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PIR - Q4 2016 Pier 1 Imports Inc Earnings Call

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OVERVIEW:

Co. reported 4Q16 total sales of $542m and net income of $19m or $0.23 per share. Expects FY17 EPS to be $0.42-0.50 and 1Q17 loss per share to be $0.04-0.08. Expects 2Q17 EPS to be loss of $0.02 to profit of $0.02.

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to the Pier 1 Imports fourth quarter fiscal 2016 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.

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

Thank you and good afternoon, everyone. Today, after market close, we issued an earnings press release which included the detailed financial results for the fiscal 2016 fourth quarter and full year. 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 he remind you that certain comments made during this call may be deemed to include forward-looking statements that are based on management's current estimates or expectations of future events or future results. These statements are not historical in nature, and can generally be identified by such words as believe, expect, estimate, anticipate, plan, may, will, intend and similar expressions.

Management's expectations and assumptions regarding future results are subject to risks, uncertainties and other factors that could cause actual results to differ materially from the anticipated results or other expectations expressed in the forward-looking statements included in the press release mentioned earlier in this conference call.

These risks and uncertainties include, but are not limited to, the effectiveness of the Company's marketing campaigns and customer databases, consumer spending patterns, inventory levels and values. The Company's ability to implement planned cost control measures, the expected benefits from the real estate optimization initiative, including cost savings and increases in efficiency and changes in foreign currency values relative to the US dollar. These and other factors that could cause results to differ materially from those described in the forward-looking statements made during this call can be found in the Company's annual report on Form 10-K and in other filings with the SEC.

Refer to the Company's most recent SEC filings for any updates concerning these and other risks and uncertainties that may affect the Company's operations and performance. Undue reliance should not be placed on forward-looking statements, which are only current as of the date they are made. The Company assumes no obligation to update or revise its 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 S-K, 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 we issued this afternoon which is available on our website at pier1.com.

Now I would like to turn the call over to Alex Smith, Pier 1 Imports' President and Chief Executive Officer. Alex?

Alex Smith *- Pier 1 Imports Inc - President & CEO*

Thanks, Bryan, and good afternoon, everyone. Also joining me on the call is Jeff Boyer, Executive Vice President and Chief Financial Officer, and other members of our senior leadership team are in the room with us today as well.

2016 marked our first year as a fully capable omni-channel retailer. Without doubt, it was a of tough year ending a tough transformation process, but we have emerged stronger with a clear view of the future.

We have a new dynamic omni-channel business model that we can now exploit. Indeed, we have full scale omni-channel capabilities, some of which are well ahead of our home furnishing peers. We have so many opportunities to make our well loved Company not only loved by more customers, but also more profitable.

Our brand health, which we measure through research multiple times a year, is extremely strong, at or near all-time highs from most of the metrics which we measure, and the Pier 1 Imports name carries 99% brand awareness. The consistency of our brand positioning resonates as always.

Our customers love Pier 1 Imports, our stores, and our site. She loves our broad, unique assortments that cover multiple aesthetics, our good quality products that are priced to be affordable, merchandise that allows her to create her personal style. And products that reflect the artisans who made them, products with a soul.

Baby boomers, generation X and millennials can all showcase their creativity. We don't need multiple brands. Pier 1 Imports appeals to all.

Increased competitive activity, especially from on and offline deep discounters, has altered the home furnishings playing field considerably. That said, specialty home furnishings is still a high margin business, part of a large and fragmented industry, and there is ample room for many of us to succeed. There's certainly room for a vibrant and successful Pier 1 Imports.

It's clear to us that the high level of promotional activity we've been witnessing across the retail spectrum for some time now is here to stay. It's regrettable, but the industry has done it to itself. We will continue to engage and remain competitive.

Fortunately, recent history has taught us how to be smarter and more sophisticated about the way we spend our promotional dollars in this new era of retailing. And as we continue to develop our advanced analytical skills, we'll continue to finesse our activities.

We're also developing ways to offset necessary discounts by concentrating on reducing other sources of merchandise margin degradation. We also believe we can grow initial markup without raising selling prices.

I'm glad to tell you that we've completed the heavy lifting related to our inventory problems. And in the process, we laid the groundwork to build a more efficient distribution network, helped by our ongoing commitment to inventory turn improvements and our single inventory for both stores and e-Commerce.

I am very excited to see how our use of data and advanced analytics are changing the Company for the better on many fronts. They will help us find cost efficiencies across the organization, and help make us better decisions around promotional activity, media spend and real estate. Our use of data is expanding our understanding of how customers behave in the omni-channel world so we can talk to her the right way, and drive our retention and frequency rate even higher, beyond the all-time highs we achieved in fiscal 2016.

Our total sales and Company comp sales in fiscal 2016 registered low single-digit increases on a constant currency basis. Both sales and earnings were pressured by internal and external factors, namely our inventory issues and the intensely, promotional competitive environment which we've discussed on previous calls. Nevertheless, there are a number of positive financial highlights from the year.

We achieved strong double-digit growth in e-Commerce sales, which reached 18% of total revenue. The business generated strong cash flow from operations of $164 million. We returned nearly $100 million of cash to shareholders by way of repurchases and cash dividends.

We bought down our inventories by 15% from a year ago, and we took significant costs out of the business. We're planning fiscal 2017 to be a year of modest growth, as we start to leverage our new omni-channel business model to drive sales, improve our operating efficiency and rebuild profitability.

Let me talk about some of the things that are top of mind for us. The first is merchandising. Product is always front and center at Pier 1 Imports. The creativity of our merchant team and their ability to develop and orchestrate our unique assortments is, as we know, one of our not so secret secret weapons. We're not a furniture store, or a tabletop store, or an anything else with a narrow focus store.

Our broad spectrum of merchandise categories is a strong competitive advantage, which our customers love. We have considered purchases, we have impulse items.

This year, we're evolving our go-to-market strategies to emphasize newness more strongly, and are increasing our focus on our strongest categories. For example, seasonal and holiday, fragrance, and textiles which includes the expansion of bed and the introduction of bath this spring. We continue to have a robust furniture business, and this year, we'll bring some of our best performing online only SKUs to the stores.

My second topic is marketing. We are significantly increasing our spend in fiscal 2017. This will allow us to reincorporate television into our media plan without going backwards on our successful digital and print activity. So we'll continue to utilize the digital e-mail and social media strategies that have resulted in more frequent purchasing among not just our best customers, but among all known customers.

In fiscal 2016, as you know, we rebuilt our legacy customer database and added new CRM functionality so that our marketing, customer relations and store teams have access to detailed and accurate information about how and when our customers spend. The database and CRM projects is the most ambitious and complex IT work that we've undertaken, and its impact will be felt enterprise-wide.

Equally exciting, the new database provides us with a platform to develop an extension to our successful Pier 1 Rewards Credit Card loyalty program. This new entry level non-tender loyalty program is currently being piloted in three states. We will roll out nationwide later this year.

The combination of the new database, an expanded loyalty program and our new customer relations functionality should translate to higher spend from known customers and increase the number of new customers coming into the Pier 1 family. Additionally, we will increase the attractiveness of the Pier 1 Rewards Card by offering a zero interest option on larger purchases.

Our ability to talk to known customers directly will also be helped by entry into the gift registry business this year. This will initially be rolled out online only, with functionality coming to the stores at a later date.

In fiscal 2016, known customers accounted for greater than 70% of sales, while repeat customers accounted for approximately 60% of sales. We anticipate being able to push these rates higher in fiscal 2017 as more customers enter our database.

Now let's talk about supply chain. We're starting the new fiscal year on the right foot. With leaner inventory levels, increased capacity within our DC network and getting back on track with improved execution against our existing KPIs. There is more work to be done and opportunity to drive greater efficiency in the years ahead. More from Jeff on this a little later in the call.

If merchandise is our first not so secret secret weapon, stores are our second. We've begun the multi-year process to close our lower volume, low profitability stores. What remains is a large and highly productivity portfolio and nationwide network that is essential to our dynamic omni-channel model.

Well over 90% of our revenues touch a store in one way or another. Our stores are important because they drive revenue, they serve as perhaps our best marketing vehicle, and our store associates are our outstanding brand ambassadors.

As part of our store optimization program, we're looking closely at the percentage of sales that transfer when we close a store, all sales, including e-Com. We're also studying the long-term impact of our store relocation and refurbishment program that we've been implementing for over the last five years. And we're also starting to reimagine our stores, and are embarking on a store of the future project which we expect to begin testing late in summer.

Costs, of course, are always a focus. As I mentioned earlier, we made excellent progress towards bringing down costs in fiscal 2016. As you'll hear from Jeff, we are working to uncover additional opportunities across the Company from the field organization to corporate headquarters.

When we look at the year ahead, we see a tale of two halves. In the first half of fiscal 2017, our top line assumption reflects a few key factors including a cautious overall outlook, the closure of 23 Pier 1 Imports stores in February, and the shift of Memorial Day from the first quarter into the second.

From an earnings perspective, the first half will be impacted by investments in marketing and the final portion of costs from our recent supply chain issues which are, at last, starting to disappear into the rear view mirror.

Looking forward towards the second half of fiscal 2017, we expect to generate improved results across all of our key financial metrics. Sales, merchandise margin, contribution from operations and earnings per share as our initiatives around merchandising and product newness, margin structure and customer acquisition and retention begin to manifest.

There has been in much discussion in the investor community about how retail profitability is being pressured by the costs of running omni-channel businesses, and the intense pressure on pricing. Whilst in the short term, there is obviously truth to these twin thoughts, there has not been as much discussion about how retail companies are responding. At Pier 1 Imports, we believe that we have the inventiveness, adaptability and the desire to transcend these pressures over time.

We have opportunities to improve our cost efficiency across the organization in stores, in supply chain, in marketing and in corporate offices. As high-margin specialty retailers, we can learn from lower margin retail formats that have been forced for decades to concentrate on cost efficiency. We have embarked on a multi-year project to help us do just this. We are 60 days into this work, and have already identified many opportunities to streamline work and drive cost out of the business. Some of our ideas are achievable nearer term, some longer term. Some require capital investments, but everything we see at this stage looks highly achievable.

We also have promising ideas for revenue generation through product and brand extensions which we've had to put on pause, as we worked our way through the operating issues resulting from our excess inventory position.

Our entire organization worked extremely hard to make our omni-channel transformation a success. And having done it, we're all energized by the long-term opportunity it affords us. We're not planning for fiscal 2017 to be a banner year, but we believe the improvements we're expecting will serve as a foundation for a more robust performance in future years. fiscal 2017 will be about exploiting all aspects of our new omni-channel business model, and positioning Pier 1 Imports' return to a stable trajectory of profitable growth. At the same time, we remain committed to delivering shareholder value, and plan to continue to utilize our strong cash flow for share repurchases and cash dividends.

I'm extremely grateful to all our associates for all they do for our well-loved Company. They are committed to a culture of excellence, have the desire to delight our customers at every turn and continue to be inspired by the Pier 1 Imports' brand. And with that, I will now ask Jeff to review the financials and discuss our guidance for fiscal 2017.

Jeff Boyer *- Pier 1 Imports Inc - EVP & CFO*

Thanks, Alex, and good afternoon, everyone. Before I get further into my prepared remarks, I want to point out that beginning with fiscal 2016's earnings, we've changed our presentation of credit and debit card fees. What has changed is that we're no longer reporting these fees as a reduction to net sales. They're now being reported as a component of selling, general and administrative expenses.

The results of the change in presentation is that both net sales and SG&A increase in equal and offsetting amount. There's no net impact to operating income, net income, the balance sheet or statement of cash flows. To help everyone reconcile their Pier 1 Imports' financial models, in addition to the reconciliations in our press release today, we've posted supplemental historical data on the Investor Relations page of our website.

While fiscal 2016 proved to have its operational and financial challenges, we did start to see signs of stabilization in store traffic trends in the fourth quarter. We don't believe store traffic trends have fully turned the corner. But as Alex noted, our marketing plans for this year are designed specifically to drive new customer acquisition and increase store traffic.

The biggest pressure point in fiscal 2016 was at the merchandise margin level. As we've talked about on prior calls, promotional clearance pressures, necessary in order to clear inventory and remain competitive, and distribution inefficiencies contributed to the decline in merchandise margin. We're pleased with the inventory reductions we were able to achieve which were ahead of our targets, but these reductions did come at some cost.

Looking at our business model from a high-level perspective, in fiscal 2016, we began to focus on reducing store cost to offset delivery and fulfillment deleveraging. These costs include occupancy, store payroll and store operational expenses. So from the standpoint of managing the core operational cost structure underlying our omni-channel model, we made good progress thus far in balancing our store operation's costs against our delivery and fulfillment expenses.

Turning now to our financial results. Total sales in the fourth quarter decreased 1.4% to $542 million, while Company comps decreased 0.6%. On a constant currency basis, total sales were down 50 basis points and Company comps were up 30 basis points. This was ahead of what we projected, which reflects positive customer response to our holiday and seasonal goods as well as the heightened promotional activity during the period.

E-Commerce sales remained strong, with sales penetration of approximately 15% in the fourth quarter. That's up from 12.6% in the fourth quarter of last year, and represents e-Com growth of about 16% year over year. On a full year basis, e-Commerce accounted for 16% of total sales, up from 11% in fiscal 2015. Fourth-quarter merchandise margin dollars declined to $285 million from $309 million a year ago, while the merchandise margin rate came in at 52.5%, compared to 56.1% in the fourth quarter of fiscal 2015.

The year-over-year decline of 360 basis points can be traced to two factors. First, approximately 300 basis points is due to higher promotional activity in the quarter. As we expected, we saw strong response to our markdown and clearance events post holiday which helped us achieve the greater than planned inventory reductions.

At the same time, the competitive environment was intense which factored into a merchandise margin rate below where we guided. Net/net, we are comfortable with the margin impact we absorbed relative through headway made in bringing down inventories. The majority of the balance of the merchandise margin rate contraction in the quarter was tied to the recognition of incremental distribution center costs as the affected inventory was sold.

For the full fiscal 2016, merchandise margin was 55.3% of sales, a decline of 310 basis points compared to 58.4% last year. Almost two-thirds of the decline is attributable to promotional and/or clearance markdown pricing, with the majority of the balance due to costs associated with inefficiencies in our distribution centers. We're very pleased with the improvements we've made within our distribution centers, and anticipate the inventory costing and recognition effects of our fiscal 2016 operational issues will abate beginning with the second quarter of fiscal 2017.

As Alex mentioned, the first quarter of fiscal 2017 was impacted by the fiscal 2016 supply chain expenses, and an increase in our clearance cadence relative to Q1 last year. With respect to the supply chain, we see a number of areas for opportunity of improvement. These improvements should benefit merchandise margins over time. First, in the near term, we'll see reduced costs, including lower detention of the merch expenses now that we have significantly reduced our inventories.

Secondly, we're relaying the DCs based on SKU profiles and velocity of turns, which is expected to generate further efficiency in our DCs. Looking farther out, there will be ongoing supply chain productivity initiatives which could include network optimization and e-Commerce fulfillment from all DCs.

Turning back to our financial results, delivery and fulfillment net costs increased both in dollars and as a percent of total sales. We are, however, continuing to leverage these costs as a percentage of fulfilled sales. In the fourth quarter, we saw approximately two-thirds of our e-Commerce sales fulfilled to the customer through either partial or in-home delivery which is consistent with what we saw all year.

Moving now to occupancy. In the fourth quarter, store occupancy costs declined to $74.1 million, down from $75.4 million last year. As a percent of total sales, they were flat year over year. For the full year, store occupancy costs were relatively flat on a dollar basis, coming in at $298.6 million. As a percentage of sales, store occupancy costs leveraged 10 basis points to 15.7%.

Fourth-quarter profit was $196.9 million or 36.3% of total sales, compared to $220.8 million or 40.2% of total sales a year ago. For the full year, gross profit was $705 million, compared to $768 million last year. Gross profit as a percent of sales was 37.3% versus 40.8% in fiscal 2015.

We maintained strict expense control in the fourth quarter, with total SG&A down both in dollars and as a percent of sales. For the quarter, SG&A came in at $150 million, reflecting 60 basis points of leverage compared to the prior year.

For the full year, SG&A expenses totaled $579 million or 30.6% of sales. This represented improvement of 100 basis points versus fiscal 2015. 60 basis points of the improvement was attributable to savings within compensation for operations, with the balance primarily attributable to marketing.

We made good progress reducing costs, and we're continuing to look at all areas of the business for additional opportunities. In fiscal 2017, we have planned increases in our marketing spend and bonus program that we're offsetting with the expectation of nearly $20 million of expense savings, primarily coming from corporate headquarters and store operations. As Alex mentioned, we have a significant project underway to identify incremental FY17 efficiencies and cost reductions, and to generate additional savings in future years.

Q4 operating income totaled $34 million, and net income was $19 million or $0.23 per share. For the full year, operating income totaled $75 million, and net income was $40 million or $0.46 per share. Fourth quarter EBITDA totaled $46 million, which compares to $68 million a year ago. On a full year basis, EBITDA totaled $125 million, down from $176 million in fiscal 2015.

Moving to the balance sheet. At the close of the year, we had $115 million in cash and cash equivalents and no cash borrowings under our revolving credit facility. Inventory at quarter end totaled $406 million, representing a decline of approximately 15% versus a year ago. We are targeting for inventory to be down modestly year over year by the end of fiscal 2017.

Capital expenditures totaled $12 million in the fourth quarter, and $52 million for the full year. For the full year, just under half of our capital investment was in support of information technology which included sizable investments in support of our Customer Data Excellence initiative. The remainder was split between investment in stores and supply chain.

In fiscal 2017, we're planning for capital spending of approximately $55 million, which will be directed towards the same three key targets as fiscal 2016, IT, including upgrades to pier1.com, investments in stores, and also investments in the supply chain.

Looking forward to fiscal 2017, we have a number of initiatives to drive top line. But we're balancing that optimism with the recent trends in the business, especially store traffic and a declining store base. We will continue to push on operational cost levers to offset delivery and fulfillment costs, which we expect in conjunction with improvement in merchandise margin will help drive higher year-over-year gross profit and contribution from operations.

But there are headwinds to EPS growth, including a significant increase in marketing spend, an increased expense for potential bonus and equity awards and a step-up in depreciation. The biggest impact of these items will be felt in the first half, with the majority of our expected full-year growth being driven by stronger performance in the third and fourth quarters.

Turning to guidance. Please keep in mind that all the metrics we're providing are inclusive of our multi-year store optimization program currently underway. Note that the 33 net store closures in fiscal 2016 will result in a slightly wider disparity between our total sales growth and Company comp sales growth figures in fiscal 2017 on the order of around 150 basis points for the full year.

Let's start with the full-year guidance for fiscal 2017. We expect to drive Company comparable sales growth between 1% and 3%. This implies net sales will be approximately flat due to store closures I just mentioned.

Merchandise margins in fiscal 2017 are expected to be in the range of 56% to 57%, with additional improvements expected in following years. Selling, general and administrative expenses as a percent of sales are expected to deleverage by about 50 basis points. Depreciation will be higher versus fiscal 2016 at approximately $56 million, and we're guiding EPS in the range of $0.42 to $0.50 on diluted shares of 80 million.

For modeling purposes, it's important to point out that our net interest expense will be up modestly year over year in fiscal 2017 in the range of $12 million. In addition, we're forecasting our full-year effective tax rate to be approximately 39.5%.

For the first quarter of fiscal 2017, we expect Company comparable sales to contract approximately 1% to 3%, merchandise margins to be in the range of 56% to 57%, and a loss per share in the range of $0.04 to $0.08. For the second quarter of fiscal 2017, we expect Company comparable sales growth to be flat to up 2%, merchandise margins to be approximately 55% to 56% and EPS in the range of a loss of $0.02 to a profit of $0.02.

For the second half of fiscal 2017, we're anticipating continued year-over-year improvement in the top line at the merchandise margin level, and also at the bottom line. As we look at the longer-term picture, we believe we have the opportunity to rebuild operating margin and drive more consistent earnings growth, even on low single-digit top line increases. We believe this could be accomplished based on the following.

First, there's an opportunity to recapture merchandise margin dollars by freshening our assortments, rationalizing our SKUs, optimizing our supply chain, improving input costs and increasing our promotional effectiveness. Second, the rationalization of our store [race]will continue to benefit occupancy costs as well as store payroll.

Third, delivery and fulfillment costs will continue to deleverage on a total basis, but will begin to leverage as a percentage of e-Commerce sales. Fourth, we'll continue to look at all aspects of the business to drive cost efficiencies. And lastly, we expect to see depreciation level off the next few years. Thanks for your attention this afternoon. And Melissa, we can now open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Your first question comes from Brian Nagel with Oppenheimer. Your line is open.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Hello, good afternoon.

Alex Smith - *Pier 1 Imports Inc - President & CEO*

Hey, Brian.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Thank you for all the color in the call. My question -- it's probably more for Jeff. As we think about -- and I know this is a topic we've discussed before. But as we look at Pier 1 worked down inventories more than you initially expected, down 15% last year.

So as we think about here in the current year, where should we, on the P&L, where will be the biggest benefits and how should we think about those benefits of now this operating with less inventory? Obviously, one, you'll have less clearance activity as [eventual project clear]. But are there other buckets on the P&L that we should benefit -- or receive benefits from with lower inventories?

Jeff Boyer - *Pier 1 Imports Inc - EVP & CFO*

Most of those benefits will show up in the merchandise margin line. And, Brian, as you mentioned, they'll show up in two places, really, that drive that, some of the issues we had in 2016 that we will be lapping around.

One, we'll have less clearance, that will particularly happen in the second half of the year as we cycle through that and have less clearance. And secondly, we'll have more efficiencies in our DCs versus last year's inefficiencies, and that will also show up through the merchandise margin line.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Okay. As we think about how we should [end] inventories then this year, I think you made the comment in your prepared comments maybe down slightly. But so does that suggest now that inventory levels are getting to where they should be for the business?

Alex Smith - *Pier 1 Imports Inc - President & CEO*

Brian, if you look at our track record on inventory, we did a really good job for a lot of years at keeping inventory growth in line with sales growth. And our plan is, by the end of this current fiscal year to get back to the position that we should always have been in if those two had moved in sync. So once we get back to where we should be, which will be the end of this year, as far as the Pier 1 brand is concerned, we'll try and make sure that sales and inventory are pretty much in lockstep.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Okay. Thank you very much.

Operator

Your next question comes from Seth Sigman from Credit Suisse. Your line is open.

Seth Sigman - *Credit Suisse - Analyst*

Okay. Thank you, and good afternoon, guys. I have a couple questions about sales. First, I was just wondering if you could help us understand the guidance for the first quarter which implies comps weaker than what you just reported. Is that based on what you're seeing right now, and are you embedding -- like what are you embedding for that Memorial Day shift that you alluded to?

Jeff Boyer - *Pier 1 Imports Inc - EVP & CFO*

On the Memorial Day shift, that's worth about 100 basis points or so between the quarters with the shift that's going on. And I would say actually the current trends in the business are basically on track for the guidance that we provided at this point.

Seth Sigman - *Credit Suisse - Analyst*

Okay. But if you adjust for that, it still points to a slight deceleration. Any idea what may be causing that in the first quarter and how you're planning for that?

Alex Smith - *Pier 1 Imports Inc - President & CEO*

Well, I think as we said in all our prepared remarks, Seth, I think we've got a number of things on our mind. One of which is just the general environment, and two is, we're being very cautious given our recent history. And I think those are the two main factors that we've baked into those Q1 numbers.

Seth Sigman - *Credit Suisse - Analyst*

Okay. Understood. Just one follow-up. Alex, you talked a lot about some of the focused categories, you named a few.

Where do you see the biggest opportunities? And do you feel like there are specific areas where it's core to your offering, but maybe you've been under-punching your potential, maybe underperforming, but you see opportunities for improvement here in 2016?

Alex Smith - *Pier 1 Imports Inc - President & CEO*

I would say that generally speaking, I'm more pleased with our new product introductions this spring, starting in January, than I have been for a while. So I think that's good news as far as I'm concerned.

In terms of categories that we sort of under-punched or over-punched, I don't want to be too specific for obvious reasons. But I think the most important things is what we said in the prepared remarks is about focusing on newness. Because what we're seeing is our customer is responding extremely well to newness, not to say that our revised SKUs are not important. They are. They're a huge percentage of our business. But she's liking newness.

And we have a number of categories where I think our market share is significantly above our overall market share, and we're going to make sure that we exploit those to their fullest. So we're feeling very good about all of that.

Seth Sigman - *Credit Suisse - Analyst*

Okay. Thank you.

Operator

Your next question comes from Simeon Gutman with Morgan Stanley. Your line is open.

Simeon Gutman - *Morgan Stanley - Analyst*

Thanks. Good afternoon. My first question is on -- how are you? My first question is on retention from closed stores. What has been the experience thus far, whether it's the existing stores or online? And then what's the expectation that's captured for this coming -- this next fiscal year?

Alex Smith - *Pier 1 Imports Inc - President & CEO*

In terms of sales transfer. Do you want to answer that, Jeff?

Jeff Boyer - *Pier 1 Imports Inc - EVP & CFO*

The sales transfer has been consistent with our modeling, which has been about a 20% transfer to physical stores. We're actually finding that the online transfer has actually been equal to what we've been showing for those individual stores, actually picks up a little bit by about 10% or so. And likely what that is is some of our customers, rather than physically going to the other store, they've now shifted to online, they're comfortable doing that.

So we've been pretty consistent with about a 20% transfer of the sales from physical stores, and the full online transfer, same in the business transferring, actually picking up by 10% or so. That's what our models have said, and we've been pretty consistent in performing against that.

Simeon Gutman - *Morgan Stanley - Analyst*

Got it, okay. My second question, it's a little bit higher level, thinking about the financial model of the business. So this year, comps for the full year guided low positive single-digit. And my question is if you look out another year, I don't know if the competitive landscape changes much. You're trying to grow past it and gain market share. But the numbers imply you're losing some market share in totality, and clearly you want to accelerate the sales growth.

But let's say you're in this low single-digit comp environment going forward. Can the model -- is the model built to leverage, let's say, more, let's say, in the out year than it is this year? Are there levers -- are there certain spending drivers in this fiscal year that abate? Meaning some of the inventory issues subside further, some of the marketing cycle such that when you're in this low single-digit environment you'll see some stronger growth in the out year?

Alex Smith - *Pier 1 Imports Inc - President & CEO*

There's a number of things in that. First, you're absolutely correct. We've given back a bit of share in the last fiscal year after six or seven years of taking share. So we're clearly not happy with that situation. The good news is that as far as we can tell, the category is still growing, so there is room for us to get some of that share back. So I think that's the first piece.

In terms of how we generate the sales and the promotional activity, we are assuming that things continue the way they are and that the amount of discounted selling continues. And we're building our business based on that. But as we said in our prepared remarks, our job is to say, okay, well, if this is the promotional costs that we have to deal with, let's see how much of that we can offset by looking at all the other places where you get margin leakage.

Some of that is the markdown, a big piece of it is the supply chain in general and the DC specifically, efficiency. Another part is to see what we can do in terms of our initial buyer's markup versus the first costs.

So I think there's many, many opportunities, and our job now is it's a new world we're in. We have to think on a far, far more granular nature about all these parts of our business than perhaps we have had to in the past. Would you add to that, Jeff?

Jeff Boyer - *Pier 1 Imports Inc - EVP & CFO*

I would just add to that, and absolutely everything correct, Alex, on that. I'd just add to that that cost leverage across the rest of the enterprise that we're going to be very, very cost conscious. So, Alex's description was largely driving that merchandise margin level, but below that, I'm really real focused on how can we be more efficient, store operating, corporate expenses, everything else we do. So I'm trying to leverage the expense structure on a low single-digit model, that's what our plans are going forward.

Simeon Gutman - *Morgan Stanley - Analyst*

Thank you. Good luck.

Alex Smith - *Pier 1 Imports Inc - President & CEO*

Thanks.

Operator

Your next question comes from Jessica Mace with Nomura Securities. Your line is open.

Jessica Mace - *Nomura Securities - Analyst*

Hello. Good afternoon.

Alex Smith - *Pier 1 Imports Inc - President & CEO*

Hello, how you doing?

Jessica Mace - *Nomura Securities - Analyst*

I have a follow-up question on sales. I think you said that your guidance assumes that the current environment remains the same. So I was wondering if you could talk about a few of the things that give you confidence in that acceleration in the back half that are under your control?

Alex Smith - *Pier 1 Imports Inc - President & CEO*

Well, I think there's a laundry list of those things, Jessica. First of it is, just how we did in Q1 and Q2 in fiscal 2016 versus Q3 and Q4 in 2016. So we look at that. We're very cognizant of what's going to happen to the merchandise margin as we get through the back of the year and all those DC costs go behind us.

In terms of the sales specifically, don't forget, we've talked about a significant ramp up in our marketing plan. And a lot of that is about television, and we expect the television to, as we go through the year and we're on air many, many weeks, we expect that to be a cumulative impact as we go into the second half. I think those are the main ones. What have I missed, Jeff?

Jeff Boyer - *Pier 1 Imports Inc - EVP & CFO*

The expanded loyalty program will be very helpful to reach out to our customers, as well as the gift registry that we have coming and the deferred payment program. All those things are going to be nice additives.

Alex Smith - *Pier 1 Imports Inc - President & CEO*

I knew there was a laundry list.

Jessica Mace - *Nomura Securities - Analyst*

All right, understood. And then on that marketing strategy, you've laid out in the first half the marketing spend looks like it will drive some deleverage, which is implied to reverse in the second half. Will marketing levels remain elevated with some offsetting factors, or how should we think about how that trends throughout the rest of the year?

Jeff Boyer - *Pier 1 Imports Inc - EVP & CFO*

Jessica, the marketing spend is a little bit front-end loaded, just from a dollar standpoint. You also have to appreciate, that's also where we have less sales volume, so the deleverage there is greater in Q1 and Q2.

Every quarter we will spend a bit more, spend more again in Q1 and Q2, a little bit lesser rate of increase in Q3 and Q4, we have higher sales. So there will be a deleverage across all the quarters, but it's most pronounced in Q1 and Q2 for the spending levels and the dollar size that I'm talking about from a sales standpoint.

Jessica Mace - *Nomura Securities - Analyst*

Understood. Thank you so much.

Alex Smith - *Pier 1 Imports Inc - President & CEO*

You're welcome.

Operator

Your next question comes from Steven Forbes with Guggenheim Securities. Your line is open.

Steven Forbes - *Guggenheim Securities - Analyst*

Maybe just to expand on sales again. I know we touched on this a lot already. But just looking at the progression throughout the year and really breaking it down into the two channels, direct and retail. Our math, assuming that you can maintain a 20% growth right in the e-Commerce channel, the math would imply upwards of a 600 basis point improvement between the first quarter and the fourth quarter at the retail store level.

I know you laid out a lot of reasons behind that, but is that right? And going forward, where do you think e-Commerce can CAGR longer term? Can you maintain that 20% growth rate for a longer period of time here?

Alex Smith - *Pier 1 Imports Inc - President & CEO*

Steven, as far as what's going to happen in e-Com, I think we're really very focused on the omni-channel model now. And we're seeing our customers are choosing where they want to shop. We've told you that 90% of our sales touch a store in one way or other.

So that mix between what goes through our POS and what goes direct to customer is just going to sort itself out, depending on what the customer wants. So the way we're approaching it is we have sales and we have costs. We have the costs of running the stores, and we have costs of delivering to customers. And our job is to manage both those buckets of costs so that we optimize that, that important line that we talked to you about, the contribution from operations. So we are really not focused on the balance between e-Com and non e-Com, we're focused on growing the total top line.

Steven Forbes - *Guggenheim Securities - Analyst*

A follow-up on real estate. Because (inaudible) out in the stores for the past three months here, and there really is a big difference in the store experience when you see a new or a relocation that has the lighting fixtures, and the new flooring and so forth. Do you guys have a plan for relocations this year, and where do you stand as far as progress on getting some relief as it relates to rent on the existing store base?

Jeff Boyer - *Pier 1 Imports Inc - EVP & CFO*

On the relocation side of it, we have a modest relocation program for fiscal 2017 overall. But it's under 10, I think it's high single-digit overall for relocation. We, like you, really are pleased with how our newer format stores perform and we think there's a big opportunity. So we're doing a lot of analysis right now to understand what that upside opportunity is. So more to come on the relocation front. Won't be a big uptick in fiscal 2017 for that program, but looking at it for future years.

On the rent side, on the rent negotiation discussions, they're going along very well. I will tell you, our landlords understand that we are all in this together as omni-channel evolves and brick and mortar retailing evolves on it. So in our conversation with them as we get to option renewal time period or extension periods that they've been very willing to work with us on giving us lower rent levels or holding to where they are right now. So we're pretty pleased with how those discussions continue to go.

Steven Forbes - *Guggenheim Securities - Analyst*

Thanks, guys.

Alex Smith - *Pier 1 Imports Inc - President & CEO*

You're welcome.

Operator

Your next question comes from Seth Basham with Wedbush Securities. Your line is open.

Seth Basham - *Wedbush Securities - Analyst*

Thanks a lot, and good afternoon.

Jeff Boyer - *Pier 1 Imports Inc - EVP & CFO*

Hey, Seth.

Seth Basham - *Wedbush Securities - Analyst*

Alex, I know you don't want to give too much away about how you're going to change your promotional strategy going forward. But if you could give us a couple insights on how you're thinking about evolving it in 2016, that would be really helpful.

Alex Smith - *Pier 1 Imports Inc - President & CEO*

Evolving our strategy. Well, what can I say about that. I think in some respects, it's going to be following the pattern that we established in calendar 2015 with a number of exceptions.

Last year, you may remember we talked a lot about how we've been wrong footed on the outdoor business because we traditionally used to hold our price all the way through to Memorial Day, and the rest of the industry didn't. So this year, we have gone out at the beginning of the outdoor season with selective promotional offers, and you can see some of those running now if you go onto our website. So our outdoor cadence is significant.

I think you'll be seeing us hit the major public holidays a little harder than we did last year, so I think that will be different. I think in the way we project our brand in the print, in print and through our online imagery, you'll see us continue to upgrade the quality of our creative and I think you'll appreciate that and can see it to be different.

Other than that, we're going to continue to have a balance between category discounts and SKU-based discounts which we've always had. I think that's pretty much it.

Seth Basham - *Wedbush Securities - Analyst*

Okay. That's helpful. I think earlier you referenced some changes to initial markup without raising selling prices. Do I interpret that to mean that you're going to be taking markups higher and having bigger discounts off of those going forward?

Alex Smith - *Pier 1 Imports Inc - President & CEO*

That is the implication from that, yes, but the important part of what I want to make sure I'm really clear about is we're not talking about raising selling prices. Don't forget, all those supply chain costs go into our initial mark on. And as we can get improvements through both the front end of our supply chain from vendor to DCs, and the back end of our supply chain from DCs to stores and customers. The more we can pull those down, the more that can feed into our merchandise margin. And then we have some tangible benefits from currency exchange rates as well.

Seth Basham - *Wedbush Securities - Analyst*

That's helpful. And lastly a follow up. I understand that you're focused on growing sales no matter what the channel. But have you changed or modified your approach to driving online sales? It seems like the growth rate in e-Commerce sales has decelerated pretty markedly through fiscal 2016, and you how you're thinking about that in 2017.

Alex Smith - *Pier 1 Imports Inc - President & CEO*

The deacceleration was really mostly a question of cycling the huge growth that we had had the year before which we'd had in Q3 and Q4 of FY15. So that was a big piece of it.

When you look at the sales trends and the sales curve month on month in e-Com, it's still doing astonishingly well. So we're super pleased with all of that. It falls as a percentage of total revenue in the fourth quarter anyway, just because in that big holiday season you get more in store sales than online sales. But no, we're delighted with the growth and that we anticipate continuing all the way through this year.

Jeff Boyer - *Pier 1 Imports Inc - EVP & CFO*

I would just build on the comment that Steve made, but to give you a sense of what the growth rate is since we're looking at a 16% growth rate and getting into a stronger double-digit number on it. It's a little bit stronger than that 20% that Steve had, we're looking at more of a mid-20% number on that, so still strong growth on the e-Commerce channel.

And to Steve's earlier question, takes a little bit of pressure off the store delta overall. Because e-Commerce is continuing to grow strongly with strong traffic and conversion up nicely planned for in fiscal 2017.

Seth Basham - *Wedbush Securities - Analyst*

Thank you very much.

Operator

Your next question comes from Adrienne Yih with Wolfe Research. Your line is open.

Cody Ross - *Wolfe Research - Analyst*

Thank you for taking my call. It's actually Cody on for Adrienne today.

Alex Smith - *Pier 1 Imports Inc - President & CEO*

Hey, Cody.

Cody Ross - *Wolfe Research - Analyst*

Just two quick questions here. One's on the promotional environment, I know you said Q4 was a bit more promotional than you guys have seen. What are you seeing so far in Q1, and then what are your expectations for Q4 or through the rest of the year?

Alex Smith - *Pier 1 Imports Inc - President & CEO*

I think it's same old, same old. I think Q1 is -- we're seeing the same retailers coming out with pretty much the same (multiple speakers) similar to last year. So honestly, I don't see much different from this time last year.

Jeff Boyer - *Pier 1 Imports Inc - EVP & CFO*

So our position is to be more aggressive and more proactive on that, so not waiting until the end of the season. So that's a big change for us, but we think the promotional pattern is going to be really consistent as we you saw last year throughout all of it, the entire year.

Alex Smith - *Pier 1 Imports Inc - President & CEO*

We all talk about the promotional environment. At some point, we're going to have just all stop talking about it because it's just going to be the retail environment and we'll all have our own cadences of promotions to gain or maintain our market share. So I don't think that it's changing very rapidly compared to what we have seen.

Cody Ross - *Wolfe Research - Analyst*

Understood, thank you. And then just as far as your CRM capabilities and some of the systems that you guys have put in place recently, are there any learnings that you can share about us about your customer? I know you shared some data early in the call. But any additional color on the learnings that you have about your customer and what you're seeing and what you hope going forward? Thank you.

Alex Smith - *Pier 1 Imports Inc - President & CEO*

Thanks for asking that question, because it just gives us an opportunity to brag about that a little bit. I think it's a terrific foundation for us as we move forward. We're doing all the things you would expect us to see.

It's allowing us to segment our database a lot more effectively in terms of what customers are spending on, which merchandise categories and the frequency of their spend. So we can do our targeting for reactivation and frequency building.

And if you can imagine that basically we have now -- with our CRM, we have full transparency about who our customers are and her entire spending patterns. And you can imagine that is an incredible place for us to go and look for intelligence at how to speak to her as she wants to be spoken to. So it's a big, big deal for us.

Cody Ross - *Wolfe Research - Analyst*

Thank you very much, and best of luck going forward.

Alex Smith - *Pier 1 Imports Inc - President & CEO*

Thank you.

Operator

Your next question comes from Brad Thomas with KeyBanc Capital Markets. Your line is open.

Brad Thomas - *KeyBanc Capital Markets - Analyst*

Hello, thank you for taking my question. Wanted to follow up on last two topics, the CRM and something earlier on marketing. I think by our math, the marketing expenditures will be up about 30% in the first half of the year.

Obviously there's the return to television you referenced, but some new tools that you referenced like the CRM. Alex and Jeff, as you think about that incremental marketing spend, are you leveraging new tools here in the first half? And do you have a sense of your ability to maybe get a better payback on those incremental marketing dollars? And if that doesn't come to fruition, what's your willingness to maybe dial that back here in the first half of the year?

Alex Smith - *Pier 1 Imports Inc - President & CEO*

Good questions, Brad. Of course, as you know, once you've committed to your marketing, the costs are a certainty and the benefits you anticipate. So as far as Q1 is concerned, we're in the costs are a certainty mode at the moment and we have not built huge incremental sales growth in as a result of that. We want to see how efficacious they are. But we are assuming as we go into the back half that we will start to get some payback.

As far as dialing back is concerned, yes, you can always dial back. But on a good chunk of what we're doing, the return on investments that we've got out of our print and our digital, and we've talked about that a lot in terms of retention and frequency from our known customers, has been amazing. So we certainly won't be dialing that back, and certainly on the digital side we'll be spending a little more in 2017 than 2016.

Jeff Boyer - *Pier 1 Imports Inc - EVP & CFO*

And as you said, on the television side, we do have some strong analytical tools and techniques that are going to give us some better insights into what that payback is. So we're measuring how that television is operating and different levels of TV, we think that's going to be really helpful going forward.

To just that point that you made, Brad, which is possibly it could be a lot more powerful, could heavy up the spending on it if it's working very well, or we can dial it back somewhat. So we'll get a better read.

But that will take -- it will take us this quarter to be out there for X number of weeks in the quarter and read the performance, and then determine what we do with the marketing spend. But we're definitely committed in the first quarter. Anything we would do would just be in the back half from those learnings.

Brad Thomas - *KeyBanc Capital Markets - Analyst*

Great. And then I think, Alex, in your prepared remarks you referenced a store of the future, if I heard you correctly. When might that be something that we might see out in the field, and what changes might be in store to the extent you can share them with us right now?

Alex Smith - *Pier 1 Imports Inc - President & CEO*

I have nothing that we can share with you today, but absolutely we will share with you when it's a little more finalized. We're really just working with the design company. We're starting with a blank sheet of paper and saying, okay, in this world that we now live in, what could a store be like over the next few years. So we're not going to be refurbishing the whole chain any time soon, as you would imagine. So I think more to come on that. I'll talk to you more about it on the next call.

Brad Thomas - *KeyBanc Capital Markets - Analyst*

Great, thank you very much.

Alex Smith - *Pier 1 Imports Inc - President & CEO*

You're welcome.

Operator

Your next question comes from Adam Sindler with Deutsche Bank. Your line is open.

Adam Sindler - *Deutsche Bank - Analyst*

Thank you. Most of my questions have been answered. But just from a housekeeping standpoint, I think you guys guided to about a 39.5% tax rate for the year. You guys have been material below that for a very long time now, why the tax rate would be up so much in 2017?

Jeff Boyer - *Pier 1 Imports Inc - EVP & CFO*

Structurally, we tend to run at that 39% plus level. We are fortunate the last few years is to have discrete items that drive that down, and you can never predict those discrete items from a planning standpoint. We're using the higher tax rate until we successfully have some individual items to take that rate down. So 39.5% we should be fine at. But obviously, we'll try to work real hard with items that we can to take that tax rate down.

Adam Sindler - *Deutsche Bank - Analyst*

Okay. Thank you. I appreciate it.

Jeff Boyer - *Pier 1 Imports Inc - EVP & CFO*

Thanks, Adam.

Operator

Your next question comes from Dan Binder with Jefferies. Your line is open.

Dolph Warburton - *Jefferies & Co. - Analyst*

Hello. It's Dolph in for Dan, and thank you for taking my question. Just a quick question on the fulfillment. You've been reporting two-thirds of e-Commerce has been fulfilled for the past year. Is that a number that can change in the coming year? Thank you.

Alex Smith - *Pier 1 Imports Inc - President & CEO*

It's actually remarkably stable, and it's been remarkably stable since we started e-Com. We don't get wide fluctuations at all. So I think that's a number we're assuming in terms of planning our fulfillment capability.

Jeff Boyer - *Pier 1 Imports Inc - EVP & CFO*

We're not pushing it one way or the other. She's deciding you how she wants it delivered, and fairly consistently it's been about this two-thirds level.

Dolph Warburton - *Jefferies & Co. - Analyst*

Great, thank you. If I may, just a follow-up on the CapEx. Realize it came down a lot this past year. It's guided to be up a little bit in this coming year. Looking ahead, as you complete projects and you close stores, is there more room for it to come down in fiscal 2018? Thank you.

Jeff Boyer - *Pier 1 Imports Inc - EVP & CFO*

Probably not, Dan. It might just be a little bit of conservative posturing on that. Some of the conversation we had about relocation programs and the store of the future, it might change from IT or DC to more store faced on it or it might go to more DC.

So we're still planning mid $50 million to $60 million of CapEx. Anticipating there are going to be some high return projects coming out either for DC automation, optimization, opportunities, and/or growth in terms of store relocations and store -- new store formats and things. So I'd still plan a little conservatively to keep that number at least $50 million and probably closer to $60 million, consistent with 2017.

Alex Smith - *Pier 1 Imports Inc - President & CEO*

We've probably got time for one more.

Dolph Warburton - *Jefferies & Co. - Analyst*

Thank you.

Jeff Boyer - *Pier 1 Imports Inc - EVP & CFO*

Thanks, Dan.

Operator

We have time for one final question, and that comes from Cristina Fernandez with Telsey Advisory Group. Your line is open.

Cristina Fernandez - *Telsey Advisory Group - Analyst*

Hello, good evening. I wanted to see if you can share more details about the loyalty program, and which are the three pilot markets you're testing it in and what the response rate has been so far?

Alex Smith - *Pier 1 Imports Inc - President & CEO*

Thank you for that, Christina. So as you know, we have the very successful Pier 1 Rewards Credit Card, and we have two tiers for that. We have the regular card and we have our platinum customers. So what we have created with loyalty is an entry level program. It is multi-tender loyalty. So for those customers who either can't or don't want to sign up for a credit card, they can still be part of our loyalty scheme.

And we have a series of benefits for customers who are in the loyalty program, not as rich, obviously, as those who are in the Rewards Card program because we don't want to cannibalize that in any way. Our test markets are California, Hawaii and Alaska. It's been running now for a couple of weeks or so. It's a great market to test in because as you know, our ability to collect data in California is -- prior to this was practically nonexistent. So we are really pleased with the early reads.

Cristina Fernandez - *Telsey Advisory Group - Analyst*

Thank you. And one last one for Jeff. What are you building in for share repurchases for this year? Are you just assuming you complete what's remaining in the authorization?

Jeff Boyer - *Pier 1 Imports Inc - EVP & CFO*

No, we haven't gone quite that far overall. But our average shares are going to come down from about 83 million now to about 80 million shares outstanding. So you can assume on average close to 3 million plus shares that come out.

Cristina Fernandez - *Telsey Advisory Group - Analyst*

Thank you.

Jeff Boyer - *Pier 1 Imports Inc - EVP & CFO*

Thanks, Christina.

Alex Smith - *Pier 1 Imports Inc - President & CEO*

Okay, everybody. Thank you very much. We'll see you again at the end of Q1.

Operator

Ladies and gentlemen, this concludes today's conference call. You may now disconnect.