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PIR - Q2 2013 Pier 1 Imports, Inc. Earnings Conference Call

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OVERVIEW:

PIR reported 2Q13 total sales of \$367.6m and 2Q13 net income of \$26.2m or \$0.24.
Expects FY13 GAAP EPS on 52-week basis to be \$1.15-1.21.



CORPORATE PARTICIPANTS

Kelley Buchhorn *Pier 1 Imports Inc - Director of IR*

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

Cary Turner *Pier 1 Imports Inc - Senior EVP and CFO*

CONFERENCE CALL PARTICIPANTS

Matt Nemer *Wells Fargo Securities, LLC - Analyst*

TJ McConville *Raymond James - Analyst*

Simeon Gutman *Credit Suisse - Analyst*

Alan Rifkin *Barclays Capital - Analyst*

Brad Thomas *KeyBanc Capital Markets - Analyst*

PRESENTATION

Operator

Good morning, ladies and gentlemen. And welcome to the Pier 1 Imports second-quarter fiscal 2013 earnings call. At the request of Pier 1 Imports, today's conference call is being recorded. All lines will be in a listen-only mode until the question and answer period, at which time instructions will follow. I would now like to introduce Kelley Buchhorn, Director of Investor Relations for Pier 1 Imports.

Kelley Buchhorn - Pier 1 Imports Inc - Director of IR

Thank you and good morning everyone. Prior to market open today, we issued a press release which included the detailed financial results for the second quarter ended August 25, 2012. In just a few moments, we will hear comments from Alex and Cary about the financial results and the Company's growth initiatives, 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 27-A of the Securities Act of 1933 and Section 21-E of the Securities Exchange Act of 1934. And can be identified by the use of words such as may, will, expect, anticipate, believe, and 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.

The Company will also discuss non-GAAP financial measures on this conference call. Pursuant to the requirements of Regulation G and item 10-E of Regulation SK, the Company has provided reconciliations of the non-GAAP financial measures to the most directly comparable GAAP financial measures in our earnings press release that was issued earlier this morning. 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, www.Pier1.com. Now, I'd like to turn the call over to Alex Smith, our President and Chief Executive Officer. Alex?



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

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

We're very pleased with our strong second-quarter financial performance, which marks our 12th consecutive quarter of significant comp store sales gains and profitability increases. During the period, we delivered a comp store sales increase of 6.7%, achieved operating margins of 8.8%, and grew non-GAAP earnings per share by 36%. Our talented and hard working associates with their exceptional drive and their focus on creating an increasingly prosperous Pier 1 Imports, have delivered consistent top and bottom line growth, expanded our market share, and allowed us to return value to our shareholders through stock purchases and cash dividends.

In the second quarter of fiscal 2013, total sales increased 8.3%. Throughout the period, business trends grew increasingly strong as customers responded favorably to all our product categories, including outdoor and summer. By early August, our stores had transitioned to the new season and we are set with our fabulous fall, Halloween, and harvest merchandise. Early reads on these assortments have been positive.

Merchandise margins remain strong, reaching 60.1% in the second quarter. We continue to carefully and thoughtfully analyze the right balance of regular, promotional, and clearance pricing in order to maximize merchandise margin dollars, while offering our customers newness, exclusive quality merchandise, and a strong value proposition. During the quarter we had fewer clearance markdowns compared to last year, which afforded us the opportunity to deliver more promotional pricing to our customers, whom we all know in this current environment are still looking for a good deal. Our approach delivered both an improved margin rate and more merchandise margin dollars.

Let's now spend some time on what may be the single most important project in the history of our Company. It's certainly the largest and most complex. It is of course our new eCommerce enabled fully redesigned website, www.Pier1.com. We are very proud of the new site, which successfully launched just over six weeks ago, on time and on budget. The transformation is significant and truly remarkable. We view the successful launch as a major milestone which positions the business to grow into a true multichannel organization. We laid out a plan two years ago to design and develop a best-in-class website that would be fully reflective of our brand, our stores, and who we are.

Our plan called for the launch of our new website in the summer of 2012. So that's what we did. And here we are, up and running after 24 months of hard work and dedication by associates throughout the organization, as well as the commitment of our external business partners. Now that we've accomplished this monumental task in true Pier 1 Imports fashion, we're anxious to take things to the next level, and we are now in a great position to build over time an important new business.

There are a number of compelling features on our new site, including design and decor ideas and our newly unveiled Get Inspired and Learn How content section. And importantly the treasure hunt feel that Pier 1 Imports stores have been renowned for since our founding in 1962 can also be found on our website. I know many of you have already been to the new site and for those who haven't yet, I encourage you to explore, discover, and hopefully shop.

From an operations perspective, our platform is very stable and our fulfillment center is running smoothly and efficiently. Customer response has been positive, site traffic is increasing, and we're well underway with plans for increased functionality, new features, and additional enhancements in both the short and the long term. And of course more new products, always more new products. We've already made improvements to the site since our launch, and although they may not be obvious or prominent, they are indeed enhancing the customer experience. We've also made significant progress with another channel that our customers can shop. I'm happy to tell you that we launched our new mobile site just this past week, and as with our regular site, plans are already in the works to enhance functionality and features.

As we've noted on prior calls, we are employing a crawl, walk, run strategy, and given the momentum and strength of our Pier 1 Imports stores, we have the time to grow the latest edition to our Pier 1 Imports family. We don't need to compromise the potential or risk the quality of our execution by pushing our fledgling business too hard, too soon. Our current priority is the implementation of our new POS system.

Once again, we pulled together a cross-functional team comprised of highly-dedicated associates throughout the organization, and have aligned them with key business partners within the industry. The new POS system also requires back-of-house improvements, which will streamline our infrastructure and help us move more processes off the mainframe. Over the past several months, we have been developing and testing the new system in preparation for the launch of our pilot program in a handful of stores beginning towards the end of the year. Once the successful pilot has been executed, we will commence an all-store roll-out of the new POS system next year, with plans to begin eCommerce integration by autumn of 2013. We will then have the ability to gain real-time visibility of customer activity and provide a truly seamless shopping experience for our customers, whether in store or online.

So now we have two powerful growth vehicles that are mutually supportive of each other, our enhanced store portfolio of 1,058 Pier 1 Import stores, and our new online business. This fall we'll be engaging our customers in new ways, utilizing innovative marketing programs to drive traffic to both our stores and website. Our marketing team has developed a new creative approach for our fall campaign that combines aspirational brand positioning and promotional activity.

Increasingly our print vehicles will call out www.Pier1.com. Also, our national cable television ads started back up at the beginning of September, featuring our successful and popular Find What Speaks to You campaign. They also call out the new www.Pier1.com. And as we move further into the fall and get closer to the important holiday selling season, we will be more aggressive with driving traffic to our site.

Turning to our store portfolio. Our investments in remodels and refurbishments are improving the shopping experience in our stores with stronger visual presentation and improved ambience. Our store teams are doing a great job with our in store service and our customer engagements and we always strive to surprise and delight our customers and offer a special shopping experience, knowing that if we do a good job, they will always come back.

Three stores are currently in the process of being fully remodeled and will be reopened within the next three to four weeks, ahead of the holiday selling season. We recently completed the refurbishment of approximately 50 stores with enhanced merchandise fixture packages and lighting upgrades, and we plan to refurbish an additional 50 stores post holiday. By the end of the fiscal year, we should be about 50% complete with the refurbishments for the entire portfolio.

We're on track with our plans to open approximately 20 to 25 new stores this fiscal year. We closed one store during the quarter and opened five new Pier 1 Imports stores, including our second location in Manhattan at 65th and 3rd. Our ability to successfully and profitably operate stores in metropolitan trader areas represents yet another potential opportunity to grow our store base.

The new Manhattan store is just one of our -- just of a handful of three-level stores in our portfolio and it is absolutely beautiful. If you are in the city and have an opportunity to visit the store, we would love to hear your feedback. We also opened new locations in California, New Jersey, Hawaii, and Texas, and all have opened strong.

Looking ahead to the second half of the year, we feel the business is ideally positioned to continue the positive operating momentum of the past 12 quarters. We've built strength and sustainability into our business and we've enhanced the Pier 1 Imports business model to a level of sophistication previously undreamed of. We're better than we've ever been as creators of exclusive trend-right products, as efficient importers, as operators of exceptional retail stores. Now, we're going to get really good as online merchants. We're gaining market share, reaching new customers each and every day and bringing them to Pier 1, to the Pier 1 experience and brand. We fully expect with our two powerful growth vehicles to achieve continued growth and long-term success.

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

Cary Turner - Pier 1 Imports Inc - Senior EVP and CFO

Thank you, Alex and good morning everyone. We are pleased to report another strong quarter of sales and earnings growth. As Alex mentioned, second-quarter comp store sales increased 6.7% on top of last year's 10.8% gain, and total sales increased 8.3% to \$367.6 million, reflecting increased



store traffic and average ticket. On a trailing 12 month basis at the end of the quarter, sales per retail square foot were \$190, up from \$175 per retail square foot at the end of last year's second quarter.

Second-quarter gross profit improved 12.7% to \$151.5 million, compared to \$134.5 million a year ago, reflecting an increase of 160 basis points to 41.2% of sales versus 39.6%. Merchandise margins came in at 60.1% in the second quarter, and were up 70 basis points from 59.4% last year. The improvement, as Alex mentioned earlier, resulted primarily from less clearance markdowns compared to last year. Store occupancy costs were \$69.4 million, compared to \$67.2 million, and declined as a percentage of sales by 90 basis points to 18.9%.

SG&A expenses for the second quarter leveraged 60 basis points, coming in at \$112 million, or 30.5% of sales versus \$105.8 million or 31.1% of sales for the same period last year. Variable expenses were \$81.8 million or 22.3% of sales this year, compared to \$75.2 million or 22.1% of sales last year. Store salaries were leveraged as a percentage of sales for the quarter and marketing expenses as planned were up 30 basis points to 4.3% of sales. For the full year, we continue to expect that marketing expenditures will approximate 5% of sales.

Fixed expenses during the period were \$30.2 million compared to \$30.6 million last year. Our ability to effectively manage SG&A expenses helped offset the planned increases in costs associated with the launch of eCommerce and other growth initiatives. As always, we will maintain our disciplined approach to cost that we have continued to demonstrate, and anticipate that we'll continue to leverage SG&A expenses in both the third and fourth quarters.

Second-quarter operating income improved 36% to \$32.3 million versus \$23.7 million last year, while operating margin increased 180 basis points to 8.8% of sales from 7% a year ago. During the second quarter of this year, the Company reversed \$5.9 million of its reserve for uncertain income tax positions for which the statute of limitations expired. Additionally, the Company reversed \$2.8 million of accrued interest related to this uncertain tax position. As noted in our press release, the adjustments related to the income tax benefit and the reversal of accrued interest provided a \$0.05 per share benefit to earnings in the second quarter.

Net income in the second quarter was \$26.2 million or \$0.24 per share. Utilizing an effective tax rate of approximately 35.6% and excluding the reversal of the accrued interest I just mentioned, the Company's adjusted net income on a non-GAAP basis for the second quarter was \$20.7 million or \$0.19 per share, which reflects a 36% increase versus \$0.14 per share last year. The effective tax rate for fiscal 2013 is expected to be approximately 35% to 36% of pretax income. For the third and fourth quarters of this fiscal year, the effective tax rate is expected to be approximately 38% to 39%.

Turning to the balance sheet. Inventory at the end of the second quarter totaled \$420.8 million. That's up 13.5% versus a year ago, and is in line with our expectations. As we noted on our first-quarter earnings call, the planned increase in inventory was primarily due to additional inventory for the Company's new eCommerce business, and slightly larger purchases of merchandise in select categories, including seasonal goods to support higher sales. At the end of the third quarter, inventories are planned to be up approximately 10% from last year's third quarter.

The Company remains in strong financial condition and ended the quarter with \$115.1 million of cash and cash equivalents and no cash borrowings under our \$300 million credit facility. In August, the Company paid approximately \$4 million in cash dividends. During the quarter, we utilized \$30.6 million of cash to repurchase approximately 1.9 million shares of common stock at an average weighted cost of \$16.20 per share. To date this year, we have repurchased approximately 4.8 million shares at a weighted average cost of \$16.68, and a total cost of \$79.3 million. Under the current \$100 million share repurchase plan, approximately 20.7 million remains available for repurchase. Approximately 106.2 million shares of common stock are currently outstanding, compared to 109.5 million shares one year ago, and 117.2 million shares two years ago.

Capital expenditures in the second quarter totaled \$25.6 million. Of that amount, \$17 million was deployed toward the opening of the five new Pier 1 Imports stores, new merchandise fixtures and lighting, and approximately 50 refurbished locations, new impulse merchandise fixtures rolled out to all stores, and other leasehold improvements and equipment. The Company also invested \$1.3 million associated with the buildout of our eCommerce fulfillment space. The remaining \$7.3 million in capital spending was spent on 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 50% allocated to stores and the other 50% allocated to technology and infrastructure.

As we move into the back half of the year, we anticipate that depreciation and amortization expense will be at or slightly above the second-quarter levels as we continue investing additional capital into our stores and technology. During the second quarter, we opened five stores and closed one, ending the period with 1,058 Pier 1 Imports stores. That includes 977 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 six to nine stores in the third quarter, and seven to nine stores in the fourth quarter.

We plan to close five to seven stores ratably throughout the remainder of the fiscal year. These closures are strategic relocations within existing markets, which is an important part of our real estate strategy, and continue to provide us with a meaningful opportunity to improve sales productivity and store profitability while at the same time capturing additional market share.

Our partnership with Alliance Data is progressing very well. We just finished our first full quarter with our new rewards card and value proposition. The share of business on the rewards card continues to increase with response rates pacing ahead of our initial expectations. Customers are responding favorably to the loyalty program associated with the card, and as we move forward, we can utilize data from ADS to design specific promotions and incentives aimed at engaging our most valued reward card customers. We believe the opportunity to generate increased traffic and frequency is significant, with the rewards card expected to be a key sales growth driver over the next couple of years.

And finally, turning to our outlook for the full year, we have updated our expectations for earnings per share as we reported in our earnings release earlier this morning, and we're providing the following guidance for fiscal 2013 on a 52-week basis. We expect to achieve comp store sales growth in the mid-single digit range. Earnings per share on a GAAP basis are expected to be in the range of \$1.15 to \$1.21. On a non-GAAP basis, earnings per share are expected to be in the range of \$1.10 to \$1.16, representing year-over-year growth of 17% to 23%. That compares to our previously issued guidance for earnings per share on a non-GAAP basis in the range of \$1.08 to \$1.14. And as I just noted, capital expenditures are expected to be approximately \$70 million to \$75 million.

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 earnings per share. Thank you for your continued interest in our Company. And I'll now ask the operator to open the call for questions at this time.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Matt Nemer, Wells Fargo.

Matt Nemer - Wells Fargo Securities, LLC - Analyst

Congratulations on the eCommerce launch. The site looks great. I just wanted to ask a question about the site. It looks like you're already starting to offer some online-only SKUs, and I'm wondering if you can talk to the cadence of adding additional categories or SKUs that are online only.

Alex Smith - Pier 1 Imports Inc - President and CEO

Sure. I mean, you must have looked really carefully to find them because there really are not that many at the moment, but our plan is to as we move through the fall of this year, we'll start adding just a few online-only SKUs. And then as we move into next spring and summer you'll start to see extensions to some of our existing categories on an online-only basis. And then towards the summer into the fall of next year, you'll start to see some new categories that we don't have in the stores at the current time. So it's going to be a gradual process. We're going about it very thoughtfully as we've said in the prepared remarks. Yes, we're on the way.

Matt Nemer - Wells Fargo Securities, LLC - Analyst

Great. And then in terms of the new credit card agreement, could you just talk to the consumer response that you saw during the quarter around the rolling out -- the mailing of new cards, any change in the new card activation rate or credit line increases. What's the time line do you think that that penetration will get back to around 30%?

Alex Smith - Pier 1 Imports Inc - President and CEO

Cary?

Cary Turner - Pier 1 Imports Inc - Senior EVP and CFO

As I said in the remarks, we're very happy with the response rate. One, in terms of I have to thank our store associates who are really getting behind the launch of the card, and with ADS really doing a nice launch, and we're seeing it being -- the response is very favorable. Our approval rates are higher than what we saw the last two years with the old program provider, and we're just encouraged. I think our short-term goal sometime this year or into next year is more like 25% of sales, because remember, we're coming from a level of about 21% of sales, and slowly but surely we'll inch up from 25% up to 30%.

Matt Nemer - Wells Fargo Securities, LLC - Analyst

Okay. Great. And then just lastly, looking at the extra week, can you just help us understand why the incremental margins on that week would be so low? If I look at the revenue and EPS numbers you provided, you could back into an SG&A rate that's quite a bit higher than what it would be either for that quarter or for the full year.

Cary Turner - Pier 1 Imports Inc - Senior EVP and CFO

No. Remember also, you're probably not using the right margin because it's -- remember, February is our slowest month of the year.

Matt Nemer - Wells Fargo Securities, LLC - Analyst

So the gross margin actually would be quite a bit lower?

Cary Turner - Pier 1 Imports Inc - Senior EVP and CFO

There's just not as much leverage there as the rest of the year.

Matt Nemer - Wells Fargo Securities, LLC - Analyst

Okay. Great. Thanks and congratulations.

Operator

Budd Bugatch, Raymond James.



TJ McConville - *Raymond James - Analyst*

TJ filling in for Budd this morning. Congrats on the quarter. Congrats on the quarter and on the website. Let me add that it does look -- it looks great to us as well.

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

Thank you.

TJ McConville - *Raymond James - Analyst*

My first question though is actually on some of the store refurbishments. We've talked a while about trying to get some metrics around the performance of maybe a couple of the earlier buckets of stores. I know it was too soon a couple quarters ago, but is there any way we can parse out the incremental performance or the improved performance that you're seeing from some of these refurbished stores in any way?

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

Not really, TJ. I think that information is really too specific and proprietary. But what I can reassure you of is that we look at those numbers very carefully and we're very anxious not to over-invest in our stores. So we're not I think as we've said before treating all stores equally. The ones who are getting the most investments are the stores where we think there's the most upside in terms of the improvements in sales and store contribution.

And stores with a lower potential are getting a correspondingly lower investment. But I think it just all plays into, whether you're looking at the store refurbishments or whether you're looking at the rels or whether you're looking at the merchandise -- it just all -- or the service, it just all plays into our ability to sustain the growth in the business that we keep talking to you about.

Cary Turner - *Pier 1 Imports Inc - Senior EVP and CFO*

I would only add two things. One, some of this spending is going to all stores and is somewhat defensive in nature because we didn't spend much money three, four, five years ago. The other thing is that the new fixtures won't sell anything if the product's not right on. And so you need everything. And that's the main reason why we're not breaking it out with retail, you need to have the right product and the right store experience.

TJ McConville - *Raymond James - Analyst*

That's a fair point, Cary and the merchandise is certainly there as we're seeing. Then if I move to the website, we've talked about the merchandise here. Alex, can you give us a big-picture sense maybe of what you think the incremental customer looks like on the website? Is it someone who's materially different than your core customer is now? Is it someone who might have gone to the store otherwise? Can you give us a sense for what your plans are or what you're envisioning there?

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

Sure. I mean, I think the first thing I want to say, it is really very, very early days. This thing has only been going a matter of weeks, as you know. And so our knowledge and our data is going to build over time. What I would say to you is in terms of the way the spending and what they're purchasing is we're not seeing a huge difference between what sells well in the store and what sells well on the web, which is what we anticipated. So to the sense that we are appealing to customers with the same aesthetic, that's pretty much as we thought it would be.

There's no doubt that we are driving a lot of people to the stores. Any time you spend time in stores, there's always somebody who comes in clutching a handful of screen prints, so I think we're getting a benefit of driving more traffic to the stores from the site. And I think the other

interesting thing is, and we'll probably tell you a little bit more about this at the end of the third quarter, is just to look at the balance of those customers who are actually opting for the home delivery versus those who are going into the store to pick up, and that's also a very interesting ratio that we're watching very carefully. But without rambling too much, I guess in essence what I'm saying is I think it's the same customer in terms of mindset, if not actually the same customers, which is what we hoped it would be.

TJ McConville - *Raymond James - Analyst*

That's very helpful. Thank you for taking the questions. Best of luck to you on the remainder of the year.

Operator

Simeon Gutman, Credit Suisse.

Simeon Gutman - *Credit Suisse - Analyst*

Just wanted to add congratulations again to Alex and Cary on the website launch. One quick question on the housing world. I think we're starting to see some hopeful signs for the entire housing complex. It's early, but can you speak either through the mix of products you're selling or from the searches that you're seeing online any evidence of that, I don't know, an affinity to some of the furniture products being looked at more than others.

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

Cary, you want to take that?

Cary Turner - *Pier 1 Imports Inc - Senior EVP and CFO*

Yes. Simeon, when we see -- I think we've tried to tell everybody, we really don't see the tie to the housing data as strong as other macro data, like consumer confidence and other things. For the primary reason, one thing I would say is if we do get an improvement in housing, it's going to be a tailwind but it's probably going to be a tailwind over call it three years or so. Not everybody does everything to their house on day one. It takes them some time and right now they're thinking through who's coming for Thanksgiving and maybe I need to look at the dining room and maybe the bedroom. But it happens over a couple years.

Simeon Gutman - *Credit Suisse - Analyst*

Okay. And then second question on I guess two parts on the POS roll out and the rewards card. Can you just talk about on both sides what's not getting done today, so on the POS, what are you missing on the margin improvement side? Are stores over-ordering or under-ordering? How much sharper would that allow you to be? And then on the rewards card, how much of targeting is being done today? Is it coming from -- going from zero to being able to have full capability or is it going from some point you've already started at?

Cary Turner - *Pier 1 Imports Inc - Senior EVP and CFO*

First, on the point of sale, we already have all the data, and we've been very happy with our point of sale register for the last 22 years. We've gotten our money's worth and the real reason we have to switch is, number one, to ensure that the omnichannel, meaning point of sale and internet business and mobile is all seamless to the consumer. And that's the primary reason, and as we roll out we'll probably give you other specifics as to some benefits we're seeing.



In terms of ADS, I think the targeted marketing really hasn't started yet. Really, what we needed to do first was re-emboss all the cards, make sure all the customers now have new ADS cards, not using their old Chase cards, and just start making sure they're aware of the new program. The new loyalty program has been tweaked a little and we think more people will be rewarded with this new change.

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

The other thing I would just like to say about the POS, even if we weren't doing this to link in with the online, there would still be very good reasons for doing it because the 22-year-old system is somewhat clunky and hard to use. The new system will be much, much easier and much faster for the store associates, so our transaction times are going to go down. And also what we think is a benefits going to be, it will allow us to have some of our less experienced associates on the registers, meaning that we can have our more experienced associates on the sales floor. So I think there are very tangible benefits over and above the ones that Cary's just talked you through.

Simeon Gutman - *Credit Suisse - Analyst*

Okay. That's helpful, Alex. Can I just sneak in one last one on cotton and margin? Last year I don't think it was really a factor for the business, at least we didn't see it, but this year there's easier compares, especially going into the back half. Is that -- could it be a tailwind or is it a non-event for your business?

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

Well, nothing that impacts cost is a non-event, but I would say prices of commodities get lost for us in all the other costs in terms of currency exchange rates and labor costs and shipping costs. Raw materials is a relatively small percentage of our finished goods. So we're always cognizant of these things. Our buyers are cognizant of them and it helps in terms of negotiation, but it's not going to move that merchandise margin up to 65%.

Simeon Gutman - *Credit Suisse - Analyst*

Okay. Thanks a lot.

Operator

Denise Chai, Bank of America.

Unidentified Participant - *Analyst*

It's [Sincinisien] in for Denise and let me add my congratulations as well on the quarter and the launch. I wanted to ask of course first question just some additional questions about your eCommerce launch. If you guys could just provide any additional commentary around -- I know it's early, but just site traffic trends that you've seen post launching of the eCommerce functionality. And then also any commentary around your at-home delivery, if that has been so far going well?

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

Well, we're really pleased with our site traffic and I think we mentioned that somewhere in the prepared remarks. So we're seeing sustained and substantial increased traffic to the website, which has to be a plus. In terms of the home delivery, again, as we talked about, the fact that our fulfillment center is working extremely well, we've had little or no customer complaints in terms of the quality of our deliveries, so I think we've done a pretty good job, actually.

Unidentified Participant -- *Analyst*

Okay. And just one follow-up. You mentioned about later in the year you'll continue to have some site enhancements upcoming as well as new products. Anything else you can tell us there in terms of will they be more of things that consumers won't really see on the site or will it be certainly noticeable? And will the products be largely expansions of your current categories or anything really new and different from what you currently have?

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

Well, in terms of the product expansion, I think as I said just a little while ago, we're going to start with expansions of our existing assortments, leveraging off our core strengths, if you like, but then following on behind that will be brand-new categories and then ultimately, who knows. In terms of the improved -- I won't say improved -- the additional functionality and features, some of that is going to be fine tuning, which is the customer won't actually see it happen, but it will just make the experience easier for her. Some of it will be very significant additions to the functionality, and we'll describe that to you as and when we've kind of nailed down the exact dates.

Unidentified Participant -- *Analyst*

Okay. That sounds good. Thanks very much and best of luck.

Operator

Alan Rifkin, Barclays.

Alan Rifkin - *Barclays Capital - Analyst*

Thank you very much. With the roll-out of eCommerce, to use your words, Alex, being the largest, most complex endeavor this Company's undertaken in a long time, what was the magnitude of the start-up costs that were expensed in the quarter, probably impacted your SG&A line?

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

That sounds like a Cary question. Good morning, Alan. Here he is.

Cary Turner - *Pier 1 Imports Inc - Senior EVP and CFO*

I think we told you it's \$2 million.

Alan Rifkin - *Barclays Capital - Analyst*

Okay.

Cary Turner - *Pier 1 Imports Inc - Senior EVP and CFO*

And the other costs went into CapEx and will be depreciated.



Alan Rifkin - *Barclays Capital - Analyst*

Okay. Thank you, Cary. And then on the marketing line, I believe you said that that line item actually delevered in the quarter. Could you maybe just provide a little bit more color as to why that was with such a strong comp, is it more a function of accelerated marketing on the eCommerce side? And then if you were to -- I'm sorry.

Cary Turner - *Pier 1 Imports Inc - Senior EVP and CFO*

I think we told you at the end of the first quarter that it would be up about 30 basis points, and it was. Some of it was timing. Some of it is just seeing opportunities to spend a little bit more and we were very happy with the spend.

Alan Rifkin - *Barclays Capital - Analyst*

Okay. If it hits your 5% of revenues for the year, Cary, should we -- what magnitude of leverage should we expect in the third and fourth quarter on the marketing side?

Cary Turner - *Pier 1 Imports Inc - Senior EVP and CFO*

It all depends on sales, Alan.

Alan Rifkin - *Barclays Capital - Analyst*

Okay. Well, if I could just prod a little further. Whatever sales you're expecting when you say it should be 5% of revenues, if it were to hit that number.

Cary Turner - *Pier 1 Imports Inc - Senior EVP and CFO*

Let me look at it a little bit more. I'll get back to you.

Alan Rifkin - *Barclays Capital - Analyst*

Okay. Thank you very much.

Operator

Brad Thomas, KeyBanc Capital.

Brad Thomas - *KeyBanc Capital Markets - Analyst*

Let me add my congratulations as well. Just a follow-up on the website. Over the last several quarters you guys have been breaking out the contribution from Pier 1 To-Go. Are you still seeing an incremental lift as we start to anniversary that launch? And what tailwind are we seeing to comps and what do you think that's going to be in the back half of the year?

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

The problem -- well, it's not a problem. The issue is, Brad, it's not going to be an apples with apples because if you remember, the old Pier 1 To-Go was an order online, pick up and pay in store. With the new site, you actually have to pay online and then pick up in store. So it's a slightly different



model than we previously had. So what that means is we get a higher percentage of those who order because they paid, come in and pick it up, than we did with the old model. But we're still -- but it is still a very positive driver in terms of our comps, absolutely.

Brad Thomas - *KeyBanc Capital Markets - Analyst*

Great. And then just on the merchandising front, I believe this summer you had planned to roll out some more impulse items. Can you just talk a little about the success you're seeing there and any other new merchandising plans for the back half of the year in stores?

Cary Turner - *Pier 1 Imports Inc - Senior EVP and CFO*

Yes. As you heard on my remarks, we did put in new fixtures for the impulse items. To be honest with you, Brad, that was really at the end of the quarter and so this initiative of driving units per transaction is really a second-half initiative.

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

But the initial thoughts, as always, we gauge our success a lot by the reaction of the store teams and they certainly are very pleased with the new fixturing, and anecdotally they're telling us it's starting to work. So we're pretty optimistic.

Brad Thomas - *KeyBanc Capital Markets - Analyst*

Great, and if I could just squeeze in one more follow-up on Alan's earlier question about the cost for the new website. I recognize you have a number of capital plans for this year and next year. As we move into 2013, would you think that some of those expenses are leverageable or are there incremental investments that you think we should plan on making? How should we think of the one-time nature if you will of some of the costs you've made this year?

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

We are certainly going to continue to invest in the business, both in terms of home office payroll and in terms of payroll which gets capitalized. It is our intention and Cary can just talk a little more about this, to sort of keep the balances as best we can so that we continue to leverage our expenses on an ongoing basis. That's our starting position. Do you want to say a little more on that?

Cary Turner - *Pier 1 Imports Inc - Senior EVP and CFO*

I was going to say, I think you will see there's no -- at least not at this point, we don't anticipate any big one-time items coming up in SG&A. And as I said earlier, I anticipate SG&A as a percentage of sales we'll definitely leverage in the third and fourth quarter and will continue to in the next two years.

Brad Thomas - *KeyBanc Capital Markets - Analyst*

Very helpful. Thanks so much, guys.

Operator

At this time, there are no further questions.



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

Okay. Sarah, thank you very much for hosting the call today. Thank you everybody for joining us. And we'll talk to you next time. Thank you.

Operator

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

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