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# EDITED TRANSCRIPT

PIR - Q1 2013 Pier 1 Imports, Inc. Earnings Conference Call

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## OVERVIEW:

Co. reported 1Q13 total sales of \$361.1m, net income of \$17.8m and EPS of \$0.16.  
Expects FY13 EPS to be \$1.08-1.14.



## CORPORATE PARTICIPANTS

**Kelley Buchhorn** *Pier 1 Imports, Inc. - Director of IR and Financial Planning & Analysis*

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

**Cary Turner** *Pier 1 Imports, Inc. - SEVP, CFO*

## CONFERENCE CALL PARTICIPANTS

**John Marrin** *Jefferies - Analyst*

**Brian Nagel** *Oppenheimer - Analyst*

**David Berman** *Berman Capital Management - Analyst*

**Helen Pan** *Barclays Capital - Analyst*

**Simeon Gutman** *Credit Suisse - Analyst*

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

**Matthew Nemer** *Wells Fargo - Analyst*

**Anthony Chukumba** *BB&T Capital Markets - Analyst*

**Denise Chai** *BofA Merrill Lynch - Analyst*

## PRESENTATION

### Operator

Good morning, ladies and gentlemen. This is the Pier 1 Imports first-quarter conference call. At the request of Pier 1 Imports, today's conference call is being recorded. All lines will be in a listen-only mode. I would now like to introduce Kelley Buchhorn, Director of Investor Relations for Pier 1 Imports.

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### **Kelley Buchhorn** - *Pier 1 Imports, Inc. - Director of IR and Financial Planning & Analysis*

Thank you, Ashley, and good morning, everyone. Prior to market open today, we issued a press release which included the detailed financial results for the first quarter ended May 26, 2012. In just a few moments, we will hear comments from Alex and Cary about the financial results and the Company's growth initiative, followed by a question-and-answer period.

Before we begin, I need to remind you that certain comments made during this call may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, and can be identified by the use of words such as may, will, expect, anticipate, believe and any other similar words and phrases.

Our actual results and future financial condition may differ materially from those expressed in any such forward-looking statements as a result of many factors that may be outside of our control. Please refer to our SEC filings, including our annual report on Form 10-K, for a complete discussion of the major risks and uncertainties that may affect our business.

The forward-looking statements made today are as of the date of this call, and we do not undertake any obligation to update our forward-looking statements.

If you do not have a copy of today's press release, you may obtain one, along with copies of prior press releases and all SEC filings, by linking through to the Investor Relations page of our website, Pier 1.com.



Now I would like to turn the call over to Alex Smith, our President and Chief Executive Officer. Alex.

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

Thanks, Kelley. Good morning, everyone, and thanks for joining us today. Also on the call with us is Cary Turner, our Senior Executive Vice President and Chief Financial Officer. Cary will of course provide a detailed review of our first-quarter financial results in just a few minutes.

We are very pleased to begin the new fiscal year with another quarter of strong financial performance. In fact, this is our 11th consecutive quarter of comp store sales and profitability gains. Total sales were up 7.9% to \$361 million, while comp store sales rose 7.2%, reflecting strength throughout all of our merchandise categories and across all geographic regions.

Customers responded well to our outdoor spring and Easter assortments during the early spring months of March and April. In May, our biggest month of the quarter, we achieved strong sales gains surrounding Mother's Day and the Memorial Day weekends, both benefiting from our creative marketing campaigns and an optimal level of promotional offerings.

In the first quarter, we delivered strong gross profit and merchandise margins, drove further improvements in operating margin and posted a 33% increase in earnings per share. At the same time, we returned value to shareholders through share repurchases under our buyback program and a quarterly cash dividend.

Our investments in marketing are certainly helping our business with a media strategy that utilizes creative communication to strengthen our brand positioning and drive traffic. We finesse in real time our media budget in order to maximize overall customer reach, shifting more of our investments into those vehicles that are driving a higher customer response rate. We've had great success with our television campaigns, and our plans call this year for national cable television in nearly every month.

For the launch of Pier 1-to-You nearing, we will increase the level of our paid search and digital media to increase the awareness of Pier1.com and, more importantly, drive traffic to our sites. Subsequent to the launch of the new Pier1.com, we will up the weight of our digital media program more significantly, starting early this fall.

You will remember that in April we announced our new three-year growth plan, designed to drive profitable top-line growth, expand our market share and increase shareholder value. Here is an update on some of the key components of the plan. First and foremost, we are fully prepared to execute the soft launch of our new eCommerce-enabled website. The launch date is July 28. We have fully redesigned the look, feel and functionality of our site, which will be unveiled in conjunction with the launch of Pier 1-to-You.

Excitement and anticipation is, as you may imagine, building throughout the whole organization as the launch date approaches. Our operational teams are in testing, training and implementation phases, and we are building and training new customer relations teams specifically to support to our eCommerce business.

The buildout of our fulfillment space is complete. We've begun to receive inventory, and we are running capacity and final systems testing. Importantly, our current online trends remain strong, with increases in both the number of unique visitors and time spent on the site. Our current initiative, Pier 1 To-Go, continues to account for about 1% of our comp store sales increases.

Next, related to the previous point, we are working diligently towards the implementation of our new point-of-sale system, which we expect to pilot in a handful of stores this fall. Our game plan is to begin integrating the new POS system with eCommerce by summer of 2013, strengthening our foundation as we build out our multichannel capabilities.

We are making great progress with our plans to improve the store portfolio. This quarter, we opened two new stores in Redwood City, California and Brownsville, Texas, and completed one major remodel in Culver City, California. We remain on track this fiscal year to open approximately 20 to 25 new stores, which includes six to eight relocations.



As we outlined on our last call, we are taking advantage of opportunities in select markets to execute strategic store relocations, with a goal of improving our market position and long-term profitability. Our plans also include refurbishments to approximately 100 stores with enhanced merchandise fixture packages and lighting upgrades. The stores we have refurbished thus far are producing positive returns on our investments. Going forward, we will continue to analyze stores and identify those locations that have the greatest potential to provide the highest return on our investments.

We are delighted with the seamless transition of our Pier 1 Imports Reward Card business to Alliance Data Systems, a leader and innovator in loyalty and marketing solutions, which occurred at the end of March. In May, over 1 million new cards were reissued to existing customers with our new value proposition. The share of business on our Rewards Card has already grown, and sales on the card are up considerably since the transition, with responsibly trading ahead of the initial expectations. On average, Reward Card customers spend two to three times more than non-Reward Card customers.

We believe the opportunity to generate increased traffic and average ticket through the ADS partnership is significant, and anticipate it will be one of our key sales drivers going forward.

Lastly, we were thoughtful and careful with respect to our stock buyback activity during the quarter, and we paid a \$0.04 quarterly cash dividend, both firmly reflecting our commitment to return value to our shareholders.

Looking at the balance of the year, we see a number of key drivers of strong sales and earnings growth. As we announced this morning, we have raised our full-year earnings guidance and now expect to deliver earnings per share in the range of 15% to 21%.

Certainly, the launch of eCommerce will play a role in terms of broadening our reach and raising brand awareness. Importantly, our merchant teams are constantly developing and improving the management and development of our assortments, providing our customers with more reasons to shop the Pier 1 Imports brand. Additionally, we have a sharp focus on in-store presentation and customer service, which enables us to provide a unique and differentiated shopping experience for our customers.

I am in the stores virtually every week, and I see firsthand what is working and what is not, how our customers are reacting to the assortments and how they are interacting with our associates. We are executing well, but always striving to improve our assortments, in-store presentation and customer engagements.

We are pleased that we have been able to drive strong financial results while simultaneously investing in new growth opportunities and also returning value to our shareholders. We are tracking to meet the goals under our three-year growth plan and look forward to updating you next quarter.

Finally, I would like to thank our Board of Directors for their continued support and confidence, and for providing me the opportunity to continue leading our well-loved company. I look forward to working with both my outstanding executive team and our many talented and enthusiastic associates throughout the organization as we drive to extend the reach of the Pier 1 Imports brand and achieve our three-year growth plan objectives. Together, we work hard and smart each and every day to make Pier 1 Imports a great place for our customers. We have an exciting future ahead of us and we look forward to the many great successes still to come.

Thanks for your attention this morning. Now I'll ask Cary to review our first-quarter financial results and outlook. Cary?

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**Cary Turner** - Pier 1 Imports, Inc. - SEVP, CFO

Thank you, Alex, and good morning, everyone. We are pleased to report another strong quarter of top- and bottom-line performance. As Alex said, comp store sales increased 7.2% on top of last year's 10.2% gain, and total sales rose 7.9% to \$361.1 million, reflecting increases in both store traffic and average ticket.



On a trailing 12-month basis at the end of the quarter, sales per retail square foot were \$187, up from \$171 per retail square foot at the end of last year's first quarter. Gross profit improved 12.1% to \$150.3 million compared to \$134.1 million a year ago, and it increased 150 basis points to 41.6% of sales versus 40.1%. Merchandise margins came in at 60.2% in the first quarter. That is up 40 basis points from 59.8% last year, and reflects strong input margins, the right balance of regular and promotional pricing and well-managed inventory levels. Store occupancy costs were \$67.2 million compared to \$65.9 million and declined as a percent of sales by 110 basis points to 18.6%.

SG&A expenses for the first quarter leveraged 40 basis points, coming in at \$116.3 million, or 32.2% of sales, versus \$109.2 million, or 32.6%, for the same period last year. Variable expenses for the quarter decreased 40 basis points, primarily resulting from the leveraging of store payroll. As many of you know, we have maintained a highly-disciplined approach to expense control over the past three years and anticipate that we will continue to leverage variable expenses throughout the remainder of this year.

Marketing expenses came in at \$17.9 million, or 5% of sales, compared to \$16.3 million, or 4.9% of sales, in the first quarter of last year. We have planned a shift in the timing of certain marketing expenses between the second and third quarters this year, and therefore, marketing expenses are planned to increase about [30] basis points as a percentage of sales in the second quarter compared to the same period last year. Similarly, we expect third-quarter marketing expenses to decrease approximately 30 basis points year-over-year.

As we have previously noted, we expect to maintain our current rate of spending and anticipate that full-year marketing expenditures will be approximately 5% of sales.

Fixed expenses during the quarter were 9.3% of sales, essentially flat as a percentage of sales compared to last year. Administrative payroll increased \$2.9 million or 30 basis points versus a year ago, primarily due to planned investments in headcount to support our upcoming eCommerce launch and other growth initiatives. For the second quarter, we expect year-over-year increases of approximately \$3 million to \$4 million in fixed expenses to support these growth initiatives.

First-quarter operating income improved 38% to \$27.4 million versus \$19.9 million last year, while operating margin rose 170 basis points to 7.6% from 5.9% a year ago. Nonoperating income was \$0.6 million in the first quarter this year compared to \$1.8 million in the first quarter of last year.

As Alex noted, we transitioned to ADS, our new Rewards Card provider, at the end of March. Prior to that transition, we had been recording a non-cash amortization of a deferred gain associated with the Company's former Rewards Card provider contract. The decline in nonoperating income this quarter is related to the completion of the contract and the amortization of the gain.

Net income in the first quarter was \$17.8 million, or \$0.16 per share, compared to \$14.1 million, or \$0.12 per share, last year. The effective tax rate for fiscal 2013 should approximate 35% to 36% of pretax income.

Turning to the balance sheet, inventory at the end of the first quarter was in line with management's expectations and totaled \$333.5 million, up 5.8% versus a year ago. At the end of the second quarter, inventories are planned to be up approximately 10% from last year's second quarter. The planned increase is related to, one, additional inventory to support our new eCommerce business; two, earlier receipts of Halloween, harvest and holiday merchandise; and three, an increase in certain categories where sell-throughs have been particularly strong. We expect inventory to be slightly above last year's levels at the end of fiscal 2013.

The Company remains in strong financial condition and ended the quarter with \$217.9 million of cash and cash equivalents and no cash borrowings under the \$300 million credit facility. In May, the Company paid approximately \$4 million in cash dividends. During the quarter, we utilized \$48.7 million of cash to repurchase 2.9 million shares of common stock at an average cost of \$17 per share.

Since the end of the quarter, we have repurchased an additional 450,000 shares for \$7.1 million. To date, we have repurchased a total of 3.3 million shares at a weighted average cost of \$16.85 and a total cost of \$55.9 million. Under the 100 million share repurchase plan, approximately 44.1 million shares remain available to repurchase, and there are approximately 107.3 million shares of common stock currently outstanding.



Capital expenditures in the first quarter totaled \$12.2 million. Of that amount, \$7.1 million was deployed towards the opening of two new Pier 1 Imports stores, one major remodel, new merchandise fixtures and lighting, other leasehold improvements and costs associated with the buildout of our eCommerce fulfillment space located in our Mansfield, Texas distribution center. The remaining \$5.1 million in capital spending was deployed to technology and infrastructure initiatives, including eCommerce and our new point-of-sale system.

We continue to expect total capital expenditures to be in the range of \$70 million to \$75 million for fiscal 2013, with roughly half allocated to stores and the other half allocated to technology and infrastructure. As we move further into the year, we anticipate that depreciation and amortization expense will increase slightly above first-quarter levels as we invest additional capital into our stores and technology.

During the first quarter, we opened two stores, ending the quarter with 1054 Pier 1 Imports stores. That includes 973 locations in the US and 81 in Canada, for a total of 8.3 million retail square feet. During the remainder of fiscal 2013, we plan to open approximately 5 to 7 stores in the second quarter, 9 to 11 in the third quarter and 4 to 5 stores in the fourth quarter. We plan to close 6 to 8 stores ratably throughout the remainder of the fiscal year.

As Alex stated, strategic relocations within existing markets is an important part of our real estate strategy and provides us with meaningful opportunity to improve sales productivity and store profitability, while at the same time capturing additional market share.

Turning now to our outlook for the remainder of the year, as we noted in this morning's press release, we are raising our expectations for earnings per share and providing the following guidance for fiscal 2013 on a 52-week basis.

First, we expect to achieve comp store sales growth in the mid-single-digit range. Earnings per share are now expected to be in the range of \$1.08 to \$1.14, representing year-over-year growth of 15% to 21%. That compares to our previously issued guidance for earnings per share in the range of \$1.06 to \$1.12.

As a reminder, this fiscal year includes 53 weeks of operating results. We expect the 53rd week to contribute approximately \$25 million to total sales and \$0.01 to \$0.02 to earnings per share. And as I noted earlier, capital expenditures are expected to approximately be \$70 million to \$75 million.

Thank you your continued interest in Pier 1 Imports and I will now ask the operator to please open the call to questions at this time.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) John Marrin, Jefferies.

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### John Marrin - Jefferies - Analyst

Can you guys talk for a moment about how you are feeling about the performance of stores that you opened last year?

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### Cary Turner - Pier 1 Imports, Inc. - SEVP, CFO

We are very pleased with the stores we opened last year, and we continue to see that they come out of the gate very strongly. And we are particularly pleased with the relocations. I would say all the relocations we've opened have performed probably at least 20% better than the stores that were in those markets.



**John Marrin** - Jefferies - Analyst

That's great color. Thanks, Cary.

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**Operator**

Brian Nagel, Oppenheimer.

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**Brian Nagel** - Oppenheimer - Analyst

Congratulations on another nice quarter. The first question I wanted to ask is more directed, I guess, to Cary. This one on expenses. The last few quarters, we've had extra expenses now as -- related to the forthcoming launch of your eCommerce effort. So how should we think about -- as we look over the next few quarters and the balance of '12, how should we think about how those expenses are basically going to fall into the quarters?

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**Cary Turner** - Pier 1 Imports, Inc. - SEVP, CFO

I think I've tried to give you that picture. One, we are going to -- in terms of variable expenses, we are definitely going to leverage them, except for marketing, which will be up some 30 basis points from last year.

And in terms of fixed expenses, for the second quarter, add \$3 million to \$4 million for this quarter. And then as we go out, we started building the expense structure really in the back half of last year. And also, we will start getting some sales. So it will be comparable to last year's numbers.

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**Brian Nagel** - Oppenheimer - Analyst

So to be clear, there is no expense sort of, say, startup costs in there for eCommerce? It will essentially go away once it is launched?

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**Cary Turner** - Pier 1 Imports, Inc. - SEVP, CFO

The real startup costs are really that \$3 million to \$4 million that we are talking about in terms of planned additional headcount. And the other costs are really being capitalized.

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**Brian Nagel** - Oppenheimer - Analyst

Okay.

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

There's a (inaudible) chunk in capital, as Cary said. Obviously, all the fulfillment center and all the systems piece is capitalized.

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**Brian Nagel** - Oppenheimer - Analyst

Got it. And then the second question I had, with respect to the buyback, you guys bought back a nice chunk of stock here just recently. Going forward -- and I know the commentary before has been you had that \$100 million authorization, which was basically, you said, opportunistic. Do you still look at the balance of that as opportunistic or do you think there is going to be more of kind of a steady buyback here now until it is completed?



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

That is a great question, Brian. And you know, we have been debating that internally as to whether, like you say, just to sort of dive into the market when we think it is -- we are a little low. And I can't give you a definitive answer to that. But what I can say to you is it is a topic that we are going to be discussing fairly shortly with the Board. So once we've resolved what our strategy is going to be about this, we will certainly let you know. But it is on our minds.

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**Brian Nagel** - *Oppenheimer - Analyst*

Thank you and congrats again.

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**Operator**

David Berman, Berman Capital Management.

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**David Berman** - *Berman Capital Management - Analyst*

Good job (inaudible). Just wondering if you could embellish place on the Internet strategies. I think you had mentioned before that you expect over five years Internet to be 10% perhaps our sales, which I think you probably can do that. How do you expect that to ramp up and how do you see the Street looking at this as well?

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

Well, I think the problem we have at the moment is we have no Internet business. And so after July 28 and from there on, we are going to get a whole lot wiser a whole lot quicker.

We are certainly very optimistic about it. As I think we've said in previous calls, our first job is to put online the existing Pier 1 Imports assortments. Our second job will be to add additional categories that we don't normally sell in the store and expand the existing categories. And the third job will be to leverage the Pier 1 Imports into whole new areas. So there is kind of three prongs to that.

We've set what we think are -- in our three year plan we think is a very achievable number. But that is kind of not -- that's not the number we are aiming to hit and sit back. We think there is considerable upside.

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**David Berman** - *Berman Capital Management - Analyst*

Interesting. Do you intend to include a same-store sales in the comps or not? Have you decided on that?

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

As far as reporting is concerned, we are not going to include our direct-to-consumer business in our comp store sale calculation, no.

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**David Berman** - *Berman Capital Management - Analyst*

And if it is picked up from the store?

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

Sorry?

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**David Berman** - *Berman Capital Management - Analyst*

If it is picked up from the store, will you include it then?

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

Yes, yes. And what we are doing, which I think is important to know, we are working on a way to -- this is for internal consumption only -- to credit the stores with the sales that come from the trade areas surrounding their store, because we really want them to feel that it is all one Company, and that they have a stake in encouraging our online business as well.

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**David Berman** - *Berman Capital Management - Analyst*

So at the end of July you (inaudible) you're going to have a soft opening, I would imagine. When do you expect to start ramping it up, start marketing it and letting people know that you're actually selling through it and all that kind of stuff and [when] are you going to do it?

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

It will be a gradual process as we move through the fall. I think you will probably notice it most as we move into holiday. But as I said in the prepared remarks, once we get into fall, we certainly are going to switch more of our marketing dollars into digital media, just to highlight the fact that we are open and ready for business.

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**David Berman** - *Berman Capital Management - Analyst*

So one final question based on, I guess, looking at (technical difficulty) and what you expect. What do you think the cannibalization might be for the stores with the Internet?

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

In truth, I just don't know. There is going to be some. I don't think it is going to be significant, because one of the great joys of shopping at Pier 1 Imports is that whole sensory experience. You have to be in our stores and touch it, feel it, smell it. So I don't -- I think that is what our customers tell us they like, and they are not going to stop doing that. But there is bound to be a little, I guess.

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**Cary Turner** - *Pier 1 Imports, Inc. - SEVP, CFO*

The flipside of that is really we are anticipating a fair amount of people picking up the product at the store so they don't have to incur a shipping cost. And if that number is relatively high, then we are taking advantage of our existing store base that much more.

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**David Berman** - *Berman Capital Management - Analyst*

That could be as high as 50%, right.

**Cary Turner** - *Pier 1 Imports, Inc. - SEVP, CFO*

We hope so.

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**David Berman** - *Berman Capital Management - Analyst*

Thank you very much. That's very exciting.

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

Okay. Thanks, David.

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**Operator**

Alan Rifkin, Barclays.

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**Helen Pan** - *Barclays Capital - Analyst*

This is actually Helen Pan filling in for Alan. Congratulations on the strong quarter. I was wondering if you could comment on the promotional environment in this sector, as well as online competition, especially as you gear up to launch your new website. And also what you plan to do with shipping and pricing online versus stores.

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

Okay, is that Helen?

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**Helen Pan** - *Barclays Capital - Analyst*

Yes.

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

On the promotional environment, I don't think it has changed very significantly. It doesn't feel much different to us than it felt last year in terms of what our competitors are doing. I think we all know that the consumer has been a little more cautious, but I don't think that has resulted in retailers being any more aggressive about their promotional activities. So to me, it feels pretty much steady as she goes.

As far as online, there were questions. What was the first one?

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**Helen Pan** - *Barclays Capital - Analyst*

The shipping and also pricing online versus in the stores.

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

Pricing versus in stores. Everything will be priced the same as in stores. It is very important to us. We are talking about building a broad franchise here which is based on our customers being able to shop where they want and when they want. And it is very important that the experience that they have is as similar as we can make it, whether they are shopping in store and online. And obviously a big piece of that is maintaining price parity between the stores and online.

As far as shipping is concerned, we are going to give our customers options. They will be able to pick up in-store, in which case their shipping costs will be zero, or they will be able to pay and have it delivered. We don't have any plans for large amounts of free shipping or things like that. To me, free shipping is just a markdown. I mean, people call it free shipping. It's not; it's a discount, it's a markdown. And we are not reckless with markdowns and discounts in our stores' business; we are certainly not going to be in our online business.

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**Helen Pan** - *Barclays Capital - Analyst*

Great. Thank you.

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**Operator**

Simeon Gutman, Credit Suisse.

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**Simeon Gutman** - *Credit Suisse - Analyst*

Alex, just a quick follow-up on some comments you just mentioned a minute ago on the macro. Because there has been -- I guess the data is coming in a little more uncertain and there is some worries reentering the picture. Are there any changes that are visible to you, either through data of some of the categories or anecdotes in your business?

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

It is kind of really hard to read on a day-to-day basis. I would say two things. Firstly, in our prepared remarks, we alluded to the right balance of promotional activity. And certainly that activity is necessary. I think you've heard me say, sort of going back over previous calls, that if the consumer got very strong we would be able to dial back our [sale] pricing strategies and that would flow through into merchandise margin increases. Now is certainly not the time to do that. We have to maintain the balance we have at the moment. So in that respect, I think the customer is a little bit cautious.

The other thing I would say happens -- and you will have heard this from other retailers that you talk to -- after these big holiday weekends, such as Mother's Day and Memorial Day, you get this little lull for a few days afterwards, a sort of buyer's remorse, if you like, which we didn't see when the economy was stronger. So we are still seeing that pattern. So I do believe that customers still have a sense of how many dollars have I got to spend and when it is spent, it is spent. So I don't know whether that helps you any, but that is kind of as we see it.

Cary, do you want to (multiple speakers)?

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**Cary Turner** - *Pier 1 Imports, Inc. - SEVP, CFO*

What I would say too -- what we continue to see -- we've probably seen it for the last 18 months; we are planning on the environment to stay about the same -- and what we see is a balance of 50% is either promotional or clearance and the other 50% is regular price.



**Simeon Gutman** - *Credit Suisse - Analyst*

Okay, that's helpful. And just a question on marketing dollars, and thanks for the color on that, Cary, between the quarters. The 5% number, I think -- or it has been said a few times that you don't expect to leverage -- the Internet business will obviously be above that, no sales, and there will be marketing dollars. So you are just simply shifting dollars away from I guess brick-and-mortar and there still should be a halo from that, and then you're going to put dollars toward the Internet.

Is that the right way to think about it? Or is there some nervousness that as you put money towards Internet and you deemphasize the brick-and-mortar, there will be some impact there?

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

Nervousness, zero. As far as -- I don't want to overplay this -- we are not talking about moving sort of 30% of our -- and maybe I didn't make that clear enough, so I apologize. We are talking about relatively small adjustments in terms of our total media spend from what we've got at the moment towards digital.

But again, I really want to emphasize that we are not thinking in terms of, here is what we do to support stores, here is what we do to support the online. What we are trying to do is to optimize the support of both. We love all our children, and we want to do the best by all of them. And in the short term, we've got 1054 -- 1053 stores which need to be looked after, so we are absolutely not going to jeopardize that.

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**Cary Turner** - *Pier 1 Imports, Inc. - SEVP, CFO*

And what we continue to find is the more you spend on social media, the more you need to spend on television and radio, because they need something to talk about.

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**Simeon Gutman** - *Credit Suisse - Analyst*

Okay. And just one item to clarify. Cary, you mentioned in response to someone's question -- I think I caught it right -- \$3 million to 4 million of fixed expenses incremental from here. Is that (multiple speakers)?

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**Cary Turner** - *Pier 1 Imports, Inc. - SEVP, CFO*

From last year.

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**Simeon Gutman** - *Credit Suisse - Analyst*

From last year, okay. So just relative to what you previously said, is that a change or is that the same?

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**Cary Turner** - *Pier 1 Imports, Inc. - SEVP, CFO*

No, that's the same. So you saw this first quarter we were up just -- what -- \$2.9 million.

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**Simeon Gutman** - *Credit Suisse - Analyst*

Okay, that's good. Thanks.



**Operator**

Brad Thomas, KeyBanc Capital Markets.

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

Let me add my congratulations on the quarter, and Alex, congratulations on the extended contract with the Company. Wanted to just ask about the new private label card. Appreciate the prepared remarks that you gave, Alex. Just in the short term, was there any negative effect from switching it over? And then as it really gets out there and the customers have this new card, what kind of impact are you expecting in the coming months and quarters?

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

When you do a changeover like this, you always in a sense -- the guys did a magnificent job in terms of planning it, but your heart is always in your mouth a little bit until it happens. But I have to say it just went superbly. We got no complaints to speak of. It just all went incredibly smoothly. Everybody did an outstanding job. So kudos to the team here and kudos to ADS.

In terms of -- what were you saying -- in terms of promoting it --

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**Cary Turner** - *Pier 1 Imports, Inc. - SEVP, CFO*

I would say the best way to think about it, Brad, is the last two years, our Rewards Card had been 21% of the business. Our short-term goal, we anticipate it to go up to about 25% of the business. And then ultimately getting closer to 30% of the business, which is the level it was at when we actually owned the receivable and drove that business.

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

And if I understand correctly, Cary, so the customer spending on this card is spent at a higher average level, so that should help sales. You do not incur a MasterCard or Visa processing fees, so that should improve the profitability. But are there offsets to that in terms of the promotional spend to get the customer spending on this card? What are some of the puts and takes as we look at this opportunity?

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**Cary Turner** - *Pier 1 Imports, Inc. - SEVP, CFO*

No, there is also a transactional amount that we get from ADS on every sale. But in addition to that, there is an offset, where for every dollar she gets a point, and for every \$200 she spends, she gets a \$20 gift certificate to spend at her next visit.

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

But on the whole, it sounds like (multiple speakers)

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**Cary Turner** - *Pier 1 Imports, Inc. - SEVP, CFO*

So we want to drive frequency and average ticket.

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

But on the whole, it is very much in that positive, isn't it?

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

Not on the whole; it is totally -- there is no downside to this at all.

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

Perfect. Thank you for the clarification. If I could just squeeze in two housekeeping items. Cary, as we forecast the kind of net income and other expense of line item, I think there was about \$9 million last year. What are you expecting for this year?

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**Cary Turner** - Pier 1 Imports, Inc. - SEVP, CFO

I would just say for each quarter, use what happened in the first quarter.

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

Great. And then lastly, what was the share count at the end of the quarter? Do you have that handy?

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**Cary Turner** - Pier 1 Imports, Inc. - SEVP, CFO

Well, we said -- it's just slightly higher than 107 million. And going forward, I would, for fully-diluted, use 108 million, 109 million for now.

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

Perfect. Thanks so much guys and congratulations again.

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**Operator**

Matthew Nemer, Wells Fargo Securities.

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**Matthew Nemer** - Wells Fargo - Analyst

So just a few questions on eCommerce. The first is you talked to the expected increase in inventory next quarter. Can you give any more color on how much of the three drivers of that is eComm? Is it split one third, one third, one third, or should eComm be maybe as much as half of that expected inventory increase?

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

I don't think we would want to split it out in detail for you, but I think if you use one third, one third, one third, you're not going to be too far wrong.

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**Matthew Nemer** - Wells Fargo - Analyst

As a follow-up to that, can you talk to how much volume your current eCommerce distribution infrastructure at launch can support? And at what point would you need to potentially go to three PLs to supplement that?

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

Well, let me say this. It can support significantly more than we are anticipating doing in the first couple of years. So once we see how this business is going forward, we have got more than enough time to build out our second facility. And indeed, we already have space identified within our existing network.

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**Cary Turner** - Pier 1 Imports, Inc. - SEVP, CFO

So we are not talking about [going] out to an APL.

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**Matthew Nemer** - Wells Fargo - Analyst

Okay, great. Lastly, and this is probably farther out into the future, but we noticed that one of your IT vendors has the capability to do -- offer ship from store. And I'm wondering if that is on the table and at what point we might see that and are the stores set up for that. Is that enough room to package small items and send them out, are there enough labor hours to do something like that?

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

That is not on any plan that we've looked at. I think it would be hideously inefficient.

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**Cary Turner** - Pier 1 Imports, Inc. - SEVP, CFO

The nice thing is we have Pier 1 To-Go, which you can basically order online and pick up that inventory that is in the store. So that is an aspect of that that we already have.

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**Matthew Nemer** - Wells Fargo - Analyst

Got it. Okay. That's all I've got. Congrats, guys. Thank you.

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**Operator**

Anthony Chukumba, BB&T Capital Markets.

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**Anthony Chukumba** - BB&T Capital Markets - Analyst

Let me add my congratulations, Alex, to you for the appointment agreement. Certainly very well-deserved.

My question, I had one question on eCommerce. You mentioned that you are going to be overhauling the website in advance of launching Pier 1-to-You. And I was wondering of you could give us a little bit of color in terms of what exactly that is going to entail. Is that going to be changes to the look of the website, the functionality, the search, sort of all of the above?



And then my second question was just -- so you got over the 60% merchandise margin. I know that has sort of been sort of a taboo. I guess just how are you thinking about merchandise margin? Are you still sort of -- it is still going to be sort of that 59%, 60% [roll or] are you thinking maybe we can push it a little bit higher than that? Thanks.

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

Thanks for the nice comments. As far as the new website is concerned, it is of course a brand-new website on a brand-new platform, and all those things that you listed out will be new and improved. It is going to look better, the search is going to be better, there is obviously a ton more functionality on it compared to what we've got at the moment. So I think you're really going to love it, actually. It is an extremely pretty and attractive website.

As far as margin is concerned, well, I go back to the comments which we had earlier about the environment and the amount of promotional pricing. The first two components of merchandise margin, the first two big ones in terms of what we buy at, that is pretty stable. So the buyer's margin, which you guys don't see, is strong and stable.

The first decrier of that is, of course, markdown. And our markdown percentage has moved down very significantly over the last few years. But I think we are getting to a point now where we kind of like the level of markdown in a sense that we give ourselves enough flexibility to clear out all the slow-selling merchandise in a timely manner and bring in new merchandise. So we don't see very big decreases in that.

Which leaves us with the promotional pricing part. And I think that is going to stay at or around the current levels until we see a much stronger tailwind from the economy.

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**Cary Turner** - *Pier 1 Imports, Inc. - SEVP, CFO*

I think everybody has to remember, we do not plan to a rate. We plan to margin dollars. And if we can generate additional incremental sales and have a margin that is in that 59% to 60% range, we will be very, very happy.

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**Anthony Chukumba** - *BB&T Capital Markets - Analyst*

Okay, that's very helpful color. Thank you.

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**Operator**

Denise Chai, Bank of America.

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**Denise Chai** - *BofA Merrill Lynch - Analyst*

Congratulations on another good quarter. You mentioned that your relocated stores have been performing at least 20% better than the stores that were in those markets before. So could you give us an update on the kind of comp lift you're seeing from refurbished and reconfigured stores?

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**Cary Turner** - *Pier 1 Imports, Inc. - SEVP, CFO*

We definitely see a lift, and we are not going to give you the exact dollar amount. What I tell everybody is we have learned an awful lot about how important lighting is to our concept, and we continue to look at improving the lighting in all the stores.

The refurbishments that we've done, Alex said we did the one in Culver City. We are definitely getting a very strong lift; it is like opening a brand-new store. But I will also say we've mentioned that we are touching 100 or so stores this year, that not every store is created equal. If a store has the potential, we will put all the new fixtures in. But if a store, maybe it just needs a nice paint job and some improvement in the lighting and not all the fixtures. So it is all relative to what we anticipate getting.

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

I think the other thing I would say, just to add to what Cary said, is for the most part, the stores we relocate [in these] are the ones which are underperforming the chain anyway. So if you can take a store that was -- let's say, you know, it was doing zero or minus two when the chain was doing sort of plus seven -- if we can bring that relo store effectively up to the chain average, well, it moves the average up. So it is a -- they are great moves for us. Because the ones we are relocating are pretty old and tired stores.

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**Cary Turner** - *Pier 1 Imports, Inc. - SEVP, CFO*

But remember, last year, it was six of them and this year it is going to be six to eight, so it is not a meaningful impact in total.

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**Denise Chai** - *BofA Merrill Lynch - Analyst*

Okay, got it. Thank you. And then I just want to ask one more time on the incremental admin spend for eCommerce. So you mentioned second quarter would be up \$3 million to \$4 million. But in the second half, given that you started the ramp in spending in the second half of last year, will we see the dollar spend flatten out, or can you just give us a little bit more color around that?

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**Cary Turner** - *Pier 1 Imports, Inc. - SEVP, CFO*

Yes, the spend should flatten out. It might be up \$1 million or so, but you won't see it.

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**Denise Chai** - *BofA Merrill Lynch - Analyst*

Okay, great. Thank you very much.

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

Okay, everybody. Well, thank you very much for your questions and listening to us today, and we will be back in a few months. Thank you very much.

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**Operator**

Thank you, ladies and gentlemen. This does conclude today's conference call. You may now disconnect.

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