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Q3 2019 Pier 1 Imports Inc Earnings Call

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to the Pier 1 Imports Third Quarter Fiscal 2019 Earnings Call.

At the request of Pier 1 Imports, today's conference is being recorded. (Operator Instructions) Today, after market close, the company issued an earnings press release, which included the detailed financial results for the third quarter of fiscal 2019.

In a separate press release, the company also announced the appointment of Cheryl Bachelder as interim Chief Executive Officer, along with a number of strategic actions to enhance shareholder value and position the company for long-term growth and profitability. In just a few moments, you will hear comments from Cheryl and Nancy, followed by a question-and-answer period.

Before we begin, I need to remind you that statements made today regarding Pier 1's business may be deemed to include forward-looking statements that are based on current estimates or expectations of future events or future results, and are made pursuant to and within the meaning of the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995.

Forward-looking statements are subject to both known and unknown risks and uncertainties that could cause actual results to differ materially from such statements. Any forward-looking statements made today are as of the date of this call, and the company does not assume any obligation to update or revise any such forward-looking statements.

The company will also discuss non-GAAP financial measures on this conference call. Pursuant to the requirements of Regulation G and Item 10e 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 its earnings press release that was issued this afternoon. That press release is available on the company's Investor Relations website at investors.pier1.com.

Now I would turn the call over to Cheryl Bachelder, interim Chief Executive Officer.

Cheryl A. Bachelder *Pier 1 Imports, Inc. - Non-Employee Director*

Thank you very much. Good afternoon, everyone. I'm pleased to be speaking with all of you today in my new role as interim CEO. We have a lot to cover today, but let me just start by saying that I come to this role with a genuine passion for this brand, Pier 1, and a commitment to serving all of its stakeholders well. I also want to convey on behalf of the Board of Directors, our thanks to Alasdair James for his service and contributions to Pier 1.

As just bit of background on me, I've been a Director here at Pier 1 since 2012. My work experience is more than 40 years in retail brand building, guest experience, human capital and operations. I have first-hand experience in transforming retail brands to bring them back to growth and profitability, and I see a tremendous opportunity to do that here. I also bring together highly capable and cohesive teams that have the experience to act swiftly.

Let me now start by talking about Pier 1's third quarter results. During the quarter, the business experienced similar challenges as we



saw in the second quarter. It's become clear that we're not giving our Pier 1 customer the style, the value, the selection that she wants to find in our stores and online. The sector is performing well, so we know the opportunity is there for Pier 1, we just have to capture it.

When I look at the strengths of the Pier 1, I believe we have an iconic brand and we have talented store associates, and these are advantages. Paired with loyal customers and vendor partners, these give us the right building blocks for success. So now it is all about focus, execution and taking the bold actions needed to restore the health and promise of the business. I'll talk about each one of these items individually, and then I'll be turning the call over to Nancy to discuss our results.

First, I think it is clear that the New Day strategic plan did not deliver the desired results fast enough. What we need to do now is narrow our focus, pace and sequence our initiatives and reengineer our cost structure. I look forward to outlining a tightly focused plan of action in short order.

We have also realigned our leadership team to drive more consistent execution. Donna Colaco, an outstanding merchant with extensive background in brand leadership and business transformation has been on board as our new Chief Customer Officer since December 3. Her enthusiasm and drive have been quickly felt throughout the organization. We will continue working closely with our vendor partners as we move forward, and we will manage the day-to-day execution of our business with the added resources of an internationally recognized consulting firm.

As Nancy will discuss, we have proactively expanded our secured revolving credit facility, which will immediately enhance liquidity and create greater financial flexibility. We are also reducing our capital expenditures and implementing a rigorous cost-reduction program to ensure we have an appropriate cost structure for today and well into the future.

In addition, our Board has initiated a process to evaluate strategic alternatives to enhance shareholder value and we have retained Crédit Suisse to assist in this effort. While the leadership team and organization stay focused on the considerable work ahead to drive improved performance, the exploration of strategic alternatives will enable our Board to review the current state of the company and opportunities that may be available to create more value. As the Board does this, Pier 1 will remain laser-focused on driving improved results for the benefit of all of our stakeholders. We believe in our brand, and have conviction about its power to grow in the future. Our talented and dedicated associates, along with our customers, vendors and partners will get us there. We will be taking bold actions, and making tough decisions for the sole purpose of establishing a stronger footing for the future.

Now I'll turn the call over to Nancy to take you through the financials and then we'll be opening up the call for questions. Nancy?

Nancy A. Walsh *Pier 1 Imports, Inc. - EVP & CFO*

Thank you, Cheryl, and good afternoon, everyone. Net sales declined 11.9% to \$413 million in the third quarter, while company comparable sales declined 10.5%. As we noted in our earnings press release, we estimate there was approximately 600 basis points of benefit from the shift of certain selling days between quarters. As you would anticipate, we expect the impact of this timing shift to have the reverse effect in the fourth quarter.

Third quarter gross profit was \$131 million versus \$177 million a year ago. And gross margin rate came in at 31.6% versus 37.7% in the third quarter of fiscal 2018. The pressure on our gross margin rate reflects lower merchandise margin as well as 150 basis points of deleverage on occupancy due to the lower sales base. The year-over-year decline in merchandise margin can be primarily traced to higher promotional discounts and supply chain costs.

Third quarter SG&A dollars totaled \$147 million, down approximately \$3 million versus last year, while our SG&A rate deleveraged by 350 basis points, coming in at 35.6% due to the lower sale base. As you heard from Cheryl, we are taking a number of actions to not only improve execution, but equally important to position the business for long-term success. This includes reducing our expenses to bolster the bottom-line, while we work to get the top-line growing again. We have been maintaining ongoing expense discipline and recently embarked upon a more rigorous program to establish an appropriate cost structure for the business, today and in the future. As we talked about in previous quarters, we have been working with a highly regarded procurement firm and, together, we've already identified and captured approximately \$20 million of annualized savings for fiscal 2020. We view this as a solid starting point and expect to



ultimately realize upwards of \$35 million in annualized savings for the next fiscal year.

Our third quarter net loss totaled \$50 million or \$0.62 per share and EBITDA was negative \$17 million. As we noted in today's press release, this includes a noncash charge of \$20.8 million or \$0.26 per share to establish evaluation allowance against certain deferred tax assets.

Moving now to the balance sheet and cash flow. As you can see from our announcements today, we are taking proactive steps to enhance our liquidity, provide greater financial flexibility and reduce spending. At the close of the third quarter, we had \$71 million of cash and investments. Ending inventory was down -- ending inventory was \$388 million, down 7% from a year ago. We anticipate that new product will begin flowing into the business in Q4 and therefore, we would expect to end the year with inventories up versus fiscal 2018.

At quarter end, there was a \$192 million outstanding under our term loan, and we did not have any short-term borrowings under our revolver. We are pleased to have successfully completed the FILO transaction, which was funded last Friday and expands the total availability under our revolver from \$350 million to \$400 million.

Importantly, we've also reduced our capital spending plans for fiscal 2019 bringing our anticipated spend down from \$60 million to \$40 million for the full year. These actions immediately enhance our liquidity. We will continue to be mindful of spending as we focus on reinvigorating the top-line and anticipate that capital expenditures will be further reduced in fiscal 2020. As Cheryl mentioned, we plan to outline a new plan of action in short order.

Let me briefly take you through, at a high level, some of the operational updates of the quarter in a few key areas, which we will use as a foundation for strengthening the business as we enter fiscal 2020. On pricing, in Q3, we rolled out a new markdown optimization tool and we're already seeing early benefits. Over the long term, we anticipate this will help us generate higher margin dollars and improve inventory turns. On the shopping experience, we continue to receive positive feedback about our new store environment. Approximately 85% of customers tell us from surveys that the stores feel more spacious and are easier to shop. Notably, our conversion rates continued to strengthen in the third quarter.

Turning now to sourcing, supply chain and distribution. Our sourcing team has been focused on consolidating our vendor base, developing new partnerships and driving cost savings. Thus far in fiscal 2019, we have negotiated cost savings in excess of our \$18 million target, which is expected to flow through the P&L in fiscal years 2020 and 2021. We are beginning to drive further automation at our newly configured Columbus fulfillment center, which is expected to improve customer experience and generate labor efficiencies over time. Additionally, we recently started the transition to pool distribution which will facilitate quicker replenishment and allow our customers to buy online and pickup in-store much faster than they can today. We appreciate your time this afternoon and the continued support of our analysts and shareholders.

Now I'll turn the call back over to Cheryl for some concluding remarks.

Cheryl A. Bachelder *Pier 1 Imports, Inc. - Non-Employee Director*

Thank you, Nancy. I hope you have heard from me today that I am enthusiastic and committed to working with this leadership team and Board to take the actions necessary to strengthen the business and put Pier 1 on track. We appreciate how hard our associates have been working to take great care of our customers this holiday season, and I do want to encourage all of you to stop in and see what Pier 1 has to offer.

I'm now going to ask the operators to open the line for Q&A. As a quick reminder, I'm sure you will all understand that we're not going to be answering questions regarding strategic alternatives.

Operator, you can open the line.

QUESTIONS AND ANSWERS



Operator

(Operator Instructions)

Our first question comes from the line of Steve Forbes of Guggenheim Securities.

Steven Paul Forbes Guggenheim Securities, LLC, Research Division - Analyst

So I realized things have changed dramatically just from the P&L perspective over the past 12 months. So just curious, if you can comment as you head into this strategic plan, comment on how many stores are unprofitable? Or maybe just give us sort of that commentary on the profitability of the store base as is sits today.

Nancy A. Walsh Pier 1 Imports, Inc. - EVP & CFO

So this is Nancy. As we've talked about in previous calls, the number of four-wall cash flow negative stores is very low compared to our total portfolio. We continue to evaluate our stores all the time, and are focused on trying to find the right balance of stores. And as we move forward, we'll continue that process.

Steven Paul Forbes Guggenheim Securities, LLC, Research Division - Analyst

And then just as a follow-up, maybe a two-part question just on the model. So can you give some color on your outlook for cash at year-end given the last -- the burn rate over last 2 quarters, which obviously, should improve here heading into the fourth quarter. And then regarding CapEx, right, so you talked about the \$20 million revision in the full year guide. Can you comment on what's driving that? Because I thought the majority of the CapEx of \$60 million was in IT and supply chain, which obviously are strategic initiatives in and of themselves. So is it -- does it have to do with that or is it mainly just investments in the stores?

Nancy A. Walsh Pier 1 Imports, Inc. - EVP & CFO

We have gone back and reviewed all of the CapEx spending that we planned for this year, and focused on the things that we think are going to have the best impact on the business. Always when you're putting a CapEx plan together and certainly at \$60 million, there's inevitably going to be things that will not be completed during the year as well. So with the combination, we have not had quite as much maintenance on the stores as we forecasted. And again, we're just going to really focus on those initiatives that we think are going to drive the business in the direction we want it go. In terms of any forward-looking statements at this time, we're not providing any guidance for Q4 on anything.

Operator

Our next question comes from Chuck Grom of Gordon Haskett.

Andrew James Minora Gordon Haskett Research Advisors - Research Associate of Retail

It's Andrew on for Chuck. Just had a quick question. I know you're not talking about 4Q, but can you remind me, I know that December makes up a huge chunk of your actual 4Q sales historically. I think it was running in the 50%, 60% range. Is that still -- it that correct? Is that the right number that I'm [pending]?

Nancy A. Walsh Pier 1 Imports, Inc. - EVP & CFO

It's in the ballpark, yes.

Andrew James Minora Gordon Haskett Research Advisors - Research Associate of Retail

It's in the ballpark. Okay. And could you remind us of the cadence...

Nancy A. Walsh Pier 1 Imports, Inc. - EVP & CFO

Historically, yes, I'm corrected. But historically, that has been the correct ballpark.

Andrew James Minora Gordon Haskett Research Advisors - Research Associate of Retail

Okay. And then could you just remind us of the cadence of last year's fourth quarter? I know you're not going to talk about this quarter, this year.



Nancy A. Walsh *Pier 1 Imports, Inc. - EVP & CFO*

The cadence of comp sales, sales?

Andrew James Minora *Gordon Haskett Research Advisors - Research Associate of Retail*

Yes, please.

Nancy A. Walsh *Pier 1 Imports, Inc. - EVP & CFO*

So give me just 1 second here. Hang on. So last year, we had negative 14.6% for comps in December, negative 3.6% in January, negative 3.9% in February for a total negative 9.8% in the quarter.

Andrew James Minora *Gordon Haskett Research Advisors - Research Associate of Retail*

Okay. And then if I could just ask one more, and I'm just not trying to get too detailed into your strategic focus, I know you guys aren't going to talk a lot about it. But when you talk about narrowing the strategic focus, I take from it as some things worked, some things didn't work from the New Day. Like, could you talk about perhaps what are some of the positives at work that you see so far and maybe some of the things that didn't work out as well you expected? And that's all I had.

Cheryl Bachelder

Sure. Andrew, we definitely saw some things improve. Some of the new things we tried, but I think the way I'm thinking about it is we've basically been trying to do too much at once. So when I use the word focus, I think, we're going to have to scale back to a few things that have the most impact on top line and drive them hard. Another way to say that is, I think, we may have confused our customer a bit by the number of items and value opportunities we put in front of them. So I think, getting really crystal clear on the items and the focus that's going to drive our top-line is one of our first to-do's -- that balanced by the cost work that Nancy will lead. I'm excited about Donna leading the style value side of that equation and Nancy leading on the cost side.

Operator

Our next question comes from Michael Lasser of UBS.

Michael Goldsmith *UBS Investment Bank, Research Division - Associate Director and Associate Analyst*

It's Michael Goldsmith on for Michael Lasser. First, so what has changed in the underlying business this year in that the comps are down double digits? Because last year it wasn't down that bad, it was down low single digits, so what has fundamentally changed where we're seeing, like, this incremental pressure?

Cheryl A. Bachelder *Pier 1 Imports, Inc. - Non-Employee Director*

I'm not sure I understand your question, but I guess, 2 things come to mind. We have tried to reframe our value proposition with our customer, which means lower prices in some segments. And we've had mixed success there, but we have lost some ticket. I think that's fair to say, Nancy?

Nancy A. Walsh *Pier 1 Imports, Inc. - EVP & CFO*

Yes. And as we've talked about particularly at Q2, what has really happened is we feel good about the plan, our execution was not so good. So we specifically talked about from the marketing perspective and then inventories that we didn't have the right levels of inventory and didn't necessarily have the inventory, the products that our customer was looking for. So that is really the big year-over-year change, I think. And the competitive base continues to be extremely promotional and without the other execution areas working effectively that has had an impact as well this year.

Cheryl A. Bachelder *Pier 1 Imports, Inc. - Non-Employee Director*

Michael, I would call this, if you let me use the word self-inflicted. Those are executional things that we should be able to do well.

Michael Goldsmith *UBS Investment Bank, Research Division - Associate Director and Associate Analyst*

That's helpful. And as a follow-up, it's more forward-looking. So you talked a little bit about pulling back on cost and savings there. But how do you plan on balancing pulling back on cost without sacrificing the customer experience?

Cheryl A. Bachelder *Pier 1 Imports, Inc. - Non-Employee Director*

I think that's a good comment, Michael. Particularly for this brand, I think, our associates in the stores are one of our greatest assets. And the fact that we have experienced people to offer our customers advice is distinctive about Pier 1. And so, I think, as we look at cost, we're looking at finding those things that have the most impact on bringing our guest into our stores for those associates to serve and want to be careful to take out cost that aren't customer-facing as we look at the cost structure.

Nancy A. Walsh *Pier 1 Imports, Inc. - EVP & CFO*

And I would just add to that, that we are also focused on the noncustomer-facing costs first, that would be the priority and rightsizing the business to the sales level.

Operator

Our next question comes from Anthony Chukumba of Loop Capital Markets.

Anthony Chinonye Chukumba *Loop Capital Markets LLC, Research Division - SVP*

I guess, my question and -- I guess, it falls a little bit on some of the questions that have been raised earlier. But I'm just trying to understand what happened in the third quarter particularly from a comp perspective. I know last quarter you talked about the fact that you had all this new merchandise that just didn't fall into the stores the way that you thought it was going to. So it kind of you didn't get the merchandise -- the main merchandise on the floor, and I'm trying to figure out was that also the case this quarter? Or did you not reduce prices enough? Or did you not promotional? I'm just trying to reconcile kind of what my expectations were versus the comps that you recorded particularly, given the fact that you had a 600- basis point benefit, so it would've been worse without the calendar shift.

Nancy A. Walsh *Pier 1 Imports, Inc. - EVP & CFO*

I think the biggest driver is the traffic that we're just not getting the traffic into the stores. You heard us mention in our remarks that conversion continued to be strong in the store and that speaks tremendously to what Cheryl was saying about our associates, and the value that they bring to the -- the whole value to the company. But the traffic continues to be one of our big drivers and the inventory is more of a mix issue. And we were still seeing some of the delays that we talked about in terms of inventory being in place in Q3 at the time that we wanted it to, we're seeing that, that came in a little bit later.

Anthony Chinonye Chukumba *Loop Capital Markets LLC, Research Division - SVP*

Okay. But mainly it was more of a traffic issue than anything else in terms of the comp decline. Okay. All right, that's helpful.

Nancy A. Walsh *Pier 1 Imports, Inc. - EVP & CFO*

That's correct.

Operator

(Operator Instructions) .

Our next question comes from the line of Jeremy Skrezyna of Southpaw.

Jeremy S. Skrezyna *Southpaw Asset Management, LP - Senior Research Analyst*

I wondered if we could dissect the merchandise margin and gross margin declines a little bit. I know there was a lot of conversation in new strategy about lowering the price points, but not necessarily sacrificing merchandise margin because products will be reengineered cheaper. So I'm wondering if you could talk about how much of the decline in gross margin this quarter was from sacrificing margin from lowering prices, but not necessarily having lower cost? How much of it was occupancy deleverage? How much of it was just having to promote more aggressively than planned? And can you just give us a little more color on that topic?

Nancy A. Walsh *Pier 1 Imports, Inc. - EVP & CFO*

I will start out by saying as we've mentioned since we talked about the introduction of our strategic plans, that we were making those price reductions to offer our consumer the price value proposition she was looking for, and that was taking place in advance of the sourcing savings that we mentioned, those will kick in starting next year. As a result of that, we did plan for the IMU to be impacted this



year. So that was kind of a starting point for that. For Q3, we are seeing -- and I did the similar split out last time -- that it was roughly about 2/3 of the difference was a result of additional promotions and the rest of it had to do with some of the freight and handling costs that we are seeing higher than we planned.

Jeremy S. Skrezyna Southpaw Asset Management, LP - Senior Research Analyst

And with the occupancy deleverage, you gave that last quarter, do you have that handy this time?

Nancy A. Walsh Pier 1 Imports, Inc. - EVP & CFO

It was in my comments. It was 150- basis points and just to do the lower sales volume. I will say the same comment I said last time, we are seeing the store occupancy dollars decline as we continue to close stores and aggressively renew some of our leases as they come up, but just as a function of deleveraging against the sales.

Jeremy S. Skrezyna Southpaw Asset Management, LP - Senior Research Analyst

Okay. And then, I guess, on that same topic because it seems like the margin decline is the one of the biggest issues here. There's lots of companies comping negative low double digits, but not seeing gross profit drop 30% or EBITDA turn meaningfully negative. What -- are there any new plans to kind of get a lift there? Are you taking any additional actions besides kind of what was already planned in terms of reengineering the supply chain and the product cost to kind of get a lift there? Or are we living closer to the new normal?

Nancy A. Walsh Pier 1 Imports, Inc. - EVP & CFO

Well, remember, we took the price reductions at IMU in advance of the stores source savings coming through. So we will see a natural lift next year as those sourcing savings come in. So it was more of a timing difference, if you will. That was really the majority of the impact you're seeing in Q3, the rest of it comes from a combination of things that I talked about being more promotional and just seeing additional pressure on the distribution side.

Jeremy S. Skrezyna Southpaw Asset Management, LP - Senior Research Analyst

Okay. And then lastly for me. In the last call, I believe it was talked about in terms of driving traffic that the advertising strategy maybe hadn't worked as well, so you were going to make some adjustments there, reducing the time of the advertisers, but increasing the frequency, gearing it a little bit older than you went. Is it -- is that -- did that just not do it and what's kind of the next step for advertising, marketing and driving traffic?

Cheryl A. Bachelder Pier 1 Imports, Inc. - Non-Employee Director

That's one of the areas, I think, needs full review going forward, finding out how to reach our core customer and draw her in more frequently with a compelling story. We've had some positive learning around digital. We're seeing the benefit of awareness and traffic building when we are on air, but we've got to find the optimization of that marketing mix to drive traffic. And so I think we've got some work to do there.

Operator

There are no further questions at this time. I will now turn the call back to management for any closing comments.

Cheryl A. Bachelder Pier 1 Imports, Inc. - Non-Employee Director

I want to thank you all for your time today and your continued support of Pier 1. Wish you a happy holiday season and I look forward to further conversations to keep you up-to-date on Pier 1. Thank you for your time.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you for your participation and have a wonderful day. You may disconnect your lines at this time.

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