistically expect that trends would dramatically turn quickly.

**<A>**: Well, these initiatives will absolutely impact average ticket. I mean, average ticket on these goods are 60 times, 70 times, 80 times what our overall average ticket is. So, you get a few percentage points of sales on something that's 70 times your existing average ticket. I mean, you move that needle, comp store sales have only two components, it's traffic and average ticket. And so, what we're trying to outline for everybody is, here is what we're doing about traffic and we really believe that POP will move the needle on traffic. But what we really think we can do something about is this average ticket thing and we're really excited about it. Melissa, can you go over the timetable again of the -- both the...

**<A - Melissa Meyer Reiff>**: Well, POP again it will be rolled out to all stores and online tomorrow. And we already -- the responses to these are...

**<A>**: Sales mean what they're in the first quarter, we wish it was all everything was rolled out this quarter, but it's kind of a phased in thing so.

**<A - Melissa Meyer Reiff>**: Tomorrow, right. So -- and we've got ATHOME in the Manhattan market, in all of Texas and we're going to be rolling that out to Chicago and LA and D.C. as I said earlier by the end of the year and then we'll [ph] draw the rest of the markets for ATHOME next year. And then again we're going to be piloting this new exclusive custom solid drawer and shelving closest solutions. We're going to be piloting that this fall.

And -- so I do think that's going to impact more the longer term than the short term, because we're going to be piloting that in the Dallas-Fort Worth Metroplex. But it's certainly -- the plan is for it to also impact at least in those Texas stores this fourth quarter coming up.

**<A - William Arthur Tindell>**: But, I think that we're planning to roll that out in the first quarter or second quarter of the new fiscal year?

**<A - Melissa Meyer Reiff>**: 2015, yeah.

**<A - William Arthur Tindell>**: Yes.

**<A - Melissa Meyer Reiff>**: Exactly.

**<Q - Gary Balter>**: Okay. Thank you very much.

**<A - Melissa Meyer Reiff>**: Thanks, Gary.

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## Operator

Thank you. The next question is from John Heinbockel of Guggenheim. Please go ahead.

**<Q - John Heinbockel>**: Hey, guys. So, just going back to the new closet product, what are the thoughts early on here about creating space forward in the store, the training that you're going to have to provide incremental training to the folks in the store? And then marketing, it kind of getting the word out, thoughts on all of those as you think about the Texas pilot? And then I have a follow up on the closet.

**<A - William Arthur Tindell>**: I'll let Melissa answer that. But, we've major Elfa introductions before and so we have lot of experience in introducing new products of this significance. This was probably the biggest ever. With that kind of average ticket, I mean, there is – we'll be able to find plenty of square footage for that, there is a lot of duplicity if you will in some of the Elfa closet thing. So, I think there is some room there. And another thing that I meant to mention earlier and did not is that, the way this product will work, there is no inventory on it. And so profit in retail I believe is volume plus margin plus annual return, this thing kind of has sort of an infinity annual term because there is no inventory on it. But I'm sorry, go ahead Melissa.

**<A - Melissa Meyer Reiff>**: Right. Hey, John, it's Melissa.

**<Q - John Heinbockel>**: Hi.

**<A - Melissa Meyer Reiff>**: Yes. We are working right now on crafting. Sharon Tindell our Chief Merchant and our visual team and others training. We're working on the displays in our store right now for this product collection. And we don't see any problem with that at all. We are working on the training program. Everybody in our store will be trained on this collection and then of course we will go into even more man in the desert in depth selling with our sales people who absolutely have all the knowledge to sell this product to our customers.

It's going to go hand-in-hand John with our ATHOME organizers and our installation service, because we will sell the customer on this collection in the store, but then the ATHOME organizer and the installer will go to the customer's home, do all the measurements, because this is custom, custom, custom. And then the product will ship directly from the manufacturer to the installer and they will install it and then the organizer will organize it or do whatever needs to be done.

So, we also have a – what I think is a quite robust marketing plan to support this, albeit the pilot is in the Dallas-Fort Worth area. But I have always been of the opinion in my marketing career that, you've got kind of one chance to make that big kind of volcano, big impression happen and we want to do that and we're working very diligently on the public relations, because we're quite adaptive on that. So we've got a whole plan there. We will talk about this on social. We will use medium of our kind magical marketing mix that we can and of course be prudent and strategic in doing so. So yeah, we are excited about it and I can't wait for you to see it.

**<Q>**: No. And then as a follow up, as you think about -- does this do anything for you to on the B2B side, because we've talked in the past working with maybe homebuilders to have the [indiscernible] product, the ultra product or other product put into a newly built home or remodeled home. Does this is too much for you on the B2B side in getting this product eventually into the hands of developers for their houses?

**<A>**: Well, B2B is going really well and as we said before it's bound to be the most rapidly growing part of our business for the foreseeable future. And what we're discovering is people from throughout different industries are very excited to talk to us because we're their Container Store and they're very excited to have the opportunity to buy B2B from us. Elfa is a major, perhaps even a majority of our B2B sale so far. We certainly wanted to be the whole store and we don't have this particular solid closet plan to be a major component of the B2B, but we just don't know yet. I'm certain it will be. It's got the margin for us to play in that arena as well and a strongest of sales have been for Elfa with B2B, I think that's something that certainly can make a lot of sense and give them the same option we're giving the consumer. But this is really just meant to be our top customer who is in their buying the code hangers and the shoe boxes and everything else. She is our best customer and she is not putting Elfa in her master bedroom closet and we are confident that this will be the nicer system on the planet and she'll put this in there. I mean it's everything we know



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after 36 years of designing closets. So we do think well. We design great closet and so we're finally – as Melissa has given her what she wants.

<Q>: All right. And then lastly, you're talking about the funk, when you look at geographies, categories, talk to your customer, is there anything more than just a consumer malice, because again you're not low income, right? So you would think – you'd side steep it a little bit more. What's your best guess as to the kind of the source of this?

<A>: Well, what we know from our involvement with National Retail Federation and all of that is that over the past several months, this funk – this retail funk seems to be not just limited to sort of lower-end retail that's also hitting the higher-end retailers and certainly us to surprising extent all of a sudden. We don't see any geographical differences between it. It seems to be all over the place and we have pretty robust database. Our highest-end customer seems to be a little bit infrequently shopping us for some darn reason and so does the – I mean we have a very uneven economic recovery still. So for a long time it was the lower-end retailers we're suffering and the higher end, we're doing better and we were doing better. Now, it seems to be more democratic. It seems to be kind of across the board. So, all we know to do is to accelerate our efforts to increase traffic with initiatives designed to do that and to really hit the average ticket thing because even if the traffic stayed – even if it was zero, if you can have 5% or 6% or better percent average ticket increase, you got to have some nice 3%, 3.5% comp store sales increase.

<A>: Well, one of our biggest differentiators John, as you know, is our expert sales people who we provide so much training and so much confidence building and so much knowledge and that just drives that average ticket and I don't know of any other retailer that can do that quite like we can.

<Q>: All right. Thank you.

<A>: Thanks.

## Operator

Thank you. The next question is from Simeon Gutman of Morgan Stanley. Please go ahead.

<Q - Patrick O'Brien>: Good afternoon. This is Patrick O'Brien on for Simeon.

<A>: Hello.

<Q>: Perhaps, you can talk about the future pipeline pass the stores that you've called out. Can you talk maybe about the availability of size and the quality of locations. You basically -- are you seeing some kind of marginal improvement on the real estate side of things?

<A>: Well, we're not seeing a lot more retail real estate development unfortunately, that's not really happening. But it doesn't matter. I mean, we're very excited about the new store locations that we have in the pipeline or even more excited about the experience of our newest stores never before still have our new stores contributed so much to the profitability of the company. We're still getting this 23% maybe a little better. First year, four walls EBITDA which is -- that's why we're opening so many stores 12%, it's a lot compared to what most retailers are doing right now. But, if you can get 23% of first year four walls EBITDA, that's a wonderful business opportunity.

The Internet sales are growing. We don't really believe that people are going to quit going to bricks and mortar and it's all about Internet. Internet sales aren't that great across the retail sector either is. But as long as these sort of Indianapolis level locations yield even more profitability than our exciting LA and Chicago locations, I think we got to try to pick up the pace on at least 12% sales. And we emphasized on the last call, another thing that's happened is that we kind of come of age. After 36 years, we truly are the first call a developer will make for this type of retail and we're getting what used to be consider sort of department store anchor, pricing and location within the few centers that will be undeveloped. And we're perfectly happy to go in. We do a book store or something else on our own CapEx dollars if that's what we need. But, we remain as picky as ever about locations. We really want the corner of main and main and we're just delighted to learn that the corner of main and main in Kansas City cost a lot less than it does in LA and our sales are pretty much close to the same.

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<Q>: Hey. Its Simeon. I was able to jump on. Just a follow up, and looking at the POP program, now that you have a growing with the [ph] e-mails granted that's on the markets where you've been in. And I can see from my own inbox a greater flow of communication. Can you talk about the response of the conservation rate, how closely you're tracking it, who's clicking through the website or someone ends up buying something in the store, you're able to track that as well?

<A>: You know Simeon, hi. We actually don't have that data here in front of us to be able to speak specifically. But, yes we do have the ability to track any and all communications that we're doing to each and every one of our POP numbers. So I'm not sure what the click through rate is. We're still continuing to sign up almost half of the sales in those markets that have the POP program are coming from POP numbers. So, I think it's up to 48% if I'm not mistaken Mellissa?

<A - Melissa Meyer Reiff>: Yes, POP! Stars – 48% of that POP store sales are from our POP! Stars.

<A>: Say that that's a [indiscernible].

<A - Melissa Meyer Reiff>: 48% of POP store sales are from our wonderful POP! Stars.

<A>: And you remember Simeon, today really the primary market that we've had POP and it has been California. So it's just now starting to move further beyond California.

<A - Melissa Meyer Reiff>: So we need another,

<A>: Yeah, we're not quite to where we've got any experiences other than California. But we're very excited to now have this rolled out based on what we've seen so far.

<A>: You pilot in California, because they have the weirdest privacy laws and if you can do it there you can do it anywhere. And also the sign up ratios are so much higher than we planned, I think that people are signing up better in Iowa and Texas than they did in California. We're delighted with the ratios we've got in California.

<A>: Yeah. We are already seeing – I'm sorry Simeon I'm just going to comment that we're already seeing because we're in Scottsdale and Vegas and a few other stores that those customers are really sharing with us, not only their e-mail address because this is an e-mail based program, you have to give us your e-mail, so we can track the perks and so we can surprise and delight you every month. But they're giving us their phone number, they're giving us their mailing address and the percentage that we are receiving is incredibly gratifying.

<Q>: Got it. And so, I guess presuming in those where you have the ability to directly communicate a direct market, are you seeing that it is driving traffic going back to the traffic drivers that we talked earlier, are you seeing a direct impact when you send some e-mails out and you're able to bring people into the store?

<A>: We are Simeon. They are coming back. I mean, it's amazing, in the test in California, one of the perks for the month was we partnered with one of our vendors and we gave our POP! Stars a little goodie bag of three products. And you just wouldn't believe these people would drive two hours and three hours to receive that little goodie bag of products and then of course they shop and their average ticket is higher than non-POP! Stars.

<A>: Yeah. It's not really designed for average ticket, but wonderfully enough it has a positive impact there as well.

<A>: I'm sure it does.

<Q>: Thank you.

<A>: You bet.

## Operator

Thank you. [Operator Instructions] And the next question is from Dan Binder of Jefferies. Please go ahead.

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<Q - Dan Binder>: Hi, good afternoon. It's Dan Binder.

<A>: Hi.

<Q - Dan Binder>: My question was around the comp guidance for Q4. I mean, given your current view that maybe it's not old weather and we're in a bit of a funk, it's a pretty big stretch to get to mid-single from where we just finished. Just trying to understand how much of that is, if you could pass it to how much of it is easy comparison versus initiatives versus some underlying assumption in the core ... ?

<A>: Right. Well, I'll let Jodi answer that question, but something I want to just comment on is there is a 7% comp store sales differential between stores that had a lot of weather and stores that had some weather in the fourth quarter. And so, we're just up against the easiest comps in our entire history, but go ahead.

<A - Jodi Taylor>: Yeah, Dan. It would be primarily due to the expectation of improving weather, since it had been such a significant impact to us in the fourth quarter. Secondly, would be the impact of the initiatives far more because of the weather.

<Q - Dan Binder>: And on the – your earlier comments about not promoting. I'm just curious in this kind of environment, why not come out a little bit more to try and get the traffic?

<A>: We're not – we'll do some promotions. What we're trying to emphasize is, we did not do more promotions this period than we did a year ago. We are beginning to feel like – our consumer, everybody is reacting more to – I mean, retailers are just training – it is the most promotional environment I have ever seen in my carrier, I think. And so, we're not stubborn. We're not overly proud. We have the best relations with our vendors in the industry and we can gain their participation and if we need to do more of that, we'll do more of that. We still done some of it. But if we need to do more of it, we will. We're flexible about that. When we hit the weather last year, we kept Elfa on sale for additional period of time. We're not foolishly proud on that and we're very confident of our ability to get our vendors to work with this to pass on those discounts when and as needed and my wife, Sharon, our Chief Merchant and she – we're looking to that, we're looking at SG&A reduction, we're looking at sort of limited impact gross margin more price promotion and we're doing everything that we've learned to be able to do in our carriers when we get a little unexpected patch of sluggish sales.

<A>: Yeah. And I think the point give us that we are strategic with that and we're certainly not proud with that. We'll do what we need to do without harming the brand, but I think we're very strategic with our sales and our promotions. And if you're in our store right now, most of the time throughout the year we had either a collection or a section of the store something on sales which again we've worked with our vendors to pass that on so that it makes it very profitable.

<Q>: And then just finally if I could, can you give us any kind of definition on success in these new initiatives whether it's where you see that – those businesses for the custom closet, the ATHOME initiative, how would you define success in the first year? Is it may be a level of sales or a percentage of the mix or number of transactions, any help you can give us on that, on what your expectations look like?

<A>: Well, I guess we've avoided in the call – in the quarterly call getting too specific on that since we're still in test mode, but I mean you've got a product that we think is the biggest thing we've done. Maybe in our history it's got 60 times or 70 times the average – the overall average ticket. And so if it amounts to very mini percent at all of total sales it really raises your average ticket and that falls straight to your comp store sales increase. So let's say we're able to take traffic from minus a half to plus a half and then if you add some points to this average ticket thing you get back to where we need to be.

<A>: Yeah. I think the short answer to your question, Dan, is with regards to both ATHOME and the new custom closet offering that we'll have, those are both going to be the report card so to speak will be average ticket without a doubt. Seeing that growth, as we said, it has always grown at this company. That's not a new phenomenon for us. We are very proud of our average ticket growth that we've seen and that is...

<Q>: About 5.6% last year?

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<A - **Melissa Meyer Reiff**>: 5.6% and 4.2% the last two fiscal years. So certainly it's been growing nicely.

<Q>: And that's without this kind of initiative?

<A>: Right.

<A>: Right. And then you get all the frequency from the POP! Starts and introduce them to all this new wonderful collection, there you go.

<Q>: Yeah.

<A>: That's right.

<A - **William Tindell**>: So, for us it's easier to raise average ticket than it is to raise traffic and I think that's probably because we have these well paid, well trained sales people and then we have the average tenure in buyers is like 17 or 18 years, so we're bringing in higher end product that the customer has been asking for and gosh, we – the average first year employ at the Container Store gets trained, how many hours Melissa?

<A - **Melissa Meyer Reiff**>: Over 280 hours.

<A - **William Tindell**>: 280 hours and the industry average is less than 10 hours. So we're good at training. This product is like a lot of products out there, that's why I jokingly call it – you can call this Texas closet in Texas. And it's just a matter of expediting the rollout of it, because the sales are a little more sluggish than we thought.

And you know I mean they are a little more sluggish than we thought the first quarter. I mean we'll see about the second and third quarter. We're trying to be very conservative and mindful of how they were in the first quarter by lowering the second and third comp estimate, but we've – like everybody, we've had comp store sales in the double digits and we've had them negative, but not very often. So we'll see how long this persists.

<Q>: Thanks.

## Operator

Thank you. We have no further questions at this time. I would like to turn the floor back over to management for any closing remarks.

## William Arthur Tindell

Okay. Well, I think this retail funk is real. Yeah, we're a little surprised by it. But we're not immune to it. We are very mindful of our employee morale and our customer morale, if you -- people haven't stopped loving us. I mean, they seem to love us more than they ever have. We are very confident of that and I think it's important to remember the first quarter is our least important quarter. Simply put, it represents less than zero percent of our annual earnings.

We believe the second and third quarters will improve. We're trying to be very modest and conservative on how we project that, but we're confident they will improve for a lot of reasons. But we're of course looking forward to that fourth quarter as we comp against the worst weather we've had in our history, but also believe that everything that we're doing will help a little bit more in the second quarter, a little bit more in the third quarter, a little bit more in the fourth quarter. And with the historical 60% of the earnings occurring in the fourth quarter and as Jodi mentioned, this year we expect that to be 70% of the earnings in the fourth quarter. That's when accounts it.

We wish we weren't like a basketball game, where all that matters is the fourth quarter, but that's just the way our business is and we'll take it and we're going to maximize that fourth quarter. We're attacking the slight traffic declines with other initiatives besides just POP. POP is just the main one and we're increasing average ticket with all of our abilities, but the ATHOME and closet domination things I think will really give us tailwinds on that. We're very pleased to get to 12% minimum square footage growth even this fiscal year. It normally takes us eight months or 10



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months to open a store, but we wanted to get that one signed and illustrate that we're not just doing the 12% next year, we're doing 12% right now and we're proud of our employees kind of pitching in.

It's kind of like the family around the dinner table, where you're holding hands and we're saying, okay, we're going to grow at 12% square footage or better and we're going to somehow get that stubborn traffic thing up to slightly positive, but we got to do what we do best with this average ticket thing and we got to really make some in roads there and The Container Store is not designed to have a minus 0.8% comp store sales increase – decrease. We get 3%, 4%, 5% or better, we do fabulously well. So, it's almost joyful. It's kind of like going [indiscernible] together and doing that thing that we do best, which is average ticket growth.

So, thank you again for all of your time and your interest today and I look forward to updating you again next quarter particularly on that average ticket thing. Thank you again.

## Melissa Meyer Reiff

Thanks, everyone.

<<Jodi Lynn Taylor, Chief Financial Officer>.

Thank you.

## Operator

Thank you. Ladies and gentlemen, this does conclude today's teleconference. You may disconnect your lines at this time and thank you for your participation.

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