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SCSS - Q3 2017 Select Comfort Corp Earnings Call

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OVERVIEW:

SCSS reported 3Q17 net sales of $403m and diluted EPS of $0.62. Expects 2019 EPS to be $2.75. Co. also expects 2017 EPS to be $1.30-1.45.

CORPORATE PARTICIPANTS

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

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

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PRESENTATION

Operator

Welcome to Select Comfort's Q3 2017 Earnings Conference Call. (Operator Instructions) Today's call is being recorded. If anyone has any objections, you may disconnect at this time. I would now like to introduce Mr. David 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 Third 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, everyone, and thank you for joining our call today. My SleepIQ score last night was 74. Our consumer innovation strategy continued to gain traction in a dynamic retail environment. The investments we've made to strengthen our competitive advantages and expand our brand reach are resulting in profitable growth and strong cash flow generation.

With the progress we've made these past few years towards our vision of becoming one of the world's most beloved brands by delivering unparalleled sleep experiences, it is an appropriate time to change our corporate name to Sleep Number Corporation effective November 1. At that time, we will also change our NASDAQ ticker symbol from SCSS to SNBR.

Our reported third quarter net sales of $403 million reflects steady growth throughout the quarter including Labor Day weekend. The exception to our consistent performance was the week before and the week after Labor Day weekend, which were each impacted by Hurricanes Harvey and Irma. About 13% of our store portfolio was directly affected by the hurricanes, including stores in Florida, Texas and the surrounding states. We also experienced consumer distraction across the country during this specific time frame. We estimate that the hurricanes resulted in $12 million to $15 million in lost or delayed sales in the quarter.

Traffic and sales before and after these 2 weeks were on plan, and all affected stores are now open. We are thankful that our team members in Florida and Texas are safe, and we're very proud of how they have supported one another and their communities. In addition to our team's individual efforts, Sleep Number has made a $1 million donation of products to support the recovery in affected communities.

We offset most of the sales impact from the hurricanes with stronger-than-expected gross margin and expense control. Earnings per share in the quarter were $0.62, up 11% versus prior year. Year-to-date, we gained market share with an 8% sales increase over the prior year, with EBITDA up 15% and earnings per share up 36%. We are maintaining the midpoint of our 2017 EPS guidance of $1.38 and narrowing the range to $1.30 to $1.45. We remain on track to deliver $2.75 in earnings per share in 2019.

I will now provide an update on our drivers of sales growth, which are resulting in consistent traffic, high conversion and ARU growth. Demand for our revolutionary Sleep Number 360 smart bed remains ahead of our expectation. With consumers increasingly understanding the linkage between sleep, technology and wellness, our 360 smart bed contributes to building a more broadly relevant brand. Our customers are enthusiastic about the effortless adjustability that seamlessly integrates smart connectivity, comfort and design. One of our customers in Georgia said, "Love the technology, love the comfort, and it's beautiful."

As we outlined at the beginning of the year, we planned for a phased implementation of our 360 smart bed line. We deployed 2 of our higher-end models, the i7 and i10 360 smart beds in the second quarter. Strong consumer adoption of these 2 models is resulting in both ARU growth from favorable mix and increased FlexFit attach rates.

We plan to launch a third 360 smart bed model, the p6, in November. As we fully transition all of our portfolio to 360 smart beds by the first half of next year, we expect to continue to drive growth through both units and ARU.

In addition to generating demand, the 360 smart beds have also driven significant change throughout our organization. Our phased launch approach is allowing us to build on learnings and deliver efficiencies as we continue the rollout. Here are 2 examples. First, our new adjustable base design has a proprietary modern sleek surround that makes the base more broadly appealing. We discovered elevated levels of damage to this new design as it moved through our supply chain's multiple touch points en route to our customers' homes. Our teams rapidly implemented packaging and handling process changes to mitigate this issue. As we simplify our supply chain, we expect additional benefits.

Second, our popular feature -- another popular feature is our new proprietary foot warmer, which helps people fall asleep faster. The foot warmer feature is available with our Sleep Number 360 smart beds when sold with our FlexFit 3 adjustable base. During the quarter, we identified a component defect in some of our foot warmers delivered prior to mid-August. This resulted from a supplier manufacturing defect that has now been fully resolved.

In abundance of caution, we are working voluntarily with the Consumer Product Safety Commission. We expect to recall and replace the potentially affected components in the fourth quarter. We do not expect this to have a material effect on our financial results.

We've strengthened our proactive supplier management processes and resources in addition to other supply chain improvements. These actions are making a difference now and will lead to stronger leverage and profits. We are excited about how the 360 smart bed is improving people's sleep and therefore, their overall well-being. And we look forward to the strong value we will deliver with the launch of the p6 smart bed and the remaining models.

Now let me update you on our other growth drivers. First, we continue to efficiently expand our brand reach, connecting more effectively with customers and activating our loyal insiders. Advancements in our media strategy are delivering ongoing efficiency and effectiveness. We planned for and experienced a significant increase in competitive media spending this quarter. In this environment, we optimized our media mix for higher-quality traffic and delivered 60 basis points of media leverage in the quarter.

Qualified unique visitors to our website were on plan, and media ROI remained at the highest levels we've achieved since we implemented our econometric model in 2013. We expect more than 50 basis points of media leverage for the full year.

In today's digital world, consumers want to engage directly with brands that inspire them, and Sleep Number is one of those brands. We continue to make strong progress on our digital strategy. We recently in-sourced our social media buying to further optimize our digital media mix in realtime. We also improved our online experience for easier search, navigation and transaction. Over the quarter, these actions contributed to higher online engagement, well-qualified traffic and strong conversion.

Our loyal insiders continue to be the most efficient source of new sales. Our referral and repeat business was very strong in the quarter at over 35% of our sales and growing. And our recently launched digital loyalty program is driving higher-than-expected redemptions, spend and referral.

Finally, we continue to advance our direct-to-consumer retail strategy, which results in high conversion and productivity. Our store experience is a clear point of differentiation in overall retail. Existing stores are delivering positive sales comps, and new stores contributed 6 points of growth in the quarter as planned. We expect to grow our store base by 3% to 4% this year and remain on track to end 2019 with 600 to 650 stores in all 50 states.

Turning to our drivers of business leverage, we again delivered strong gross margins in the quarter due primarily to our product mix and higher manufacturing productivity. We successfully completed the pilot of a second hub that is now fully assembling beds, and we are on track with our multi-year plan for assembly sites. We have significant leverage opportunities still ahead as we become more efficient with our 360 smart beds and complete our network reconfiguration.

Year-to-date, we have generated $176 million in cash from operations. We invested $38 million in support of our business initiatives and repurchased $115 million of our shares. Our trailing 12 months ROIC was 13.8%, well in excess of our weighted average cost of capital.

With confidence in our progress and plans for continued cash generation, we have increased our share repurchase authorization to $500 million as of the beginning of the fourth quarter. We will continue to execute against our 3 cash priorities: investing in our growth, financial flexibility and share repurchases.

We are on track to deliver superior value to our shareholders. Our investments to differentiate Sleep Number are proving to be the right ones in this dynamic environment. With our Sleep Number 360 smart bed, we are changing how people think about sleep and delivering life-changing value. We are building connected life-long relationships with our customers. Our cohesive retail experience is strengthening our brand while also improving accessibility and convenience. And our mission-driven culture, which inspires innovation, continues to be a real differentiator.

Next week, we will be in our new corporate headquarters in downtown Minneapolis. Our new home is designed for how people work today, with a connected environment that makes it easy to coordinate and collaborate wherever or whenever you work. It is an innovative workplace that inspires individuality and a place where well-being is fostered and starts with great sleep. We expect to benefit from improved recruitment, productivity, creativity and retention with this move.

I want to thank our team for their dedication to our mission of improving lives by individualizing sleep experiences. Their care for our customers and for one another is an amazing strength, and it makes a difference every day in so many ways.

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

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

Thank you, Shelly. As a sleep innovation leader, we are on the right path to deliver superior shareholder value. So far in 2017, our demand drivers, which include our latest innovations in the 360 smart bed, led to 8% net sales growth in a noisy retail and changing consumer environment.

Our leverage drivers have delivered a higher-than-expected 120 basis point year-to-date gross margin rate improvement. These drivers, combined with our capital initiatives, have led to a 30% increase in year-to-date free cash flows, a 36% increase in our diluted earnings per share and an ROIC of nearly 14%, more than 70% stronger than our estimated 8% weighted average cost of capital. This is the beginning of the cash and profit acceleration we expected when building our differentiated business model.

For the third quarter, net sales increased 9% to $403 million. Our results include the $25 million of delayed deliveries carried over from Q2. As noted in Shelly's prepared remarks, our business during this seasonally largest sales quarter were negatively affected by Hurricanes Harvey and Irma the week before and the week following the Labor Day weekend. Our sales performance was steady prior to and after these storms and were on plan for the Labor Day weekend. However, we operate in a low interest category, and during those 2 weeks, consumers across the country were concerned by the extensive damage from the hurricanes. We estimate these temporary disruptions cost us $12 million to $15 million in net sales in the quarter, which equates to $0.05 to $0.08 of EPS.

That said, we offset most of the earnings impact of these lost sales through stronger-than-expected gross margin and expense controls that I'll discuss further in a moment. We continue to expect high single-digit sales growth for 2017 and mid to high single-digit growth in Q4.

The effectiveness of our demand drivers is reflected in our Q3 sales metrics. Our ARU grew 11% in Q3, benefiting from a strong mix of our 360 smart beds and continued growth in FlexFit bases and SleepIQ technology.

Deliveries of company-controlled units in Q3 were equal to the prior year, bringing our year-to-date unit growth to 4%. Our net new stores contributed 6% of year-over-year growth while comp store sales grew 5%. We ended the quarter with 553 stores, up 5% versus the prior year third quarter. Our trailing 12-month average comp store sales were $2.4 million, up 5% versus the prior year.

Our demand drivers, in concert with our leverage initiatives, delivered a stronger-than-expected 62.9% gross margin rate in the third quarter. Our favorable mix of 360 smart beds and our operating lean initiatives more than offset margin pressures from excess freight, handling and supplier transition costs.

As you think about our gross margin in Q4, remember that the prior year fourth quarter included a 50 basis point benefit from the reversal of incentive compensation accruals. For 2017 in total, we now expect to deliver 70 to 90 basis points of improved gross margin on top of the 80 basis point increase in 2016.

On the second quarter call, we detailed how our global sourcing efforts are critical to both our innovation and achieving our profit goals. We also discussed the successful relocation of 2 partner hubs and the in-hub assembly of our 360 smart beds, which are now being produced at 2 company-operated locations. Today, we'll go deeper into the third element of our multi-year supply chain evolution that focuses on optimization of our outbound logistics operations.

Our current hub and spoke network includes 15 hubs and more than 120 spokes, which are purely cross-docks, where no inventory is stored. Today, we service about 70% of our orders through spokes. This requires multiple touch points and less-than-truckload shipments around the country. Our multi-year effort will realign our fulfillment to support 80% of our business from 30 to 40 assembly and delivery warehouses with 20% serviced through spokes. This structure will reduce total square footage by more than 25%, improve customer delivery reliability, reduce in-transit handling damage and release efficiencies across the network through fewer handoffs.

I mentioned earlier that we're now operating 2 assembly hubs. We have also successfully established 2 new delivery distribution centers to service Houston and Austin markets, which were previously supported through spokes. We are pleased with the results of this initiative so far and are confident it will help us deliver on our profitability commitments.

Transition costs in Q3 were $4 million as planned or $0.06 per diluted share. About 2/3 of these costs were in COGS with a balance in operating expenses. We continue to expect transition costs of $3 million to $4 million in the fourth quarter of 2017.

Our overall operating expenses in Q3 were lower than planned. With Q3 being our largest selling period of the year, our sales and marketing costs were fully committed. However, we are very disciplined with our discretionary G&A and R&D spending to help offset the impacts from hurricane-related sales pressure in the quarter. For modeling purposes, we expect sales and marketing to be about 45% of net sales for the year and G&A expenses in Q4 to be about $34 million to $35 million. We continue to expect about 50 basis points of deleverage in 2017 in G&A and R&D combined due largely to incentive comp, transition costs and higher depreciation.

In Q3, we delivered $0.62 of earnings per diluted share, up 11% versus the prior year. Year-to-date, our initiatives have delivered a 36% increase in EPS on 8% top line growth, demonstrating the power of our differentiated business model.

We've rebuilt our inventories from the $70 million last quarter to a healthy $79 million, which is appropriate to support our plans. You'll also note that our customer prepayments have come down about $6 million from last quarter, having serviced the higher-than-normal Q2 backlog in Q3.

As expected, our initiatives are accelerating profits and cash generation. The $176 million cash from operations year-to-date is a record and is up 21% versus the prior year-to-date. So far this year, we've invested $38 million as planned to support high-confidence, high-value capital projects. Diligent execution of our strategy has accelerated our year-to-date free cash flow generation by 30% to $138 million for support of our deployment to shareholders.

We continue to see value in our shares and bought $40 million worth in the third quarter and $115 million year-to-date. The new $500 million share repurchase authorization at the beginning of Q4 supports our capital deployment plans through 2019.

With our EPS drivers delivering the results we expect, we are maintaining the $1.38 midpoint of our 2017 EPS guidance range. We've also narrowed our 2017 EPS guidance range to $1.30 to $1.45. This guidance reflects the assumptions I've called out throughout my prepared remarks. We continue to advance the value drivers to accelerate profit and cash generation on our path to deliver $2.75 in earnings per share in 2019. Achieving our financial commitments presents a compelling investment opportunity. Aljo, at this point, we'd like to open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is coming from John Baugh with Stifel.

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

I was just curious on the hurricane impacts that you broke out. Could you -- you mentioned you were on plan before and after and during Labor Day, and I don't recall the exact timing of the 2 storms. But I was wondering if you could just parse it a little finer and -- just so we can discern how you came up with the number. Appreciate it.

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

Yes, thanks, John. It's exactly the way that I was describing it. It was about the week prior to the Labor Day weekend and then the week after -- or that was Hurricane Harvey. And then the week after Labor Day weekend, Hurricane Irma came ashore. Those are the 2 weeks in which we saw a meaningful difference in our performance versus our plans. That's how we've triangulated the estimated impact of $12 million to $15 million on our net sales for Q3.

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

Okay, thanks. And I noticed payables were up significantly. Is there something driving that? Or was that just timing?

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

John, we continue to work on all elements of our balance sheet, including our working capital management. Largely though, that's just timing.

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

Okay. And then on the hubs and spokes and DCs, it sounds like there's a fair bit going on. And it sounds like there's some transition costs within benefits. And I guess I'm trying to discern what happens, what's helping, what's hurting and sort of the timing of all that. And I'm not looking for quarters but maybe the '17, '18 and '19, the annuals.

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

Yes, John. This goes back to our conversation at the November investor conference. We highlighted then that we're going to have some transition costs associated with the launch of the 360 as well as the evolution of our supply chain, both of which we've highlighted that they pale in comparison to the benefits that we'll ultimately gain. We're starting to see some of those benefits already. You've seen, based on the 2 360 models that we've had launched, very strong ARU growth, very high demand with consumers. They love the product. And on the supply chain evolution, we've encountered a couple of hiccups that we've highlighted but resolving those rapidly and taking care of our customers is our focus. And we expect the transition costs, we've highlighted that they're about $0.18 worth in 2017. And we haven't yet talked about '18, but I'm sure that they will be some level, maybe half as much again in 2018. But we'll highlight that more when we provide our 2018 guidance on the Q4 call.

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

Okay. And lastly, has there been any pricing changes? I know you change pricing in and around holiday events. But any year-over-year changes worth calling out?

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

Our promotions, John, were largely consistent with what we've run in the last year. We felt really good about the response. And as Shelly highlighted, demand and our performance was steady through the quarter other than those 2 weeks that we highlighted.

Operator

Our next question is coming from Peter Keith with Piper Jaffray.

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

Peter, are you there? Eljoe, he may have his line muted. Maybe you can...

Operator

Our next question is coming from Budd Bugatch with Raymond James.

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

I missed a little bit of the call as the operator was coming back on the line for whatever reason. But David, if you could, just on the sales issue, the way comps are calculated. If you take the $25 million out of the comp, I get sort of a negative 2% comp. Is that the right way to think about that? And then if you add the hurricane back in, the effect back in, I get a 1% to 2% positive comp, ceteris paribus, everything else being equal.

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

Yes, that's directionally okay. But I know that you don't love it when I say that. But the bottom line is the $25 million was both from new stores and comp stores, so it sounds like you're attributing it to all comp. And the same thing goes on the impact from the hurricane. But directionally, you're fine.

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

Okay. I just was trying to understand how to parse out the comp.

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

Yes, if I could highlight one thing, when we think about it in total, that adjusting for those 2 impacts, we were in the 6% to 6.5% growth range.

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

I got that. And if I look at the advertising budget for the fourth quarter, it looks to me like advertising will be flat year-over-year or very close to flat year-over-year in terms of total dollars to get to a 60 basis point improvement, which would be what, 14% versus 14.6% last year?

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

Yes, that's about right, Budd.

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

Okay. And then as I look at -- also look at then, if I take that and do the math to get what are the, what I would call, nonmedia sales and marketing expense, looked like that grew about 14% quarter-over-quarter. And I know that, that's not -- I don't think that includes the incentive comp. Can you talk about how much of that is spending and how much of that's transition? Where -- that's part of what I think I missed in the conversation you were having during your script.

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

Yes, we've highlighted that we have -- the store increase in terms of the count, the depreciation, the staffing, et cetera, that's all included in the selling and marketing costs. We've also got financing costs embedded in there. With the stronger ARU that we've been seeing, some of that's being -- more of that is being financed, and that's flowing through in the sales and marketing side. So we started the year with guidance of 44% to 45% of net sales, and we're maintaining pretty consistent to that. We're ending our guidance today, we're talking about it as 45% of net sales for the year.

Operator

Our next question is coming from Brad Thomas with KeyBanc.

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

A couple of questions if I could. First, just wanted to touch on ARU. The growth there obviously very strong. You referenced solid response to the i7 and i10 relaunches. I was hoping you could just talk a little bit more about that growth in ARU, strongest in a couple of years. And is that what you'd like to be driving in the business or perhaps is there an opportunity to drive more units if you weren't driving the ARU up so much?

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

Brad, thanks for the question. Well, of course, we always appreciate the benefits of this business model with having both ARU and unit growth. And as we've communicated for the last number of years, consistent with our consumer innovation strategy, we expect both out of the business and continue to deliver both on an annual basis. We, with this first phase, launched the high end of our 360 smart bed line, so it is driving more ARU growth than we had originally planned in the year. But we also expect unit growth, and we will expect growth from both in 2018 as well. So year-to-date, our ARU growth is 5% and 3% and -- or units is 3% -- 4%, sorry. 4%, so growth for both.

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

Got you, okay. And then just to follow up on gross margin, I think this is for 3Q and for 2Q before it, you've clocked in better than we and I think the Street more broadly was looking for. I guess I was hoping to just follow up about what it was that was driving that outperformance. And as you get further into some of the supply chain evolution, if you could just talk a little bit more about your confidence in continuing to drive margins higher over the next couple of years.

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

Well, the gross margin improvement was largely due to mix as you look at the 360 smart beds at the high end of our line and being able to drive up mix. So that's contributing to both the ARU and gross margin and also manufacturing productivity. So it's coming from 2 important aspects of our EPS drivers in demand and leverage. And of course, we like to see that in the business. And as we move forward, again, we have the additional models of 360 coming, which we expect to contribute to that unit growth as well as ARU and then also the advancements in our supply chain. Regarding confidence in the margin expansion potential as a result of the initiatives we're working on right now, it's very high. We're excited with the amount of opportunity we have in front of us. As we become both more efficient with our phased launch of 360 but also the network redesign, the continuous improvement that we're able to make progress in across our organization with all of our lean initiatives. And really, it's been quite fun to see the culture grow in this area and the desire throughout the organization to find waste and drive it out of our business.

Operator

Our next question is coming from Seth Basham with Wedbush.

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

My first question is on comp units. I know you don't provide the number, but if your comp sale is adjusted for the delayed sales as well as the hurricanes were up 1% to 2% and your ARU was up 11%, it means your comp store units on an applied basis were down high single digits. I know that's not up to your plan, but what is going to drive significant improvement in that to get to positive levels again?

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

Seth, we see when -- we see the significant improvement coming from the 360 smart bed when we roll it out with all of our models. Right now, as I stated, we're focused on the high end of the line first, that the unit growth will -- we expect to be very strong with the C series and the P series.

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

Got it. Are you guys experiencing a high level of cancellation rates more so than normal because of some of the challenges that you faced operationally?

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

Yes, slightly. But that's baked into how we're thinking about our performance and our guidance for the year.

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

Understood. And then as it relates to commodity inflation, we've seen pretty significant increases in input costs for foam. How are you looking at commodities into your gross margin plans for the balance of the year and 2018?

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

Well, that's a part of the business model, and we have contracts with our foam providers that help us limit the amount that they can increase their pricing quarter-by-quarter. However clearly, the hurricanes also impacted Houston, and there were some pressures in that region. We expect it to be short term in nature and -- but again, with this model, Seth, we love that we have pricing power over the course of time. We've had a 3% price improvement, benefit-driven price improvements over time going back for 5 or 7 years.

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

The other thing I would add, Seth, is we are working very closely with our suppliers in continuing to find more efficient and productive ways to do business and align with suppliers who have a similar lean mindset as we do. And that kind of partnership and long-term view is very helpful in us working together to find other ways for efficiency.

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

Got it. Just to be clear, you expect to be able to take price to offset any commodity price inflation?

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

No, I'm just saying that we have that capability, but we're also driving a lot of initiatives, including the lean manufacturing operational efficiencies. And we want to deliver strong value propositions to our customers as well. So we'll take it on a case-by-case basis as we encounter it.

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

All right. And lastly, as it relates to the launch of the other units in November as well as into 2018, would you expect those to be priced at the same level as the prior models? Or do you expect them to be priced higher?

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

Similar. We'll talk about the p6 because that's launching in November, and we are planning on a similar price to the p6. Again, we are benefiting from the ARU growth by attaching our FlexFit adjustable base at a higher level along with SleepIQ technology.

Operator

Our next question is coming from Keith Hughes with SunTrust.

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

First question, back to some of the product challenges you were talking about earlier, could you talk again on the adjustable bases? I was just a little confused of what happened in the quarter around those and where you are fixing that.

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

Yes. So what's important, Keith, is that these are not material items that we're talking about. What they are, are material innovations that our consumers love. And we're trying to make sure that you understand both sides of that, that it's important for our strategy and for the consumer that, in this case, we have a new surround that encapsulates the entire FlexFit base, and it's very attractive. And during the initial part of the launch, we saw more damage than we expected to that surround. We've quickly responded and fixed the packaging associated with that, and we feel good about where we're headed going forward.

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

Okay. And the other question, the expenses you're looking at another $0.08 potentially next year around launch costs, is that correct? Is that where all the $0.08 come from?

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

We haven't provided specific guidance for 2018. I just threw out that directionally, half of what we're expecting for this year, you can use that as a benchmark as you put together your model for next year. I'll provide more detailed guidance when we have our Q4 call.

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

Okay. And will the launches for the remaining of the 360, will they be done mid-year? Or are you willing to say when at this point?

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

We expect to be completely launched by middle of next year. And the other side of the transition costs though is associated with the supply chain evolution, which is a multi-year effort.

Operator

Our next question is coming from Peter Keith with Piper Jaffray.

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

So the $12 million to $15 million of sales impact from the hurricanes, how should we think about that now going forward? Are you guys -- does that maybe create pent-up demand? Or do you view it as sort of lost sales that you'll just lap next year?

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

Well, our guidance for mid to high single-digit growth in Q4 doesn't assume that we get a big rebound of those sales coming back into Q4. However, it would take us to the higher end of our guidance range should some of those sales come back, and we'd certainly -- we're here to take care of those customers.

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

Okay, very good. And just looking at Q4, using the midpoint of your guidance would imply Q4 EPS of $0.22. Consensus right now is at about $0.15, so pretty big delta. Do you have any visibility on where the Street might be underestimating your Q4 performance?

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

We can take a look at the modeling questions on the after calls, Peter. This is basically in line with how we had been thinking about the year, at the midpoint, even going back to the Q2 call when we're guiding to the midpoint, our EPS was different than where the consensus was landing, and I think the biggest delta there was in the cost structure. So let's take this off-line.

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

Okay, got it. Maybe 1 or 2 more. So you had mentioned earlier, I think in response to Seth's question, that you were experiencing a higher level of cancellations. And it did appear with some of the social media trends in the quarter that there were some delivery issues. I guess, a, are you through the delivery issues? b, why are you experiencing them? And then c, when can we expect maybe getting back to a normal level of cancellation?

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

I talked about the cancellation rates being just modestly higher. We talked, coming into the quarter, that we'd had some inventory challenges that we got resolved pretty quickly and taking care of those customers in the quarter, that created some noise for us. We highlighted a couple of things related to the 360 launch that we've worked through, and those created a little bit of noise for us. We are really excited about the p6 launch next month in November and feel good about where we are and our ability to deliver a very strong customer experience with that. I guess the other element I highlighted as well during the call that the hurricane also impacted our supply. And we had FlexFit bases coming out of Tampa that were delayed, and that impacted some of our deliveries as well in the quarter.

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

And Peter, just as an example, those FlexFits coming out of Florida, they were being delivered in customers' homes who were not at all affected by the hurricane. So that created some confusion for those customers not understanding that, that would be a delay that would impact them.

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

Okay, very good. One last one here. So on the Sleep 360 rollout, I believe you have 2 models, 2 of 7 in the marketplace today. You have the p6 coming out in November, so that I guess would imply sort of by year-end, you'll have less than half of the line converted, yet the transition costs are expected to step down meaningfully. I guess can you -- in 2018, can you tie it together when it seems like there's more models rolling out next year versus this year?

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

Yes, glad to do it. And I think what you're seeing is that ramping up suppliers is a bigger component of the transition costs than maybe you were thinking about before. And that's kind of front-loaded.

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

And also as we've talked about this phased approach and we gave you a couple of examples of learnings in the quarter and efficiencies that we're able to improve on prior to the next phase. And so you can expect that too as we move forward with our transition costs, we'll be more efficient.

Operator

Our next question is coming from Michael Lasser with UBS.

Unidentified Analyst

(inaudible) calling in for Michael Lasser. So I missed a little bit of the call early on, so I'm sorry if you already answered these questions. But on the hurricane, the $12 million to $15 million that you mentioned that you lost during the couple of weeks that we had hurricanes, is it a total amount for the quarter? Or is it a net amount, assuming that you recaptured a bit in the final couple of quarters -- the final couple of weeks of the quarter, sorry?

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

Yes, we're highlighting that the $12 million to $15 million is attributed to the 2 weeks where the hurricanes were coming ashore and impacting the country and impacting broadly in this low interest category consumers across the whole country as they were focused on seeing the devastation that those hurricanes were causing.

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

And also the specific 13% of our stores that were directly impacted.

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

Yes, both the direct impact on the 70-plus stores, almost -- about a 340 lost days of sales, and then the indirect impact for the consumers that were distracted.

Unidentified Analyst

Okay. So just to clarify, you were not seeing much of a recapture in the last 2 weeks when the weather stabilized in those markets.

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

As we highlighted, we were steady. Our performance was steady across the entire quarter outside of those 2 weeks.

Unidentified Analyst

Okay, that's fair. And as my follow-up, can you just remind us as to how much of the $0.18 of launch costs have you already incurred in the first 3 quarters of the year?

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

$0.12.

Operator

Our next question is coming from Curtis Nagle from Bank of America.

Curtis Smyser Nagle - *BofA Merrill Lynch, Research Division - VP*

So I guess the first one is what is your level of confidence that you guys think your I guess -- through I guess potential new issues with the 20 new vendors after the foam issue in 1Q and then another albeit smaller issue this quarter? I mean, are you guys going back and perhaps doing audits? I guess, how comfortable are you feeling with the new suppliers?

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

We've done our homework with our suppliers, and we're working with suppliers that are working with us both on the innovation side as well as the profit objective side. And we've implemented some stronger controls and inspection over our suppliers and moving from a reactive place where we identify problems once they're already in their customers' homes to more of a preventive strategy where we're focused on solid quality coming out of our suppliers' factories before they ever get to us.

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

It's a great question. This is one of the reasons why we've taken additional time in this particular phase as we uncover learnings and doing the -- taking this time to do the deep dive in all aspects and striving to gain as much efficiency as we can and great customer experience before we roll out the next phase. And we're about to do that with the p6, and that speaks to our confidence.

Curtis Smyser Nagle - *BofA Merrill Lynch, Research Division - VP*

Got it. And then just a quick follow-up. On the new $500 million buyback authorization, could you give us some sense on perhaps what the timing would be? Is this perhaps, I don't know, maybe a 3-year window? Or are you thinking something a little shorter or longer?

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

Yes, Curtis, this is really important relevant to our strategy, and we've been highlighting that we expect from the model that we will accelerate profits and accelerate our cash generation. We are seeing that already, and we're at the beginning phases of that. We expect that the $500 million will give us capacity to execute against our plans, our commitments to all 3 EPS drivers, that's demand, leverage of our operations and the accretion through share repurchases. And this gives us the capacity to do that through 2019.

Operator

Our next question is coming from Jim Larkins with Wasatch.

Jim Larkins - *Wasatch Advisors Inc. - Portfolio Manager*

Hey, a couple of numbers, I may have missed, if you could review these. Did you give the number of shares you bought back in the quarter?

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

Just a second, Jim. Did you have that handy? We bought $40 million worth, Jim, at about $31 a share.

Jim Larkins - *Wasatch Advisors Inc. - Portfolio Manager*

Okay, great. And then could you give me the dollars you spent on media this quarter and last quarter?

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

This quarter, it was up about 5%. Let me just dig through my notes here. Media spending in Q3 was about $56 million and last quarter, $42 million.

Jim Larkins - *Wasatch Advisors Inc. - Portfolio Manager*

Great. Can you give some more color on what's working with the 360? It sounds like you're above plan. Just maybe give us some more color on that.

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

Yes, a couple of things. First of all, I highlighted the consumer trends around the smart connect, smart products as well as the interest and the understanding that sleep contributes to improved wellness. And what's great about the 360 product and consumers are responding so strongly to is the effortless nature of this bed, the effortless adjustability as well as connecting to your other devices. So the bed is there, and the customers really does not need to do anything because the bed will do it for her, and it delivers a higher-quality sleep, and again, that leads to improved wellness. I would also highlight the way the bed works with the adjustable base. So our FlexFit adjustable base and the Sleep Number 360 mattress were designed together, and the customer is experiencing that in our stores with our selling process in a way that they're choosing both, that integrated design driving the ARU.

Jim Larkins - *Wasatch Advisors Inc. - Portfolio Manager*

Okay, great. And then could you talk about kind of when do you expect to kind of have optimal delivery and set-up times kind of hitting your targets? And what would those targets be?

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

As far as our delivery time period, we're on...

Jim Larkins - *Wasatch Advisors Inc. - Portfolio Manager*

I guess, how long would it take to get a bed after it's been ordered and then set-up times. When do you think you'll be to the optimal level and what's your target for those levels?

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

Well, the optimal level may continue to move based on the consumer. What we love about our new system as a result of our ERP system is the ability to schedule customers in store. And this will vary depending on where a customer lives. So if you go into a store today and depending on what bed you select and where you live, there could be a delivery window as soon as 3 days from now and you could have your bed. Or if it's in a more rural area, it may be 2 weeks before that first available delivery. So there is variation and there will be as we move forward who won't optimize to every last delivery zone. This will continue to move and advance as we go through our network evolution.

Jim Larkins - *Wasatch Advisors Inc. - Portfolio Manager*

And what kind of a sales opportunity is there as you improve on those metrics?

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

Jim, I'm not sure if it's as much about the number of days as it is being on time and being there when you say you're going to. And our focus for our business is first time complete, being on track with what we promised our customer. That's our priority and where we're staying focused and what's most important to our customer.

Jim Larkins - *Wasatch Advisors Inc. - Portfolio Manager*

Okay, very good. And then any color on kind of mall versus off-mall? Any important trends that we'd be surprised by there?

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

I would say no. No important trends that you would be surprised by other than the fact that we continue to have strong success in both mall and nonmall. Our portfolio is heavier now in nonmall than mall, so that significant change when you consider our first nonmall store was built in December of, I think it was 2010, and here we are at the end of Q3, about 56% of the portfolio in nonmall. I will say that we still have very strong significant stores in malls and the right malls. And we're happy with both, and we're really thrilled that we're driving a portfolio that allows the customer -- allows us to be where the customer is shopping.

Jim Larkins - *Wasatch Advisors Inc. - Portfolio Manager*

Okay. And then any update you can give us on -- I think you call it your focused markets or I'm not sure of the exact name you use on that, but I think you rolled out a new one this year. And just I know you're pretty quiet on kind of what those look like, but any color you'd give us to that strategy?

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

On our aggressive growth strategy, continuing and continuing to make the progress that we expect and the necessary progress to achieve our goals.

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

Hey, Jim, I'm going to have to go to the next caller. We've got a couple more we got to get through yet.

Operator

Our next question is coming from Seth Basham with Wedbush.

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

Just 2 quick follow-up questions. In the past, you gave us some color on your ARU components in terms of mix as well as contribution from attachments. Can you break down that 11% for us any further?

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

I don't think we -- I don't recall providing a breakdown of our ARU, but the bulk of it was from stronger attach.

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

Okay, that's helpful. And then lastly, some of the data that we've seen recently suggested an increase in the negative reviews of your SleepIQ app. I'm wondering if there have been any integration issues with the 360 beds or anything else that might be driving that.

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

Yes, we saw a little bit of some challenges in the early deliveries, Seth, and we've since remedied that with a software push. And we're seeing very strong participation enrollment with our 360 customers on SleepIQ.

Operator

Since we have no questions in queue, I turn the call over to the company for closing remarks.

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

We look forward to discussing our fourth quarter 2017 performance with you next year. Sleep well and dream big.

Operator

That concludes today's conference. Thank you for your participation. You may disconnect at this time. Thank you, everyone.