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# EDITED TRANSCRIPT

PIR - Q3 2017 Pier 1 Imports Inc Earnings Call

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**OVERVIEW:**

PIR reported 3Q17 net sales of \$476m and net income of \$13.6m, or \$0.17 per share. Expects FY17 net sales to decline approx. 4-2%, GAAP EPS to be \$0.30-0.34 and adjusted EPS to be \$0.37-0.41. Expects 4Q17 net sales to decline approx. 1-3%, GAAP EPS to be \$0.26-0.30 and adjusted EPS to be \$0.28-0.32.



DECEMBER 14, 2016 / 10:00PM, PIR - Q3 2017 Pier 1 Imports Inc Earnings Call

## CORPORATE PARTICIPANTS

**Bryan Hanley** *Pier 1 Imports, Inc. - Director of IR*

**Alex Smith** *Pier 1 Imports, Inc. - President and CEO*

**Jeff Boyer** *Pier 1 Imports, Inc. - EVP and CFO*

## CONFERENCE CALL PARTICIPANTS

**Dan Binder** *Jefferies & Company - Analyst*

**Joshua Siber** *Morgan Stanley - Analyst*

**Abul Misuary** *UBS - Analyst*

**John Heinbockel** *Guggenheim Securities - Analyst*

**Brian Nagel** *Oppenheimer & Co. - Analyst*

**Alan Rifkin** *BTIG - Analyst*

**Brad Thomas** *KeyBanc Capital Markets - Analyst*

**Cristina Fernandez** *Telsey Advisory Group - Analyst*

## PRESENTATION

### Operator

Good afternoon, ladies and gentlemen. Welcome to the Pier 1 Imports FY17 third-quarter earnings call. At the request of Pier 1 Imports, today's conference call is being recorded.

(Operator Instructions)

I would now like to introduce Bryan Hanley, Director of Investor Relations for Pier 1 Imports.

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### **Bryan Hanley** - *Pier 1 Imports, Inc. - Director of IR*

Thank you and good afternoon, everyone. Today after market closed we issued an earnings press release which included the detailed financial results for the FY17 third quarter. In just a few moments, we will hear comments from Alex and Jeff about the results, our strategies and outlook. This will be followed by a question-and-answer period.

Before we begin, I need to remind you that any statements made today regarding our business may be deemed to include forward-looking statements that are based on current estimates or expectations of future events or future results and are made pursuant to, and within the meaning of, the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are subject to both known and unknown risks and uncertainties that could cause actual results to differ materially from such statements. Any forward-looking statements made today are as of the date of this call and Pier 1 does not assume any obligation to update or revise any such forward-looking statements.

The Company will also discuss non-GAAP financial measures on this conference call. Pursuant to the requirements of Regulation G and Item 10 E of Regulation SK, the Company has provided a reconciliation of the non-GAAP financial measures to the most directly comparable GAAP financial measures in our earnings press release that was issued this afternoon, which is available on our website, Pier1.com. Now, I'd like to turn the call over to Alex Smith, Pier 1 Imports President and Chief Executive Officer. Alex?

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## DECEMBER 14, 2016 / 10:00PM, PIR - Q3 2017 Pier 1 Imports Inc Earnings Call

### **Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

Thanks, Bryan, and good afternoon, everyone. Joining me on the call is Jeff Boyer, Executive Vice President and Chief Financial Officer. Other members of our leadership team are also with us in the room today and in fact, we have a very full house. When we spoke to you last quarter, our teams were busy preparing for the start of the holiday season. You may recall that our strategies around merchandising, marketing and promotion were starting to take hold. Sales and margin trends were on the rise.

Today, I'm pleased to tell you that we have more good news on all fronts. Sales have, for the most part, remained strong. After seeing some impact in the two weeks surrounding the election, we ended the third quarter with comp sales of a positive 1.8%. Indeed, our sales rebounded in the last two weeks of November, culminating in an outstanding Thanksgiving event and a record Cyber Monday, thanks to flawless execution on the part of our teams. Brand traffic was strong in quarter three, up nearly 10%.

We're also very pleased with the strength of our merchandise margin and how that has flowed through to contribution from operations and our overall profitability. The combination of our much improved top-line performance, merchandise margin expansion and ongoing cost controls lead to better-than-expected earnings. The strengthening of our merchandise margin is the result of a few key factors, including greater efficiency in our distribution centers and reduced inventory levels.

Equally important, we continued to improve the effectiveness of our promotional activity in the third quarter, which enabled us to maximize merchandise margin dollars. Specifically, we streamlined our cadence and emphasized broad-based promotions that more accurately reflect the underlying value of our merchandise. We believe our free shipping promotions helped to drive healthy eCommerce sales, as our customers increasingly shopped Pier 1 Imports both online and in store, choosing whichever channel suits her purchasing decision on any given day. For perspective, in just four years we've established an eCommerce business with trailing 12-month revenues of over \$340 million. In the third quarter this year, eCommerce sales grew 28% to nearly \$100 million.

The mists that have been swirling around our Company for several quarters now are clearing. What you can now see is our wonderful brand, which has always been known for its unique merchandise, loyal customer base, and customer-centric culture. You can also see more clearly our enhanced business model, an omnichannel platform that we believe will allow our well-loved Company to thrive far into the future and generate meaningful returns for our shareholders.

We have talked at length over the last two years about our capabilities, but they have largely been obscured by the mists of the retail environment and our own inventory-related problems. When we compare ourselves against our peers in the home furnishings sector, we are proud of the formidable capabilities we've built, but that said, our teams are not ones to rest on their laurels. We're always setting new goals, but we know the foundations we've laid are pretty remarkable.

The transformation of our business from store only to omnichannel has in my mind similarities to what we experienced during the great recession. At that time, many people had a propensity to concentrate on the bleakness around them. We didn't. Instead, we focused on improving our business one SKU and one transaction at a time and we could see positive customer response to our brand even in a depressed market, which made us feel confident that as the recession eased, we'd come out strong. That's exactly what happened.

Of late, we've had to navigate the peaks and valleys inherent in a transformation of the magnitude we've undertaken, made harder because we've been sailing in uncharted waters. Nevertheless, all the while we have remained focused on making Pier 1 Imports a better version of itself. We've done this by giving our shoppers the experience they crave in the new retail world, one SKU, one transaction at a time. Since the end of the great recession in 2009, we have registered comp sales increases in 25 quarters and grown our market share. The complexities and challenges of our omnichannel transformation, coupled with a highly competitive environment, led to a few quarters of negative comps, but we're making our way back to positive territory, and in fact, over the last six years, even with this hiatus, our six-year comp stack at the end of FY17 will be in the order of 25%.

We're proud of our unique position in the home furnishing space and believe we have brand attributes that truly set us apart. The first is our merchandise. Our products reflect current fashion trends but are interpreted in our own way with an emphasis on color, finishes and embellishes,



## DECEMBER 14, 2016 / 10:00PM, PIR - Q3 2017 Pier 1 Imports Inc Earnings Call

sparkling our customers' creativity with product she won't find elsewhere. Our assortments are cohesive and speak with one voice. Our assortments are highly edited. We don't have, nor do we want, millions of SKUs and our prices are affordable and represent great value.

The second attribute is our Pier 1 Imports stores, and their unique visual merchandising. They are an important source of inspiration for our customers, where she can discover her own personal style. As you've heard me say, nearly 95% of our sales touch a store in some way. Next are our amazing store associates, who always go the extra mile to delight our customers. I've often said that they are our not so secret, secret weapon. In survey after survey, year after year, customers talk about how our associates make them feel valued and help to create a memorable shopping experience.

Speaking of our customers, our loyalty program is another great brand attribute of Pier 1 Imports. At the end of quarter three, nearly 75% of total sales were attributed to customers enrolled in loyalty, which is up substantially from 33% a year ago. This growth reflects the success of our new Pearl multi-tender loyalty tier, which is met with terrific response and is bringing more and more known customers into our database.

Lastly, but certainly not least, is our marketing, which is aspirational yet approachable and fun. Our latest television ads are resonating with customers and we believe helping drive new customers to the brand and keeping us top of mind with existing customers. As you know, we undertake a sizeable amount of market research, which tells us we're beginning to realize the benefits of our refined marketing program, including the television advertising. Through the third quarter, store and website brand consideration, three months shopping intention, and advertising awareness were all up considerably over our spring and summer brand tracking waves.

One of the key metrics we used to gauge our progress is contribution from operations. It's something we've been talking to you about for two years now. This quarter we saw improvements in this important metric on both a dollar basis and as a percentage of sales. Under our omnichannel model, we're always striving to keep our rents, store payroll and fulfillment costs as lean as possible and Jeff will address our containment initiatives in greater detail during his remarks, but generally speaking, we believe the improvement we delivered this quarter is the turn we have been anticipating

We at Pier 1 Imports love holiday and it certainly feels great to be in the throes of the successful season. Our biggest days are still ahead, but we are presently on course to achieve our goals. Now I'll turn the call to Jeff to discuss the financials. Jeff?

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### **Jeff Boyer** - Pier 1 Imports, Inc. - EVP and CFO

Thanks, Alex, and good afternoon, everyone. We delivered a strong quarter, highlighted by positive comp sales, solid margin improvement, and earnings per share above our guidance range. Net sales decreased 40 basis points to \$476 million, as Company comparable sales increased 1.8%. As Alex mentioned, we did see some sales pressure around the time of the election, but our trend strengthened in the later weeks of November, surpassing our expectations for the quarter.

ECommerce sales grew 28% in the third quarter, with sales penetration expanding to 20% versus 16% of total sales in Q3 last year. The proportion of our eCommerce sales that are fulfilled or delivered to the home moved up a bit in the third quarter to about three-quarters of our eCom sales. Previously they've been trending closer to two-thirds of eCom sales.

Third-quarter gross profit improved to \$196 million versus \$184 million a year ago, while gross margin rate expanded 280 basis points to 41.3% from 38.5% in the third quarter of FY16. Looking at the components within our gross margin that we break out for you, and starting with merchandise margin, we delivered increases in both dollars and rate. Specifically, merchandise margin dollars increased to \$286 million from \$269 million a year ago, while merchandise margin rate expanded 400 basis points to 60.2%. That compares to 56.2% a year ago and is substantially above our guidance range of 57% to 58%.

The upside reflects our more balanced promotional strategy, which resulted in fewer promotional discounts and improved clearance markdowns and also the decision to shift a portion of our promotional spend to our shipping offers. We also captured improvement from general overall efficiency in our DCs, favorable comparison related to the recognition effects of last years DC issues and lower DC handling and freight costs.



## DECEMBER 14, 2016 / 10:00PM, PIR - Q3 2017 Pier 1 Imports Inc Earnings Call

Turning now to delivery and fulfillment costs, as a percentage of net sales, we deleveraged on a year-over-year basis, primarily due to the new lower free shipping threshold we initiated in the third quarter. The majority of our fulfilled orders were eligible for this promotion in the period. Lastly, store occupancy costs in the third quarter decreased a little over \$1.5 million to approximately \$73 million. As a percentage of net sales, we realized 20 basis points of leverage year over year. We continue to anticipate that our real estate program and cost initiatives will enable us to end FY17 with occupancy costs below FY16 levels.

Moving to SG&A, we continue to do an excellent job with our cost containment initiatives, which have been in place for five quarters now. We captured SG&A efficiencies across the organization, particularly in our stores and our corporate functions. During the quarter we achieved savings of close to \$2 million in compensation for operations year over year and a similar amount in corporate payroll and benefits.

However, those savings were offset by three major areas of additional expense during the quarter. The first was our planned increase in marketing spend of \$2 million. The second consisted of certain incremental expenses that are affecting us in the short-term but which we expect will be transitional. Specifically, we incurred approximately \$3.7 million of expense for legal and advisory fees, CEO transition costs, and certain costs for sublease in portions of our corporate headquarters. The third bucket of additional expense includes approximately \$8 million of costs related to Alex's upcoming departure.

Due to the investments for marketing and incremental expense items, in total SG&A dollars grew 6% year over year to \$161 million and our SG&A rate increased by 210 basis points to 33.8%. Third-quarter operating income came in at \$22 million, while net income was \$13.6 million, or \$0.17 per share. Adjusting for approximately \$8 million of expense related to Alex's departure and the related tax effect, non-GAAP adjusted net income was \$17.6 million, or \$0.22 per share. That's above the high end of our guidance range and reflects the factors I discussed earlier, a strengthening sales trend in the final weeks of the quarter, solid margin improvement, and ongoing cost controls.

Moving on to the balance sheet, the Company ended the third quarter with \$86 million of cash and cash equivalents and \$25 million of working capital borrowings under our revolving credit facility, which has been repaid subsequent to quarter end. Third-quarter ending inventory totaled \$480 million, representing a decline of approximately 5% versus a year ago. We remain focused on carefully managing our inventory position and expect our year-end inventories to be below FY16 levels.

Turning now to guidance, we are raising our full-year outlook to reflect primarily the upside we saw in Q3 but also improvement in our Q4 forecast. Let's start with our fourth-quarter guidance. Company comparable sales of down 1% to up 1% and net sales decline of approximately 1% to 3%; merchandise margin in the range of 56% to 57%; selling, general and administrative expenses in the range of \$145 million to \$150 million; GAAP earnings per share in the range of \$0.26 to \$0.30 on diluted shares of approximately 81 million; and adjusted earnings per share in the range of \$0.28 to \$0.32 on diluted shares, again of approximately 81 million. Of note, this excludes approximately \$2 million of costs related to Alex's departure.

For full year FY17, we are providing the following guidance, Company comparable sales of down 2% to flat; net sales down approximately 4% to 2%; merchandise margin in the range of 56.5% to 57.5%; SG&A expenses in the range of \$585 million to \$590 million, which includes approximately \$105 million of marketing spend; GAAP earnings per share in the range of \$0.30 to \$0.34; and adjusted earnings per share in the range of \$0.37 to \$0.41, which excludes approximately \$10 million of costs related to Alex's departure. For modeling purposes, we continue to expect that net interest expense will be in the range of \$12 million for the year. In addition, certain discreet items will benefit our corporate tax rate this year. As such, we are now forecasting our full-year corporate tax rate to run approximately 34%.

We're pleased with the turn we're beginning to see in the business and we're encouraged with our holiday execution so far. As you think about the guidance we're providing today, keep in mind that we had a significant amount of clearance activity in January of last year, which will affect our comparisons for the fourth quarter of FY17, even on the heels of what's shaping up to be a very strong holiday season. With that, I'll turn the call back to Alex for some closing comments.



## DECEMBER 14, 2016 / 10:00PM, PIR - Q3 2017 Pier 1 Imports Inc Earnings Call

### **Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

Well, thanks, Jeff. This is my last earnings call as CEO of Pier 1 Imports. Yesterday, I had my last Board meeting and in another two weeks, I'll walk into the office my last day on the job. When I started here, I had in mind the time horizon of just three to five years, but I learned rather quickly that Pier 1 Imports is a magical place that draws you in and won't let you go easily. In our nearly 55 year history, I'm only the fourth CEO to have led our Company and it has been an honor, to say the least.

I was fortunate to have known two of my predecessors, Marvin Girouard and Clark Johnson. Unfortunately, our Founder and first CEO had passed away before I joined the Company. All of these leaders moved the business forward in their own individual and unique way and I have every confidence that our Board will appoint a new leader with great merchant sensibilities, who I hope that he or she also gets drawn into our special culture and remains part of the Pier 1 Imports family for many years.

It has been an amazing professional and personal experience to be at the helm of our well-loved Company and I'll always be grateful to the men and women across the globe who have helped and encouraged me along the way. I know that I've been a dedicated disciple and advocate for everything we set out in our compass, the unique document which speaks to our business priorities, our culture, our vision and values, and much more. I know that I've always put Pier 1 Imports first.

Many thanks to our analysts and investors who supported us over the years. This is an amazing Company, an amazing brand, and we have wonderful associates and talented vendors and a loyal base of customers who just love all things Pier 1 Imports.

### **Jeff Boyer** - *Pier 1 Imports, Inc. - EVP and CFO*

Alex, you are absolutely correct. Pier 1 Imports is a very special place, and it's a place that you had a huge impact on. You will be missed. On behalf of the management team and the 22,000 Pier 1 associates, a sincere thank you for all you've done to make Pier 1 Imports what it is today and for our terrific foundation for the future.

Now, Alex and I would be happy to take your questions. Operator, if you'd open up the call?

## QUESTIONS AND ANSWERS

### **Operator**

(Operator Instructions)

Your first question comes from Dan Binder with Jefferies.

### **Dan Binder** - *Jefferies & Company - Analyst*

Congratulations on your retirement, Alex. My question today, two questions. You talked about the post-election surge. I'm just curious as you exited the quarter and went into December, did you see that rate continue to hold up, improve, or diminish somewhat? The second question was related to promotional activity. Obviously, you've made some adjustments to your own and I'm just curious what your observations are in the industry currently.



## DECEMBER 14, 2016 / 10:00PM, PIR - Q3 2017 Pier 1 Imports Inc Earnings Call

**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

On the back end of the month, really we saw an acceleration as culminating, as I think we said in the prepared remarks, the Thanksgiving holiday weekend was really good for us. We were very pleased with it. As we moved into December, December has been a little bit softer than the actual Thanksgiving weekend but still well within what we expected. The second was about promotions, Dan, was it?

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**Dan Binder** - *Jefferies & Company - Analyst*

Correct.

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**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

Yes, well, I think this question does come up sort of most calls. I would say that as far as -- I can't speak to the other sectors but as far as the home furnishings sector, I don't feel that the promotional cadence is any stronger or more intensive than it was last year or the year before. I mean, I think we made the decision a while ago. I think we told you we stopped talking about the unusual promotion environment because it's just the world we live in now. We think that's good because it gives us the opportunities to finesse our own promotional activities, to maximize the merchandise margin dollars as I think we did in this last quarter.

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**Dan Binder** - *Jefferies & Company - Analyst*

Thank you.

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**Operator**

Your next question comes from Budd Bugatch with Raymond James.

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**Unidentified Participant**

Good evening. This is David on for Bud. Alex, congratulations and best of luck going forward. Two parts of my questions. My first, going back to promotional strategy, I think in your remarks, Alex, you said you were more across-the-board promotional this quarter versus specific products. Is that correct and if so, is that a departure from your strategy in previous quarters?

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**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

Is you heard us correctly, yes, and I wouldn't say it was a departure from a previous strategy. I'd say it's something we've been evolving for a while now. If you go back a number of years, yes, our promotional strategy was very much SKU based, with very little across-the-board promotional activity. That has evolved over time and I think we've finessed that. Laura and Kathy and their teams working with the marketing have got sort of very good at sort of balancing the across-the-board discounts with the individual SKU discounts so that we don't give away too many margin dollars. I think it's just is a very nice evolution of the business.

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**Unidentified Participant**

Okay, thanks. On the CEO succession plan, so Terry will be Interim CEO. What -- is the search process still ongoing? Any additional color you can give us about that?



## DECEMBER 14, 2016 / 10:00PM, PIR - Q3 2017 Pier 1 Imports Inc Earnings Call

**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

Well, I think, obviously I'm not actively involved in the search, as you would imagine, but the search committee and the Board is pleased with the pipeline of candidates that they've got. I think that's pretty much all we can say about that, but Terry will be here showing up for work on Jan 1 or Jan 2, whatever it is. Jan 2, Jan 3. I'll leave him a little note and he will get on with it. Okay, thank you very much. Best of luck. Thanks a lot. Thank you.

**Operator**

Your next question comes from Simeon Gutman with Morgan Stanley.

**Joshua Siber** - *Morgan Stanley - Analyst*

This is Joshua Siber on for Simeon. I'll add my congrats to Alex as well. Just a question on top-line growth for next year. You're facing easing compares in the first half, you guys had momentum since August or so, and you have advertising on TV right now, so is it possible that you could deliver low-single-digit comps for the full year?

**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

It think that's a very good question and one I will be asking Management myself when I become just a shareholder. Jeff, would you like to have a go at that one?

**Jeff Boyer** - *Pier 1 Imports, Inc. - EVP and CFO*

Actually, it's probably a little too early to say exactly. I always like to say the more recent trend is always the best indication, so the way to think about it is to think about the last quarter and our guidance for the next quarter coming up and doing averaging. That's probably the best indication you could have right now but we're not to the point right now of committing to what that guidance is for next year.

**Joshua Siber** - *Morgan Stanley - Analyst*

Fair enough. On the -- just jumping around the P&L, the marketing expense, that de-levered on a stronger comp. Are you seeing the ROI that you'd like to get on the marketing or do you think the deleverage is more a function of invest now, reap benefits later?

**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

Let me answer that and tell you this is my personal view today. Where the Company ends up, I obviously can't speak to that. Pier 1 ran this business very successfully, as you know, on 4.8% to 5% ad spend for many years, and it worked well. I tried to hold that 5% as we went through the transition to OmniChannel. As a consequence of me trying to hold that 5%, you know the history, we came off TV so that we could fund digital and print. In the cold, gray light of morning, we felt that was the wrong decision, so this year we've invested in TV and moved that ad spend nearer to the 6% than the 5%. My view, and this is not just a Pier 1 Imports view, I think that it's somewhat a more industry view, is that ad spends are going to have to be high going forward and I think that's going to have to get baked into a new business model.

**Jeff Boyer** - *Pier 1 Imports, Inc. - EVP and CFO*

I'd just add onto that, Joshua, just to build on what Alex says, we commented previously that we're going to be at least in the high 5% and that's what you're seeing us spend on a run rate basis for FY17. You're thinking about the future, it's likely going to be a similar pattern.

## DECEMBER 14, 2016 / 10:00PM, PIR - Q3 2017 Pier 1 Imports Inc Earnings Call

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**Joshua Siber** - *Morgan Stanley - Analyst*

Okay, thanks. Just one follow-up. I think, Alex, this was in your prepared remarks. Did you say that traffic was up 10% in the quarter? I can't imagine that was --

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**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

I said brand traffic was up 10%, so that's the combination of store and web traffic.

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**Joshua Siber** - *Morgan Stanley - Analyst*

Okay. All right. Thank you very much.

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**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

You're welcome.

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**Operator**

Your next question comes from Michael Lasser with UBS.

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**Abul Misuary** - *UBS - Analyst*

Hi. This is [Abul Misuary] filling in for Michael Lasser. Thanks a lot for taking our questions.

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**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

You're welcome.

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**Abul Misuary** - *UBS - Analyst*

You mentioned that you've seen strength all across the board in the third quarter, but can you highlight a few categories where you've seen the strongest result?

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**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

No, not really. I mean, I think we made the comment that we wanted to. In the past where there has been -- where we've had problem areas, we've highlighted those and when there's been real, real stand outs we've called those out, too. I think you talk the remarks as we've written them to indicate that we are pretty pleased with the performance across most of our categories.

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**Jeff Boyer** - *Pier 1 Imports, Inc. - EVP and CFO*

Nearly all our categories and new growth.

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## DECEMBER 14, 2016 / 10:00PM, PIR - Q3 2017 Pier 1 Imports Inc Earnings Call

**Abul Misuary** - *UBS - Analyst*

Okay, great. As my follow-up, can you guys remind us as to what percentage of the products that you sell in the US are actually imported from overseas?

**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

95%-plus, I would say? Okay, thank you.

**Operator**

Your next question comes from Steven Forbes with Guggenheim Security.

**John Heinbockel** - *Guggenheim Securities - Analyst*

It's John Heinbockel in for Steve.

**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

Hi, John.

**John Heinbockel** - *Guggenheim Securities - Analyst*

Congratulations, Alex, on your retirement. Sort of a strategic question. If you think about transfer of business, right, from brick and mortar to eCommerce, I know you think about it holistically. I guess, do you have anyway of telling how much of your eCommerce business is cannibalizing the stores? I assume you think you can get back to consistent comp growth at the store level, but what does it take to do that? Is that more driving value perception? Is it more customer acquisition? What will drive that?

**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

Well, John, we moved past the whole concept of cannibalization and stores that are online some time ago. We really do think holistically about the business now. I think that I just want to emphasize the points that we always make, which is that if you look at the totality of our business and you look at our eCom business that of the eCom business, more than a third of it is picked up in store. Another third of it is actually written in stores, where a customer will take an online order with the help of an associate. You're already up to a very significant percentage of our revenues which come through the store.

Then as we've indicated to you before, we know from our research that of the 10% of our business which is truly direct to customers, so order at home, receive in home, half of that, half of those customers are in a store prior to making their purchase at home. It really is just a seamless way of shopping. As we said in our prepared remarks, I think what we've done which is so terrific is now customers can just shop us how they want. Some days she might want a store visit and some days she may not and some days she may want a store visit to find out what she wants and be pushed for time and go home and purchase. That's really the way we think about the business now.

**John Heinbockel** - *Guggenheim Securities - Analyst*

Secondly, where do you think -- for you, where do you think scale exists from an eCommerce perspective? I guess you look at profitability holistically as well, so it might be okay when you think about free shipping for the eCommerce piece to maybe to be a little less profitable than it could if it's driving traffic to the stores?



## DECEMBER 14, 2016 / 10:00PM, PIR - Q3 2017 Pier 1 Imports Inc Earnings Call

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**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

Well, I think I'd like to take you back to the comments that we made about contribution from operation, because I think that really says it all. If over time we manage to grow the dollars and the rate on that contribution from operations, which is at the back end of the press release -- I'm just trying to flip and see which page it's on. Anyway, if you got the press release nearby, you can see it. You can see there, contribution from operations for the three months of the \$111 million, the 23.4%, that's getting back up to the 25%, which was the number we always use to have when it was a store-only model. We're moving strongly. I know that's just a quarter and the nine months isn't that but we are moving back towards that number. I think that is where I would focus my attention.

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**Jeff Boyer** - *Pier 1 Imports, Inc. - EVP and CFO*

Again, building on that is, John, we do take the holistic view and that's how we put that metric out, is we are taking a look at whichever channel she wants to purchase in, we are fine. We just need to optimize the contribution from operations rate, whether it be by changing promotions, getting more efficient on fulfillment, whatever it is. You can see where we did a great job in this third quarter and its building on a year-to-date basis.

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**John Heinbockel** - *Guggenheim Securities - Analyst*

Okay, thank you.

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**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

You're welcome.

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**Operator**

Your next question comes from Brian Nagel with Oppenheimer.

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**Brian Nagel** - *Oppenheimer & Co. - Analyst*

Hi. Good afternoon.

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**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

Hey, Brian.

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**Brian Nagel** - *Oppenheimer & Co. - Analyst*

First off, Alex, congratulations and best of luck in your next endeavors. Its been a pleasure working with you. The questions I had, so it's a couple questions. (Multiple speakers)

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**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

You didn't give me an opportunity, so never mind. Ask your question.



## DECEMBER 14, 2016 / 10:00PM, PIR - Q3 2017 Pier 1 Imports Inc Earnings Call

**Brian Nagel** - *Oppenheimer & Co. - Analyst*

Oh, sorry, my phone was cutting out, I'm sorry. Well, congratulations. The question I had on this, first off, maybe a bit more color on just the snapback in business here that you saw in the second half of November. You are clearly not the only retailer that discussed this type of trend in November with weakness around the election then a bounce back, but just given the cadence of your guidance and your commentary, it seems as though the sales in the second half of November topped what you expected. Any color on really how that was fueled or was there anything that stood out to help us better understand that?

**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

Well, I think the first thing is that all the noise has disappeared. I talked about the mists swirling around, so operationally we are in a far, far better situation. The inventories were sorted out, all those problems that we had that thank goodness we don't need to talk about anymore. Then I think it's really the combination of great product and strong marketing and all the improvements that we have been building in terms of the customer experience on our site, which has helped conversion on the site very substantially, the additional functionality that we've put on the site that we've been describing to you over the last couple of years.

I think all the things that we've been working on have just come together as we knew they eventually would. We weren't sure about the timing but we knew that they would all coming to at some point. As I say, it just feels to me the same as when we were coming out of the recession. We didn't know the recession would end, but we knew it would.

**Brian Nagel** - *Oppenheimer & Co. - Analyst*

In recognizing that your sector is extraordinarily fragmented but you look at a lot of data, do you think is it clear that Pier 1 may have gained some market share back in that period or was it, were you helped along by a strength in the overall category?

**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

I don't know the answer to that at the moment.

**Jeff Boyer** - *Pier 1 Imports, Inc. - EVP and CFO*

Our estimate's always been that the category has been growing in the low-single digit, 3% to 4% on it. We were about right in line with that so we're getting back to the market trend on it. We don't have a realtime view for the last 90 days so we'll find that when more people report.

**Brian Nagel** - *Oppenheimer & Co. - Analyst*

The follow-up question I had, just on the inventories, and Alex you'd mentioned this a little bit in response to my other question, but are inventories next? I know, Jeff, when we joined we talked a lot about inventories and the need to work down inventories. Are inventories now at a healthy level or as we look towards 2017, will you continue to work down inventories?

**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

Well I think there at a healthy level. They're not necessarily at the optimum level. When we look at our 12-month trailing inventories they are getting back to what the run rate we had for a long, long time. I don't think that means the team is going to be satisfied with that. I mean, there are a number of plans in development which will allow us to take a little more inventory out of the system and to ship a little more efficiently and take some time out of the supply chain which, again, will take some dollars out of the inventory. I think the most important thing that I'd like investors



## DECEMBER 14, 2016 / 10:00PM, PIR - Q3 2017 Pier 1 Imports Inc Earnings Call

to understand is there is no urgency now to reduce inventory. We are going to continue, the Company is going to continue to try to be more efficient, of course, but we are in a really, really decent place today.

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**Brian Nagel** - *Oppenheimer & Co. - Analyst*

Thank you and again, Alex, best of luck on your next endeavors.

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**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

Thank you, thank you.

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**Operator**

Your next question comes from Alan Rifkin with BTIG.

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**Alan Rifkin** - *BTIG - Analyst*

Thank you very much and, Alex, certainly, best of luck to you going forward in your next endeavor.

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**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

Thank you, Alan. You aren't going to ask me whether we can get back to a 60% merchandise margin, are you?

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**Alan Rifkin** - *BTIG - Analyst*

You've read my mind, actually, because as someone whose followed the Company now for what will be four out of five CEOs, a 60% merchandise margin has always been a glass ceiling. What do you think is your ability to maintain margins at what is now the current rate?

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**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

Well, I think we are very confident with the input margins and the stability around all of those. Those are rock solid. We are really confident that we can continue to get efficiencies in our supply chain and as you know, those costs all hit the merchandise margin. With the inventories under control, we should sequentially be able to sort of drive down the clearance markdowns. Then you're left with the promotional buckets and I think with the work that the guys are doing to use those promotional dollars more efficiently that you should continue to see progress.

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**Alan Rifkin** - *BTIG - Analyst*

Okay. I'm not sure if that counts as my first question since you prompted me, but I'll ask a second one if it's okay. With 95% of your products being imported, and certainly who knows under the new administration where tariffs are going, what type of contingency plans, if any, is the Company contemplating in case there should be more prohibitive tariffs going forward?

Then a follow-up to that, if I may. Our math actually suggests that in the 12 days between November 14 when you pre-release and the 26th, it looks like comps in those 12 days increased 22%. Not sure if that math is absolutely accurate, but I think that it's certainly pretty close. Is that creating any pressures on your inventory for the all-important fourth quarter? Thank you very much.



## DECEMBER 14, 2016 / 10:00PM, PIR - Q3 2017 Pier 1 Imports Inc Earnings Call

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**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

Okay, Jeff, would you like to answer that?

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**Jeff Boyer** - *Pier 1 Imports, Inc. - EVP and CFO*

I'll answer the comp question if you answer the tariff question.

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**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

Yes.

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**Jeff Boyer** - *Pier 1 Imports, Inc. - EVP and CFO*

On the comp question, I think your estimation is off a bit on that. We didn't have that sizeable an increase in comps. We did have a very nice snapback. We were looking at negative comps, as you can imagine. You've heard from folks around the election distraction as we were looking at that and we did see a nice reversal in the back half, but not to a 22% level.

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**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

As far as the tariff is concerned, we've had no real discussion or thought about that. I think that it's all kind of speculative and very premature at the moment. When you think about the percentage of goods that are consumed in the US that are made in China and elsewhere, if you put huge tariffs on it, clearly it's going to have an enormous inflationary impact. Personally, I don't see it, but what do I know?

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**Alan Rifkin** - *BTIG - Analyst*

Okay. Thank you. Good luck, Alex. Take care.

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**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

Thank you.

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**Operator**

Your next question comes from Brad Thomas with KeyBanc Capital.

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**Brad Thomas** - *KeyBanc Capital Markets - Analyst*

Yes, thank you for taking my question. Alex, all the best to you.

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**Alex Smith** - *Pier 1 Imports, Inc. - President and CEO*

Thank you.

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## DECEMBER 14, 2016 / 10:00PM, PIR - Q3 2017 Pier 1 Imports Inc Earnings Call

**Brad Thomas** - KeyBanc Capital Markets - Analyst

It's been fun to follow your career with the Company here. Just following up on Alan's question on the merchandise margin, I know that one of the initiatives for this year was to leverage the new CRM and try to get more targeted with your marketing. Could you maybe just shed a little bit more light on how you did the 60% merchandise margin in the third quarter? I don't think we've seen levels like this in the third quarter and in a good three or four years. Any more color would be great.

**Alex Smith** - Pier 1 Imports, Inc. - President and CEO

You're right. We haven't so we were clearly very thrilled with that number. I don't want to be redundant here. I think that it's all the things we've been talking about. It's the scientific approach to our promotional activity. It's fewer markdowns because the inventory is clean and it's getting rid of the drag that we had on our margin with all the supply chain inefficiencies. I think all those things have come together.

As far as our CRM and the new database, this is potentially very exciting for the Company going forward. We have already started to do a number of in-store events which are paying back the loyalty customer. We have been really surprised in a positive way about the response that we have got to those and we will be, the Company will be doing more of those in the next year.

The other thing which will happen over time, and I think I've alluded to this on calls before but we aren't there yet, is as our ability to analyze the behavior of the loyalty customers on a more granular level, we are going to be able to do many more specific and targeted promotions, which will only be seen by that particular group of customers. They won't be so public promotions, if you want. Over time, what I would expect to see is a moving of promotional dollars away from blanket across-the-Company promotions to targeted promotions for the loyalty customer. I think that's going to be the natural evolution as the Company sort of leverages all that investment that we made in the new database.

**Jeff Boyer** - Pier 1 Imports, Inc. - EVP and CFO

Most of that is still to come.

**Alex Smith** - Pier 1 Imports, Inc. - President and CEO

Most of that is still to come, absolutely.

**Brad Thomas** - KeyBanc Capital Markets - Analyst

Great. If I could just ask another question about the cost structure of the business. Maybe this is more a Jeff, but just as we think about 2017, could you give me insight into how you're thinking about the opportunity to continue to bring down occupancy costs and potentially continue to bring down compensation costs? If you do so, what do you think at this point the desire would be to continue to bring up marketing expense? Thanks.

**Jeff Boyer** - Pier 1 Imports, Inc. - EVP and CFO

On the cost structure occupancy and our compensation from operation, naturally we'll get some carryover effect that happens as we've done things this year, get a partial year or a full year, but in addition to that, Brad, we'll just continue to work the cost structure. We'll continue to look for opportunities for savings. We will continue to find those savings, both in occupancy and in the compensation from operations side of it. On the marketing side, I think the comment that Alex made is probably the best one, which is we are probably in a marketing environment right now where to get the right share of voice, we have to have the right spending level on it. It's probably not what the traditional 4.5%, 5% was. It's probably more of the high 5% to 6% level, so I think you can model expect numbers similar to this year on a rate basis.



## DECEMBER 14, 2016 / 10:00PM, PIR - Q3 2017 Pier 1 Imports Inc Earnings Call

**Brad Thomas** - KeyBanc Capital Markets - Analyst

Very helpful. Thank you so much.

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**Operator**

Your next question comes from Christina Fernandez with Telsey Advisory.

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**Cristina Fernandez** - Telsey Advisory Group - Analyst

Thank you and I'll add my congratulations to Alex on your retirement. I wanted to ask about the comp increase this quarter. Do you have a sense if a lot of it, if it came more from your customers, perhaps getting some back that you'd lost or was it your existing customers spending more with you?

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**Alex Smith** - Pier 1 Imports, Inc. - President and CEO

Well, it's all of the above. Obviously, with the progress that we've made on growing the database through loyalty and also growing the database through the credit card as well as the multi-tender loyalty, the percentage of our business that's coming from known customers is obviously increasing. That said, we have no doubts that we are getting incremental business from the awareness that we're doing with TV. Some of those will be brand-new customers who have never shopped Pier 1 Imports before. Many of them will be customers who maybe just have forgotten about us and we needed to remind them that we are here. As I think I said two or three calls ago, we need to shout a little louder and we have shouted a little louder and I think it's paid off for us.

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**Cristina Fernandez** - Telsey Advisory Group - Analyst

Then my follow-up, wanted to ask about delivery and fulfillment costs. The free shipping promotions work well this quarter. You got more sales, but that line went up as sales delivered to customers from eCommerce were 75% as opposed to the [234]. Do you expect that trend to continue? Are you saying it could go back to more customers picked up in store based on your promotional plans going forward?

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**Jeff Boyer** - Pier 1 Imports, Inc. - EVP and CFO

Christina, we anticipate a similar penetration level in terms of ship to home or delivery. When you have a more generous free shipping offer, she does appreciate that and so I think that's going to continue. That should continue in Q4 and probably have a similar impact in the first half of next year until we cycle around and get to a kind of a normalized level overall.

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**Operator**

There are no further questions at this time. I will turn the call back over to the presenters.

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**Alex Smith** - Pier 1 Imports, Inc. - President and CEO

Well, thank you very much and thanks for spending the time with us today. Terry and Jeff will be with you in the new year and I just like to wish you all a very happy Christmas. Thank you.

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## DECEMBER 14, 2016 / 10:00PM, PIR - Q3 2017 Pier 1 Imports Inc Earnings Call

**Operator**

This concludes today's conference call. You may now disconnect.

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