

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended **February 26, 2005**.

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. **1-7832**

**PIER 1 IMPORTS, INC.**

(Exact name of Company as specified in its charter)

**DELAWARE**

(State or other jurisdiction of incorporation or organization)

**75-1729843**

(I.R.S. Employer Identification No.)

**100 Pier 1 Place**

**Fort Worth, Texas**

(Address of principal executive offices)

**76102**

(Zip Code)

Company's telephone number, including area code: **(817) 252-8000**

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common Stock, \$1.00 par value	<b>New York Stock Exchange</b>

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark whether the Company (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Company was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Company's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes  No

As of May 9, 2005, the approximate aggregate market value of voting stock held by non-affiliates of the Registrant was \$1,261,000,000 using the closing sales price on that day of \$15.47. It is assumed for purposes of this computation that only directors, executive officers and 10% or greater shareholders of the registrant are affiliates, but this should not be deemed to be a conclusion that any such person is an affiliate of the registrant.

As of May 9, 2005, 86,083,400 shares of the Registrant's Common Stock, \$1.00 par value, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the following documents have been incorporated herein by reference:

- 1) Registrant's Annual Report to Shareholders for the fiscal year ended February 26, 2005 in Parts I and II hereof; and
- 2) Registrant's Proxy Statement for the 2005 Annual Meeting in Part III hereof.

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**PIER 1 IMPORTS, INC.  
FORM 10-K ANNUAL REPORT  
Fiscal Year Ended February 26, 2005**

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[Consent of Independent Registered Public Accounting Firm](#)

[Certification of CEO](#)

[Certification of CFO](#)

[Certification of CEO and CFO Pursuant to Section 906](#)

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PART I

Item 1. Business.

(a) General Development of Business.

Throughout this document, references to the “Company” include Pier 1 Imports, Inc. and its consolidated subsidiaries. References to “Pier 1” relate to the Company’s retail locations operating under the name Pier 1 Imports®. References to “The Pier” relate to the Company’s retail locations in the United Kingdom and Ireland. References to “Pier 1 Kids” relate to the Company’s retail locations formerly named Cargokids® and retail locations operating under the name Pier 1 Kids.

In fiscal 2005, the Company expanded its specialty retail operations by opening 67 net new Pier 1 stores, five net new Pier 1 Kids stores and seven new international stores. Subject to changes in the retail environment, availability of suitable store sites, lease renewal negotiations and availability of adequate financing, Pier 1 plans to open approximately 85 new stores and close approximately 25 stores in North America during fiscal 2006. A majority of the stores expected to close in fiscal 2006 are anticipated to be replaced with more favorable locations within the same market. Pier 1 Kids expects to open approximately four new stores and close two stores. Plans for fiscal 2006 include opening approximately 16 net new international stores in the United Kingdom, Mexico and Puerto Rico, the majority of which are planned as “store within a store” formats.

Set forth below is a list by city of Pier 1 stores opened in North America in fiscal 2005:

Alpharetta, GA	Harahan, LA	Raleigh, NC
American Fork, UT	Houston, TX (2 locations)	Rancho Cucamonga, CA
Appleton, WI	Howell, NJ	Redlands, CA
Arlington, TX	Janesville, WI	Richmond Hill, ON
Atlanta, GA	Kemah, TX	Rochester Hills, MI
Beaumont, TX	Kingston, NY	Roseburg, OR
Birmingham, AL	Kitchener, ON	Saint John, NB
Boucherville, QC	Lakewood, CO (2 locations)	San Diego, CA
Burlington, NJ	Las Vegas, NV (2 locations)	Shakopee, MN
Camp Hill, PA	London, ON	Sheboygan Falls, WI
Canton, MI	Loveland, CO	Sherbrooke, QC
Cape May, NJ	Manhattan, KS	Sherman, TX
Carmel, IN	Mankato, MN	Silver Spring, MD
Catonsville, MD	Mansfield, TX	Simpsonville, SC
Chicago, IL	Manteca, CA	St. John’s, NL
College Station, TX	Marietta, GA	St. Petersburg, FL
Collierville, TN	Marion, IA	Sturbridge, MA
Columbia, SC	Marlton, NJ	Tavernier, FL
Columbus, OH	McKinney, TX	Thunder Bay, ON
Conway, AR	Meridian, ID	Torrance, CA
Dallas, TX	Mesquite, TX	Tucson, AZ (2 locations)
Danvers, MA	Montgomery, AL	Venice, FL
Easton, PA	Mt. Laurel, NJ	Vienna, VA
El Paso, TX	Newburgh, NY	Visalia, CA
Etobicoke, ON	Newport Coast, CA	Waco, TX
Farmington Hills, MI	Oak Park Heights, MN	Waldorf, MD
Fort Gratiot, MI	Olathe, KS	Webster, TX
Gainesville, VA	Omaha, NE	West Jordan, UT
Galveston, TX	Oshawa, ON	Wilmington, NC
Gambrills, MD	Ottawa, ON	Wilsonville, OR
Gilroy, CA	Pearl City, HI	Winnipeg, MB
Grove City, OH	Philadelphia, PA	Wooster, OH
Guelph, ON	Plymouth, MA	
Hadley, MA	Princeton, NJ	

Presently, Pier 1 maintains regional distribution center facilities in or near Baltimore, Maryland; Chicago, Illinois; Columbus, Ohio; Fort Worth, Texas; Ontario, California and Savannah, Georgia.

Pier 1 Kids stores offer children’s furniture and decorative accessories. The Company started operating Pier 1 Kids stores in March 2001. Pier 1 Kids utilizes a web site at [www.pier1kids.com](http://www.pier1kids.com) to attract customers and provide information regarding placing orders, sale items and store locations.

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Set forth below is a list by city of Pier 1 Kids stores opened in North America in fiscal 2005:

Augusta, GA	Miami, FL	Vienna, VA
Baltimore, MD	Naples, FL	Wilmington, NC
Birmingham, AL	Raleigh, NC	
Ft. Lauderdale, FL	Tallahassee, FL	

Pier 1 Kids maintains a distribution center facility in Fort Worth, Texas, which presently serves all its retail locations.

The Pier, a subsidiary of the Company with locations in the United Kingdom and Ireland, operates 32 retail stores offering decorative home furnishings and related items in a setting similar to Pier 1 stores. The Pier operates a distribution facility near London, England. Additionally, The Pier has an online store, which can be accessed at [www.pier.co.uk](http://www.pier.co.uk). During fiscal 2005, The Pier opened two new stores in England, and one in a “store within a store” format located in an existing Roches store in Ireland. The Pier expects to open approximately 12 new stores in fiscal 2006, nine of which are planned as “store within a store” formats, and to close three stores.

The Company has an arrangement to supply Sears Roebuck de Mexico, S.A. de C.V. (“Sears Mexico”) with Pier 1 merchandise to be sold in a “store within a store” format in certain Sears Mexico stores. The agreement with Sears Mexico expires December 31, 2006, and substantially insulates the Company from currency fluctuations in the value of the Mexican peso. In fiscal 2005, Sears Mexico opened four new stores offering Pier 1 merchandise. As of February 26, 2005, Pier 1 merchandise was offered in 24 Sears Mexico stores. Expansion plans for fiscal 2006 include opening three new stores in Mexico.

The Company has a product distribution agreement with Sears Roebuck de Puerto Rico, Inc. (“Sears Puerto Rico”), which allows Sears Puerto Rico to market and sell Pier 1 merchandise in a “store within a store” format in certain Sears Puerto Rico stores. Sears Puerto Rico operates a total of ten stores, and as of February 26, 2005, seven of these stores offered Pier 1 merchandise. The Company is planning to open four new stores in Puerto Rico under this agreement in fiscal 2006.

The Company owns a credit card bank in Omaha, Nebraska, operating under the name Pier 1 National Bank, N.A. (the “Bank”). The Bank holds the credit card accounts for both the Pier 1 and Pier 1 Kids proprietary credit cards. As of February 26, 2005, the Company, through the Bank, had almost 5,300,000 proprietary cardholders with approximately 1,212,000 active accounts (accounts with a purchase within the previous 12 months). The Company continues to try to increase overall sales on its proprietary credit card by developing customer loyalty through marketing promotions targeted to cardholders, including deferred payment options on larger purchases.

Since June 2000, Pier 1 has operated an e-commerce web site, which can be accessed at [www.pier1.com](http://www.pier1.com). In fiscal 2005, the site received an average of 3.1 million visitors per month, making it a significant marketing vehicle for the Company while providing customers with access to Pier 1 products and services at their convenience. Customers can shop from over 2,300 merchandise items as well as purchase gift cards, create and manage bridal and gift registries, view interactive versions of newspaper ad inserts, watch the most recent TV commercials and sign up for marketing email and direct mail. Pier 1’s Internet strategy in fiscal 2006 will continue to focus on cross-channel integration and effective utilization of the web site as a marketing vehicle to reach new and existing customers. During the fall of 2004, the Company tested a mail order catalog distributed to two select markets. In March 2005, this test was followed by another distribution of almost 600,000 catalogs to six United States markets where the Company currently has 150 stores. The Company plans to distribute approximately 2,000,000 catalogs to all United States markets during the fall of 2005, and by November 2005, the Company’s e-commerce website is expected to be fully integrated with future catalogs.

### (b) Financial Information about Industry Segments.

In fiscal 2005, the Company conducted business as one operating segment consisting of the retail sale of imported decorative home furnishings, gifts and related items.

Financial information with respect to the Company’s business is found in the Company’s Consolidated Financial Statements, which are incorporated by reference into Item 8 herein.

### (c) Narrative Description of Business.

The specialty retail operations of the Company consist of retail stores operating under the names “Pier 1 Imports”, “The Pier”, and “Pier 1 Kids”, selling a wide variety of furniture, decorative home furnishings, dining and kitchen goods, bath and bedding accessories and other specialty items for the home.

On February 26, 2005, the Company operated 1,070 Pier 1 stores in the United States, 80 Pier 1 stores in Canada, and supported seven franchised stores in the U.S. Additionally, the Company operated 32 stores located in the United Kingdom and Ireland under the name The Pier, and 45 Pier 1 Kids stores located in the U.S. Pier 1’s growth strategy is to expand its North American store base to at least 1,500 locations. The Company expects to expand Pier 1

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Kids nationally, offering value-oriented home furnishings for children and families, and plans to expand the concept to 250 to 300 stores over the next decade. The Company supplies merchandise and licenses the Pier 1 Imports name to Sears Mexico and Sears Puerto Rico, which sell Pier 1 merchandise in a "store within a store" format in 24 Sears Mexico stores and in seven Sears Puerto Rico stores. Company-operated Pier 1 stores in the United States and Canada average approximately 9,700 gross square feet, which includes an average of approximately 7,800 square feet of retail selling space. The stores consist of freestanding units located near shopping centers or malls and in-line positions in major shopping centers. Pier 1 operates in all major U.S. metropolitan areas and many of the primary smaller markets. Pier 1 stores generally have their highest sales volumes during November and December as a result of the holiday selling season. In fiscal 2005, net sales of the Company totaled \$1,897.9 million.

Pier 1 offers a diverse selection of products consisting of approximately 3,500 items imported from over 40 countries around the world. While the broad categories of Pier 1's merchandise remain constant, individual items within these product groupings change frequently in order to meet the demands of customers. The principal categories of merchandise include the following:

**FURNITURE** - This product group consists of furniture, furniture pads and pillows to be used on patios and in living, dining, kitchen and bedroom areas, and in sun rooms. The product group constituted approximately 39% of Pier 1's total North American retail sales in fiscal years 2005 and 2004, and 38% in fiscal 2003. These goods are imported from a variety of countries such as Italy, Malaysia, Brazil, Mexico, China, the Philippines and Indonesia, and are also obtained from domestic sources. The furniture is made of metal or handcrafted natural materials, including rattan, pine, beech, rubberwood and selected hardwoods with either natural, stained or painted finishes. Pier 1 also sells upholstered furniture.

**DECORATIVE ACCESSORIES** - This product group constituted the broadest category of merchandise in Pier 1's sales mix and contributed approximately 25% to Pier 1's total North American retail sales in fiscal year 2005 and 24% in fiscal years 2004 and 2003. These items are imported from approximately 35 countries and include brass, marble and wood items, as well as lamps, vases, dried and silk flowers, baskets, wall decorations and numerous other decorative items. A majority of these products are handcrafted from natural materials.

**HOUSEWARES** - This product group is imported mainly from the Far East and Europe and includes ceramics, dinnerware and other functional and decorative items. These goods accounted for approximately 13% of Pier 1's total North American retail sales in fiscal years 2005, 2004 and 2003.

**BED & BATH** - This product group is imported mainly from India, Germany, Thailand and China, and is also obtained from domestic sources. The group includes bath and fragrance products, candles and bedding. These goods accounted for approximately 16% of Pier 1's total North American retail sales in fiscal year 2005 and 18% in fiscal years 2004 and 2003.

**SEASONAL** - This product group consists of merchandise for celebrating holidays and spring/summer entertaining, imported mainly from Europe, Indonesia, China, the Philippines and India, and also obtained from domestic sources. These items accounted for approximately 7% of Pier 1's total North American retail sales in fiscal year 2005, 6% in fiscal 2004 and 7% in fiscal year 2003.

Pier 1 merchandise largely consists of items that require a significant degree of craftsmanship and are mostly imported directly from foreign suppliers. For the most part, the imported merchandise is handcrafted in cottage industries and small factories. Pier 1 is not dependent on any particular supplier and has enjoyed long-standing relationships with many vendors. The Company believes alternative sources of products could be procured over a relatively short period of time, if necessary. In selecting the source of a product, Pier 1 considers quality, dependability of delivery and cost. During fiscal 2005, Pier 1 sold merchandise imported from over 40 different countries with 38% of its sales derived from merchandise produced in China, 13% derived from merchandise produced in the United States, 13% derived from merchandise produced in India and 29% derived from merchandise produced in Indonesia, Thailand, Brazil, the Philippines, Italy and Mexico. The remaining 7% of sales was from merchandise produced in various Asian, European, Central American, South American and African countries.

Pier 1 operates six regional distribution centers located in or near Baltimore, Maryland; Chicago, Illinois; Columbus, Ohio; Fort Worth, Texas; Ontario, California and Savannah, Georgia and leases additional space from time to time. Imported merchandise and a portion of domestic purchases are delivered to the distribution centers, unpacked and made available for shipment to the various stores in each distribution center's region. Due to the time delays involved in procuring merchandise from foreign suppliers, Pier 1 maintains a substantial inventory to assure a sufficient supply of products in its stores.

The Company is in the highly competitive specialty retail business and primarily competes with specialty sections of large department stores, home furnishing stores, small specialty import stores and discount stores. Management believes that its stores compete on the basis of price, constantly changing merchandise assortment, visual presentation of its merchandise and customer service. The Company also believes its Pier 1 stores remain competitive with other retailers due to name recognition, established vendor relationships and the extent and variety of the merchandise offered. The Company believes that its Pier 1 Kids operations give it the opportunity to address the children's furniture and accessories market.

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The Company, through certain of its wholly owned subsidiaries, owns, among others, three federally registered service marks under which its Pier 1 Imports stores do business and one pending federal service mark application under which its Pier 1 Kids stores do business. Additionally, certain subsidiaries of the Company have registered and have applications pending for the registration of Pier 1 and Pier 1 Kids trademarks and service marks in the United States and in numerous foreign countries. The Company believes that its marks have significant value and are important in its marketing efforts. The Company maintains a policy of pursuing registration of its marks and opposing any infringement of its marks.

On February 26, 2005, the Company employed approximately 15,600 associates in North America, of which approximately 7,300 were full-time employees and 8,300 were part-time employees. Approximately 800 additional associates were employed in the United Kingdom and Ireland, of which approximately 200 were full-time employees and approximately 600 were part-time employees.

As a retailer of imported merchandise, the Company is subject to certain risks that typically do not affect retailers of domestically produced merchandise. The Company typically orders merchandise from four to twelve months in advance of delivery and generally pays for the merchandise at the time it is loaded for transport to designated U.S. and international destinations. Fluctuations in foreign currency exchange rates, restrictions on the convertibility of the dollar and other currencies, duties, taxes and other charges on imports, dock strikes, import quota systems and other restrictions generally placed on foreign trade can affect the price, delivery and availability of ordered merchandise. The inability to import products from certain countries or the imposition of significant tariffs could also have a material adverse effect on the results of operations of the Company. Freight costs contribute a substantial amount to the cost of imported merchandise.

Section 301 of the Trade Act of 1974 provides the U.S. government with the authority to enforce trade agreements, resolve trade disputes, and open foreign markets to U.S. goods and services. Section 301 is the principal statute under which the U.S. may impose trade sanctions on foreign countries that either violate trade agreements or maintain laws or practices that are unjustifiable and restrict U.S. commerce. If the U.S. finds that a violation of Section 301 has occurred, it may increase duties on imports into the U.S. from one or more foreign countries in order to respond to the damage to U.S. exports resulting from a country's unfair trade practices. In this event, Pier 1 could be adversely affected by the imposition of trade sanctions.

In addition, the U.S. maintains in effect a variety of additional international trade laws under which the Company's ability to import may be affected from time to time, including, but not limited to, the antidumping law, the countervailing duty law, the safeguards law, and a law referred to as "Special 301," which is designed to protect intellectual property rights. Although the Company may not be directly involved in a particular trade dispute under any of these laws, its ability to import, or the terms and conditions under which it can continue to import, may be affected by the outcome of that dispute.

In particular, because the Company imports merchandise from countries around the world, the Company may be affected from time to time by antidumping petitions filed with the U.S. Commerce Department and International Trade Commission by U.S. producers of competing products alleging that foreign manufacturers are selling their own products at prices in the U.S. that are less than the prices that they charge in their home country market or in third country markets or at less than their cost of production. Such petitions, if successful, could significantly increase the U.S. import duties on those products. In that event, the Company might possibly decide to pay the increased duties, thereby possibly increasing the Company's price to consumers. Alternatively, the Company might decide to source the product or a similar product from a different country not subject to increased duties or else discontinue the importation and sale of the product.

The purpose of the World Trade Organization is to provide a framework for expanding international trade on an equitable basis and includes a process for the resolution of trade disputes among the member countries. In recent years, the dispute resolution process of the World Trade Organization has been utilized to resolve disputes regarding market access between the European Union, China, the United States and other countries. In some instances these trade disputes can lead to the threats by countries of sanctions against each other, which can include import prohibitions and increased duty rates on imported items. The Company considers any agreement that reduces tariff and non-tariff barriers in international trade beneficial to its business. Any type of sanction on imports is likely to increase the Company's import costs or limit the availability of products purchased from sanctioned countries. In that case, the Company may seek similar products from other countries .

### (d) Financial information about geographic areas.

Information required by this Item is incorporated by reference to "Note 1 – Summary of Significant Accounting Policies" of the section entitled "Notes to the Consolidated Financial Statements" set forth in the Company's Annual Report to Shareholders for the fiscal year ended February 26, 2005.

### (e) Available Information.

The Company makes available free of charge through its Internet web site address ([www.pier1.com](http://www.pier1.com)) its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed with the Securities and Exchange Commission pursuant to Section 13(a) of the Securities Exchange Act of 1934 as soon

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as reasonably practicable after it electronically files such material with, or furnishes such material to, the Securities and Exchange Commission.

Certain statements contained in Item 1, Item 7 and elsewhere in this report may constitute “forward-looking statements” within the meaning of Section 21E of the Securities Exchange Act of 1934. The Company may also make forward-looking statements in other reports filed with the Securities and Exchange Commission and in material delivered to the Company’s shareholders. Forward-looking statements provide current expectations of future events based on certain assumptions. These statements encompass information that does not directly relate to any historical or current fact and often may be identified with words such as “anticipates,” “believes,” “expects,” “estimates,” “intends,” “plans,” “projects” and other similar expressions. Management’s expectations and assumptions regarding planned store openings, financing of Company obligations from operations, results from its new marketing, merchandising and store operations strategies, and other 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. Risks and uncertainties that may affect Company operations and performance include, among others, the effects of terrorist attacks or other acts of war, conflicts or war involving the United States or its allies or trading partners, labor strikes, weather conditions that may affect sales, volatility of fuel and utility costs, the general strength of the economy and levels of consumer spending, consumer confidence, the availability of new sites for expansion along with sufficient labor to facilitate growth, the strength of new home construction and sales of existing homes, the availability and proper functioning of technology and communications systems supporting the Company’s key business processes, the ability of the Company to import merchandise from foreign countries without significantly restrictive tariffs, duties or quotas and the ability of the Company to source, ship and deliver items from foreign countries to its U.S. distribution centers at reasonable prices and rates and in a timely fashion. The foregoing risks and uncertainties are in addition to others discussed elsewhere in this report. The Company assumes no obligation to update or otherwise revise its forward-looking statements even if experience or future changes make it clear that any projected results expressed or implied will not be realized.

### Item 2. Properties.

In March 2002, the Company purchased land in Fort Worth, Texas for construction of new headquarters and relocation of its corporate offices. The Company completed the construction and relocated to its new corporate headquarters building in August 2004. The facility contains approximately 460,000 square feet of office space, intended to accommodate the Company’s future growth. Total cost of the new headquarters, including land, was approximately \$100 million, of which \$34 million was spent in fiscal 2005, \$53 million was spent in fiscal 2004, and \$13 million was spent in fiscal 2003. The Company leases approximately 12,000 square feet of office space for its Pier 1 Kids subsidiary, also located in Fort Worth, Texas. The Pier leases approximately 12,000 square feet of office space in the U.K. for its corporate office.

The Company leases the majority of its retail stores, its warehouses and other office space. At February 26, 2005, the present value of the Company’s minimum future operating lease commitments discounted at 10% totaled approximately \$1,034 million. The Company currently owns and leases distribution space of approximately four million square feet. The Company also acquires temporary distribution space from time to time through short-term leases.

The following table shows the distribution of Pier 1’s North American stores by state and province as of February 26, 2005:

#### United States (company-owned)

Alabama	17	Louisiana	16	Ohio	41
Alaska	1	Maine	1	Oklahoma	6
Arizona	21	Maryland	25	Oregon	13
Arkansas	8	Massachusetts	29	Pennsylvania	41
California	112	Michigan	41	Rhode Island	4
Colorado	25	Minnesota	20	South Carolina	18
Connecticut	21	Mississippi	7	South Dakota	2
Delaware	4	Missouri	23	Tennessee	21
Florida	75	Montana	6	Texas	82
Georgia	36	Nebraska	6	Utah	12
Hawaii	3	Nevada	9	Virginia	34
Idaho	6	New Hampshire	6	Washington	24
Illinois	46	New Jersey	34	West Virginia	5
Indiana	22	New Mexico	5	Wisconsin	21
Iowa	10	New York	47	Wyoming	1
Kansas	10	North Carolina	38		
Kentucky	11	North Dakota	4		

#### United States (franchised)

Arizona	1	Nevada	1	Texas	1
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Kentucky	1	New Hampshire	1	Vermont	1
Maine	1				

### Canada (company-owned)

Alberta	9	New Brunswick	2	Ontario	36
British Columbia	12	New Foundland	1	Quebec	15
Manitoba	2	Nova Scotia	1	Saskatchewan	2

The Pier's retail operations consist of 25 stores in England, four stores in Scotland, two stores in Ireland and one store in Wales. At the end of fiscal 2005, Pier 1 Kids had 15 stores in Florida, ten stores in North Carolina, seven stores in Texas, six stores in Georgia, three stores in Virginia, two stores in Maryland, one store in Alabama and one store in Delaware.

As of February 26, 2005, Pier 1 owned or leased the following warehouse properties in or near the following cities:

<u>Location</u>	<u>Approx. Sq. Ft.</u>	<u>Owned/Leased Facility</u>
Baltimore, Maryland	634,000 sq. ft.	Leased
Chicago, Illinois	514,000 sq. ft.	Owned
Columbus, Ohio	527,000 sq. ft.	Leased
Fort Worth, Texas	460,000 sq. ft.	Owned
Fort Worth, Texas	262,000 sq. ft.	Leased
Ontario, California	747,000 sq. ft.	Leased
Savannah, Georgia	784,000 sq. ft.	Leased

The Company also leases approximately 147,000 square feet of warehouse space in the United Kingdom for The Pier's operations and approximately 235,000 square feet of warehouse space in the United States for Pier 1 Kids' operations. The Company is currently leasing additional space under short-term agreements. In support of its long-range growth plan, the Company is continuing expansion of its distribution facilities. The Company plans to construct a new distribution center under a build-to-suit arrangement and lease the facility under an operating lease. This facility will be located in the Northwest United States and is expected to begin operations in early fiscal 2007.

### Item 3. Legal Proceedings.

There are various claims, lawsuits, investigations and pending actions, against the Company and its subsidiaries incident to the operations of its business. The Company considers them to be ordinary and routine in nature. The Company maintains liability insurance against most of these claims. While certain of the lawsuits involve substantial amounts, it is the opinion of management, after consultation with counsel, that the ultimate resolution of such litigation will not have a material adverse effect on the Company's financial position, results of operations or liquidity. The Company intends to vigorously defend itself against the claims asserted in these lawsuits.

### Item 4. Submission of Matters to a Vote of Security Holders.

There were no matters submitted to a vote of the Company's security holders during the fourth quarter of the Company's 2005 fiscal year.

## PART II

### Item 5. Market for the Company's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Information required by this Item is incorporated by reference to the section entitled "Market Price and Dividend Information" set forth in the Company's Annual Report to Shareholders for the fiscal year ended February 26, 2005. With respect to equity compensation plan information, please refer to Item 11 of this report.

The Company's common stock is traded on the New York Stock Exchange. As of April 27, 2005, there were approximately 40,000 shareholders of record of the Company's common stock.

In June 2004, the Company's Board of Directors authorized up to \$150 million for purchases of common stock, replacing the previous authorization. During fiscal 2005, the Company repurchased 3,225,000 shares of its outstanding common stock. As of April 18, 2005, approximately \$108.7 million remained available for purchase. Future repurchases of common stock will be made through open market or private transactions from time to time depending on prevailing market conditions, the Company's available cash and the Company's consideration of any loan agreement restrictions and its corporate credit ratings.

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The following table provides information with respect to purchases of common stock of the Company made during the three months ended February 26, 2005, by Pier 1 Imports, Inc. or any “affiliated purchaser” of Pier 1 Imports, Inc. as defined in Rule 10b-18(a)(3) under the Exchange Act.

Period	Total Number of Shares Purchased	Average Price Paid per Share (including fees)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (1)
November 28, 2004 through January 1, 2005	—	\$ —	—	\$ 115,425,808
January 2, 2005 through January 29, 2005	175,000	18.48	175,000	112,192,504
January 30, 2005 through February 26, 2005	38,400	18.12	38,400	111,496,848
	<u>213,400</u>	<u>\$ 18.41</u>	<u>213,400</u>	<u>\$ 111,496,848</u>

(1) On June 25, 2004, the Board of Directors authorized up to \$150 million for repurchases of the Company’s common stock, replacing the previous authorization. There is no expiration date on the current authorization and during the period covered by the table, no determination was made by the Company to suspend or cancel purchases under the program.

The Company’s primary loan agreements require the Company to maintain certain financial ratios, limit certain investments, and in some instances, limit repurchases of common stock. The Company was in compliance with all debt covenants at fiscal 2005 year-end. During fiscal 2005, the Company paid cash dividends totaling approximately \$34.8 million, or \$.40 per share. In March 2005, the Company declared a cash dividend of \$.10 per share payable on May 18, 2005. The Company’s Board of Directors may continue to pay cash dividends and repurchase its common stock in fiscal 2006, but expects to retain most of its future earnings for expansion of the Company’s business. The Company’s dividend policy will depend upon the earnings, financial condition and capital needs of the Company and other factors deemed relevant by the Company’s Board of Directors.

### Item 6. Selected Financial Data.

Information required by this Item is incorporated by reference to the section entitled “Financial Summary” set forth in the Company’s Annual Report to Shareholders for the fiscal year ended February 26, 2005.

### Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Information required by this Item is incorporated by reference to the section entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” set forth in the Company’s Annual Report to Shareholders for the fiscal year ended February 26, 2005.

### Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

Information required by this Item is incorporated by reference to the section entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operation — Market Risk Disclosures” set forth in the Company’s Annual Report to Shareholders for the fiscal year ended February 26, 2005.

### Item 8. Financial Statements and Supplementary Data.

Information required by this Item is incorporated by reference to the material in the Company’s consolidated financial statements described below, notes thereto and the Report of Independent Registered Public Accounting Firm set forth in the Company’s Annual Report to Shareholders for the fiscal year ended February 26, 2005:

Consolidated Statements of Operations for the Years Ended February 26, 2005, February 28, 2004 and March 1, 2003
Consolidated Balance Sheets at February 26, 2005 and February 28, 2004
Consolidated Statements of Cash Flows for the Years Ended February 26, 2005, February 28, 2004 and March 1, 2003
Consolidated Statements of Shareholders’ Equity for the Years Ended February 26, 2005, February 28, 2004 and March 1, 2003

Notes to Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

The unaudited quarterly information required by this Item is incorporated by reference to the section entitled “Selected Quarterly Financial Data (unaudited)” set forth in the Company’s Annual Report to Shareholders for the fiscal years ended February 26, 2005 and February 28, 2004.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.

Information regarding internal control over financial reporting required by this Item is incorporated by reference to “Report of Management on Internal Control Over Financial Reporting” and “Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting” set forth in the Company’s Annual Report to Shareholders for the fiscal year ended February 26, 2005.

There has not been any change in the Company’s internal control over financial reporting during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

As required by Exchange Act Rules 13a-15 and 15d-15, an evaluation was conducted under the supervision and with the participation of the Company’s management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company’s disclosure controls and procedures as of February 26, 2005, and based on this evaluation the Chief Executive Officer and Chief Financial Officer have concluded that the Company’s disclosure controls and procedures were effective as of such date to ensure that information required to be disclosed by the Company in its reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms.

PART III

Item 10. Directors and Executive Officers of the Company.

Information regarding directors of the Company required by this Item is incorporated by reference to the section entitled “Election of Directors — Nominees for Directors” set forth in the Company’s Proxy Statement for its 2005 Annual Meeting of Shareholders.

The information regarding compliance with Section 16(a) of the Securities Exchange Act of 1934 required by this Item is incorporated by reference to the section entitled “Section 16(a) Beneficial Ownership Reporting Compliance” set forth in the Company’s Proxy Statement for its 2005 Annual Meeting of Shareholders.

Information regarding the Company’s audit committee financial experts and code of ethics and business conduct required by this item is incorporated by reference to the section entitled “Matters Relating to Corporate Governance, Board Structure, Director Compensation and Stock Ownership” set forth in the Company’s Proxy Statement for its 2005 Annual Meeting of Shareholders.

No director or nominee for director of the Company has any family relationship with any other director or nominee or with any executive officer of the Company.

Executive Officers of the Company

MARVIN J. GIROUARD, age 65, has served as Chairman and Chief Executive Officer of the Company since March 1999 and has been a member of the Executive Committee since December 1998. He has been a Director of the Company since August 1988. From June 1998 to February 1999, Mr. Girouard served as President and Chief Executive Officer of the Company and from August 1988 to June 1998 he served as President and Chief Operating Officer of the Company. From May 1985 until August 1988, he served as Senior Vice President of Merchandising of Pier 1 Imports (U.S.), Inc.

CHARLES H. TURNER, age 48, has served as Executive Vice President of Finance since April 2002 and has served as Chief Financial Officer and Treasurer of the Company since August 1999. He served as Senior Vice President of Finance of the Company from August 1999 to April 2002. He served as Senior Vice President of Stores of the Company from August 1994 to August 1999, and served as Controller and Principal Accounting Officer of the Company from January 1992 to August 1994.

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GREGORY S. HUMENESKY, age 53, has served as Executive Vice President of Human Resources of the Company since February 2005. Prior to joining the Company, he served as Senior Vice President of Human Resources at Zale Corporation from April 1996 to February 2005.

JAY R. JACOBS, age 50, has served as Executive Vice President of Merchandising of the Company since April 2002. He served as Senior Vice President of Merchandising of the Company from May 1995 to April 2002. He served as Vice President of Divisional Merchandising of Pier 1 Imports (U.S.), Inc. from May 1993 to May 1995, and served as Director of Divisional Merchandising of Pier 1 Imports (U.S.), Inc. from July 1991 to May 1993.

J. RODNEY LAWRENCE, age 59, has served as Executive Vice President of Legal Affairs since April 2002 and has served as Secretary of the Company since November 1985. He served as Senior Vice President of Legal Affairs of the Company from June 1992 to April 2002, and served as Vice President of Legal Affairs of the Company from December 1985 to June 1992.

PHIL E. SCHNEIDER, age 53, has served as Executive Vice President of Marketing of the Company since April 2002. He served as Senior Vice President of Marketing of the Company from May 1993 to April 2002, and served as Vice President of Advertising of Pier 1 Imports (U.S.), Inc. from January 1988 to May 1993.

DAVID A. WALKER, age 54, has served as Executive Vice President of Logistics and Allocations of the Company since April 2002. He served as Senior Vice President of Logistics and Allocations of the Company from September 1999 to April 2002. He served as Vice President of Planning and Allocations of Pier 1 Imports (U.S.), Inc. from January 1994 to September 1999, and served as Director of Merchandise Services of Pier 1 Imports (U.S.), Inc. from October 1989 to January 1994.

E. MITCHELL WEATHERLY, age 57, has served as Executive Vice President of Stores of the Company since December 2004. He served as Executive Vice President of Human Resources of the Company from April 2002 to December 2004. He served as Senior Vice President of Human Resources of the Company from June 1992 to April 2002, and served as Vice President of Human Resources of the Company from June 1989 to June 1992 and of Pier 1 Imports (U.S.), Inc. from August 1985 to June 1992.

The officers of the Company are appointed by the Board of Directors, hold office until their successors are elected and qualified and/or until their earlier death, resignation or removal.

None of the above executive officers has any family relationship with any other of such officers or with any director of the Company. None of such officers was selected pursuant to any arrangement or understanding between him and any other person.

### Item 11. Executive Compensation.

The information required by this Item is incorporated herein by reference to the section entitled “Executive Compensation” and the section entitled “Matters Relating to Corporate Governance, Board Structure, Director Compensation and Stock Ownership – Fees Paid to Directors” set forth in the Company’s Proxy Statement for its 2005 Annual Meeting of Shareholders.

### Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The information required by this Item is incorporated by reference to the section entitled “Matters Relating to Corporate Governance, Board Structure, Director Compensation and Stock Ownership – Security Ownership of Management” and the section entitled “Executive Compensation – Equity Compensation Plan Information” set forth in the Company’s Proxy Statement for its 2005 Annual Meeting of Shareholders.

### Item 13. Certain Relationships and Related Transactions.

The information required by this Item is incorporated by reference to the section entitled “Compensation Committee Interlocks and Insider Participation; Certain Related Party Transactions” set forth in the Company’s Proxy Statement for its 2005 Annual Meeting of Shareholders.

### Item 14. Principal Accounting Fees and Services.

Information required by this Item is incorporated by reference to the sections entitled “Other Business – Independent Auditor Fees” and “Other Business – Pre-approval of Nonaudit Fees” set forth in the Company’s Proxy Statement for its 2005 Annual Meeting of Shareholders.

PART IV

Item 15. Exhibits and Financial Statement Schedules.

(a) List of consolidated financial statements, schedules and exhibits filed as part of this report.

1. Financial Statements

Consolidated Statements of Operations for the Years Ended  
February 26, 2005, February 28, 2004 and March 1, 2003

Consolidated Balance Sheets at February 26, 2005 and February 28, 2004

Consolidated Statements of Cash Flows for the Years Ended  
February 26, 2005, February 28, 2004 and March 1, 2003

Consolidated Statements of Shareholders' Equity for the Years Ended  
February 26, 2005, February 28, 2004 and March 1, 2003

Notes to Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

2. Financial Statement Schedules

Schedules have been omitted because they are not required or are not applicable or because the information required to be set forth therein either is not material or is included in the financial statements or notes thereto.

3. Exhibits

See Exhibit Index.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: May 4, 2005

PIER 1 IMPORTS, INC.

By: /s/ Marvin J. Girouard

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Marvin J. Girouard, Chairman  
and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Company and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Marvin J. Girouard</u> Marvin J. Girouard	Chairman and Chief Executive Officer	May 4, 2005
<u>/s/ Charles H. Turner</u> Charles H. Turner	Executive Vice President, Finance Chief Financial Officer and Treasurer	May 4, 2005
<u>/s/ Susan E. Barley</u> Susan E. Barley	Principal Accounting Officer	May 4, 2005
<u>/s/ John H. Burgoyne</u> John H. Burgoyne	Director	May 4, 2005
<u>/s/ Dr. Michael R. Ferrari</u> Dr. Michael R. Ferrari	Director	May 4, 2005
<u>/s/ James M. Hoak, Jr.</u> James M. Hoak, Jr.	Director	May 4, 2005
<u>/s/ Karen W. Katz</u> Karen W. Katz	Director	May 4, 2005
<u>/s/ Terry E. London</u> Terry E. London	Director	May 4, 2005
<u>/s/ Tom M. Thomas</u> Tom M. Thomas	Director	May 4, 2005

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EXHIBIT INDEX

<u>Exhibit No.</u>	<u>Description</u>
3(i)	Certificate of Incorporation and Amendments thereto incorporated herein by reference to Exhibit 3(i) to Registrant's Form 10-Q for the quarter ended May 30, 1998.
3(ii)	Bylaws of the Company as amended to date.
10.1*	Form of Indemnity Agreement between the Company and the directors and executive officers of the Company dated December 4, 2003, incorporated herein by reference to the Company's Form 10-K for the year ended February 28, 2004.
10.2*	The Company's Supplemental Executive Retirement Plan effective May 1, 1986, as amended and restated as of December 5, 2002.
10.3*	The Company's Supplemental Retirement Plan effective September 28, 1995, as amended and restated as of December 5, 2002.
10.4.1*	The Company's Benefit Restoration Plan as amended and restated effective July 1, 1995, incorporated herein by reference to Exhibit 10.5.1 to the Company's Form 10-Q for the quarter ended May 27, 1995.
10.4.2*	Amendment Nos. 1, 2, 3, 4, 5 and 6 to the Company's Benefit Restoration Plan.
10.5.1*	The Company's Management Restricted Stock Plan, effective June 24, 1993, incorporated herein by reference to Exhibit 10.7 to the Company's Form 10-K for the fiscal year ended February 25, 1995.
10.5.2*	Amendment Nos. 1 and 2 to the Company's Management Restricted Stock Plan.
10.6.1*	The Company's 1989 Employee Stock Option Plan, amended and restated as of June 27, 1996.
10.6.2*	Amendment No. 1 to the Company's 1989 Employee Stock Option Plan.
10.7*	The Company's 1989 Non-Employee Director Stock Option Plan, as amended effective June 28, 1989, incorporated herein by reference to Exhibit 10(r) to the Company's Form 10-K for the fiscal year ended March 3, 1990.
10.8*	Form of Post-Employment Consulting Agreement between the Company and its executive officers, incorporated herein by reference to Exhibit 10(r) to the Company's Form 10-K for the fiscal year ended February 29, 1992.
10.9*	The Company's Management Medical and Tax Benefit Plans, incorporated herein by reference to Exhibit 10.18 to the Company's Form 10-K for the fiscal year ended February 26, 1994.
10.10.1	Pooling and Servicing Agreement, dated February 12, 1997, among Pier 1 Imports (U.S.), Inc., Pier 1 Funding, Inc. and Texas Commerce Bank National Association, as Trustee, incorporated herein by reference to Exhibit 10.13 to the Company's Form 10-K for the fiscal year ended March 1, 1997.
10.10.2	Amendments Nos. 1, 2 and 3 to the Pooling and Servicing Agreement, incorporated herein by reference to Exhibit 10.13.2 to the Company's Form 10-K for the fiscal year ended February 28, 1998.
10.10.3	Amendment No. 4 to the Pooling and Servicing Agreement, incorporated herein by reference to Exhibit 10.11.3 to the Company's Form 10-K for the fiscal year ended March 3, 2001.
10.10.4	Amendment No. 5 to the Pooling and Services Agreement dated as of February 12, 1997 by and among Pier 1 Funding, L.L.C., Pier 1 Imports (U.S.), Inc., as servicer, and Wells Fargo Bank Minnesota, National Association as trustee, incorporated herein by reference to Exhibit 10.11.4 to the Company's Form 10-Q for the quarter ended September 1, 2001.

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<u>Exhibit No.</u>	<u>Description</u>
10.11*	Senior Management Bonus Plan restated as amended April 5, 2002, incorporated herein by reference to Appendix B, page B-1, of the Company's Proxy Statement for the fiscal year ended March 2, 2002.
10.12*	The Company's 1999 Stock Plan, as amended and restated as of June 25, 2004, incorporated herein by reference to Appendix C, page B-1, of the Company's Proxy Statement for the fiscal year ended February 28, 2004.
10.13*	Forms of Director and Employee Stock Option Agreements, incorporated herein by reference to Exhibit 10.2 to the Company's Form 10-Q for the quarter ended August 28, 1999.
10.14	Certificate Purchase Agreement among Pier 1 Funding, L.L.C., Pier 1 Imports (U.S.), Inc., the purchasers named therein and Morgan Guaranty Trust Company of New York, as administrative agent, incorporated herein by reference to Exhibit 10.17 to the Company's Form 10-Q for the quarter ended September 1, 2001.
10.15	Repurchase Agreements relating to the cancellation of Series 1997-1 Class A Certificates, incorporated herein by reference to Exhibit 10.18 to the Company's Form 10-Q for the quarter ended September 1, 2001.
10.16	Revolving Credit Agreement, dated August 22, 2003, among the Company, certain of its subsidiaries, Wells Fargo Bank, NA, Bank of America, NA, JPMorgan Chase Bank and others, incorporated herein by reference to Exhibit 10.1 to the Company's Form 10-Q for the quarter ended August 30, 2003.
10.17*	The Company's Stock Purchase Plan, as amended June 25, 2004, incorporated herein by reference to Appendix C, page C-1, of the Company's Proxy Statement for the fiscal year ended February 28, 2004.
10.18*	Employment Agreement between Pier 1 Imports, Inc. and Gregory S. Humenesky, dated February 28, 2005 and incorporated herein by reference to Exhibit 10.1 to the Company's Form 8-K filed March 3, 2005.
13	Annual Report to Shareholders for the fiscal year ended February 26, 2005.
21	Roster of Subsidiaries of the Company.
23	Consent of Independent Registered Public Accounting Firm.
31.1	Certification of the Chief Executive Officer Pursuant to Exchange Act Rule 13a-14(a)/15d-14(a).
31.2	Certification of the Chief Financial Officer Pursuant to Exchange Act Rule 13a-14(a)/15d-14(a).
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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\* Management Contracts and Compensatory Plans

**BYLAWS**  
**OF**  
**PIER 1 IMPORTS, INC.**

**ARTICLE I.**  
**OFFICES**

Section 1. The principal office shall be located in the City of Fort Worth, County of Tarrant, State of Texas.

Section 2. The corporation may also have offices at such other places within or without the State of Delaware as the Board of Directors may from time to time determine, or as the business of the corporation may require.

**ARTICLE II.**  
**MEETINGS OF SHAREHOLDERS**

Section 1. Meetings of the shareholders shall be held at such place within or without the State of Delaware as shall be specified in the notice of the meeting or in a waiver thereof. If no place is specified in such notice or waiver, then meetings may be held at the principal office of the corporation in the State of Texas.

Section 2. An annual meeting of the shareholders, commencing in the year 1987, shall be held on the date designated by the Board of Directors in each year. At such meeting the shareholders entitled to vote thereat shall elect a Board of Directors by a majority vote present in person or represented by proxy, and may transact such other business as may properly be brought before the meeting.

Section 3. Special meetings of the shareholders may be called by the Board of Directors, the Chairman of the Board or the President.

Section 4. Whenever shareholders are required or permitted to take any action at a meeting, a written or printed notice stating the place, date and hour of the meeting and, in the case of a special meeting, the purpose or purposes for which the meeting is called, shall be delivered not less than ten (10) nor more than sixty (60) days before the date of the meeting, either personally or by mail, by or at the direction of the President, the Secretary, or the officer or person calling the meeting, to each shareholder of record entitled to vote at such meeting. If mailed, such notice shall be deemed to be delivered when deposited in the United States mail,

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postage prepaid, and directed to the shareholder at his address as it appears on the stock transfer books of the corporation.

Section 5. Business transacted at any special meeting shall be confined to the purposes stated in the notice thereof.

Section 6. The holders of a majority of the shares entitled to vote, represented in person or by proxy, shall constitute a quorum at meetings of shareholders except as otherwise provided by statute, by the Certificate of Incorporation or these Bylaws. If, however, a quorum shall not be present or represented at any meeting of the shareholders, the shareholders present in person, or represented by proxy, shall have power to adjourn the meeting from time to time, without notice other than announcement at the meeting, until a quorum shall be present and represented. At such adjourned meeting at which a quorum shall be present or represented, any business may be transacted which may have been transacted at the meeting as originally notified. If the adjournment is for more than thirty (30) days, or if after the adjournment a new record date is fixed for the adjourned meeting, a notice of the adjourned meeting shall be given to each shareholder of record entitled to vote at the meeting.

Section 7. The affirmative vote of the holders of a majority of the shares entitled to vote and represented at a meeting at which a quorum is present shall be the act of the shareholders, unless the vote of a greater number is required by statute, by the Certificate of Incorporation or these Bylaws.

Section 8. Each shareholder shall be entitled to one (1) vote of each share of stock held by such shareholder, unless otherwise provided by the Certificate of Incorporation or statute.

Section 9. Each shareholder entitled to vote at a meeting of shareholders or to express consent or dissent to corporate action in writing without a meeting may authorize another person or persons to act for him by proxy, but no such proxy shall be voted or acted upon after eleven (11) months from its date, unless the proxy provides for a longer period. A duly executed proxy shall be irrevocable if it states that it is irrevocable and if, and only as long as, it is coupled with an interest sufficient in law to support an irrevocable power. A proxy may be made irrevocable regardless of whether the interest with which it is coupled is an interest in the stock itself or an interest in the corporation generally.

Section 10. The officer who has charge of the stock transfer books of the corporation shall make, at least ten (10) days before each meeting of shareholders, a complete list of the shareholders entitled to vote at such meeting or any adjournment thereof, arranged in alphabetical order, with the address of and number of shares held by each, which list, for a period of not less than ten (10) days prior to such meeting, shall be open for examination at a place within the city where the meeting is to be held, which place shall be specified in the notice of the meeting, or, if not so specified, at the place where the meeting is to be held, and shall be subject to inspection by any shareholder at any time during ordinary business hours for any purpose germane to the meeting. Such list shall also be produced and kept open at the time and place of the meeting, and shall be subject to the inspection of any shareholder during the whole time of the meeting. The original stock transfer books shall be the only evidence as to who are the shareholders entitled to examine such list or transfer book or to vote in person or by proxy at any meeting of shareholders.

Section 11. Nominations of persons for election to the Board of Directors of the corporation and the proposal of business to be considered by the shareholders may be made at an annual meeting of shareholders pursuant to the corporation's notice of meeting (a) by or at the direction of the Board of Directors or (b) by any shareholder of the corporation who is a shareholder of record at the time of giving of notice provided for in this Section, who shall be entitled to vote for the election of directors at the meeting and who complies with the notice procedures set forth in this Section.

For nominations or other business to be properly brought by a shareholder before an annual meeting, the shareholder must have given timely notice thereof in writing to the Secretary of the corporation, and such business must be a proper subject for shareholder action under the Delaware General Corporation Law. To be timely, a shareholder's notice shall be delivered to the Secretary at the principal executive offices of the corporation not less than 60 days nor more than 90 days prior to the first anniversary of the preceding year's annual meeting; provided, however, that in the event that the date of the annual meeting is advanced by more than 30 days or delayed by more than 60 days from such anniversary date, notice by the shareholder to be timely must be so delivered not earlier than the 90th day prior to such annual meeting and not later than the close of business on the later of 60th day prior to such annual meeting or the 10th day following the day on which public announcement of the date of such meeting is first made; and provided further, however, that in the event that the number of directors to be elected to the Board of Directors of the corporation shall be increased from the number elected at the preceding annual or special meeting and there shall have been no public announcement specifying the size of the increased Board of Directors made by the corporation at least 70 days prior to the first anniversary of the preceding year's annual meeting, a shareholder's notice shall also be considered timely, but only with respect to nominees for any new positions created by such increase, if such notice shall be delivered to the Secretary at the principal executive offices of the corporation not later than the close of business on the 10th day following the day on which such public announcement is first made by the corporation. "Public announcement" as used herein shall mean disclosure in a press release reported by the Dow Jones News Service or comparable national news service or in a document publicly filed by the corporation with the Securities and Exchange Commission pursuant to Section 13, 14 or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). A shareholder's notice shall set forth (i) as to each person whom the shareholder proposes to nominate for election or reelection as a director, all information relating to such person that is required to be disclosed in solicitations of proxies for election of directors, or is otherwise required, in each case pursuant to Regulation 14A under the Exchange Act, including such person's written consent to being named in the proxy statement as a nominee and to serving as a director if elected; (ii) as to any other business that the shareholder proposes to bring before the meeting, a brief description of the business desired to be brought before the meeting, the reasons for conducting such business at the meeting and any interest in such business of such shareholder and the beneficial owner, if any, on whose behalf the proposal is made; and (iii) as to the shareholder giving the notice and the beneficial owner, if any, on whose behalf the nomination or proposal is made (A) the name and address of such shareholder, as they appear on the corporation's books, and of such beneficial owner, and (B) the class and number of shares of the corporation that are owned beneficially and of record by such shareholder and such beneficial owner.

Only such persons who are nominated in accordance with the procedures set forth in this Section shall be eligible for election as directors at any meeting of shareholders. Only such business shall be conducted at a meeting of shareholders as shall have been brought before the meeting in accordance with the procedures set forth in this Section. The chairman of the meeting

shall have the power and duty to determine whether a nomination or any business proposed to be brought before the meeting shall have been made in accordance with the procedures set forth in this Section and, if any proposed nomination or business shall not be in compliance with this Section, to declare that such defective nomination or proposal shall be disregarded.

Notwithstanding the foregoing provisions of this Section, a shareholder shall also comply with all applicable requirements of the Exchange Act and the rules and regulations thereunder with respect to the matters set forth in this Section. Nothing in this Section shall affect any rights or requirements of shareholders regarding the inclusion of proposals in the corporation's proxy statement pursuant to Rule 14a-8 under the Exchange Act.

Section 12. Any action required by statute to be taken at any annual or special meeting of the shareholders, or any action which may be taken at any annual or special meeting of the shareholders, may be taken without a meeting, without prior notice and without a vote, if a consent in writing, setting forth the action so taken, shall be signed by the shareholders having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted. In order that the corporation may determine the shareholders entitled to consent to corporate action in writing without a meeting, the Board of Directors may fix a record date, which record date shall not precede the date upon which the resolution fixing the record date is adopted by the Board of Directors, and which date shall not be more than 10 days after the date the resolution fixing the record date is adopted by the Board of Directors. Any shareholder of record seeking to have the shareholders authorize or take corporate action by written consent shall, by written notice to the Secretary delivered to the corporation's principal office, request the Board of Directors to fix a record date. The Board of Directors shall promptly, but in all events within 10 days after the date on which such a request is received, adopt a resolution fixing the record date. If the Board of Directors shall not have acted within 10 days after the date on which such a request was received, the record date for determining shareholders entitled to consent to corporate action in writing without a meeting, when no prior action by the Board of Directors is required by applicable law, shall be the first date on which a signed written consent setting forth the action taken or proposed to be taken is delivered to the corporation by delivery to its principal office or the registered office in the State of Delaware. Delivery made to the corporation's principal or registered office shall be by hand or by certified or registered mail, return receipt requested. If no record date has been fixed by the Board of Directors and prior action by the Board of Directors is required by applicable law, the record date for determining shareholders entitled to consent to corporate action in writing without a meeting shall be at the close of business on the date on which the Board of Directors adopts the resolution taking such prior action.

### **ARTICLE III.**

#### **DIRECTORS**

Section 1. The number of directors of the corporation shall be not less than three (3) nor more than nine (9), as fixed from time to time by the Board of Directors or the shareholders of this corporation. Directors may be elected by a voice vote or by a show of hands unless a shareholder entitled to vote objects, in which case written ballots shall be used. The directors shall be elected at the annual meeting of the shareholders, except as otherwise provided in these Bylaws, and each director elected shall hold office until his successor is elected and qualified. Directors need not be residents of the State of Delaware or shareholders of the corporation.

Section 2. Any director or the entire Board of Directors may be removed with or without cause by the affirmative vote of the holders of a majority of the shares entitled to vote at an election of directors.

Section 3. Any vacancy occurring in the Board of Directors and newly created directorships resulting from any increase in the authorized number of directors elected by all of the shareholders having the right to vote as a single class may be filled by the affirmative vote of a majority of the directors then in office, although less than a quorum of the Board of Directors, or by a sole remaining director. A director elected to fill a vacancy shall be elected for the unexpired term of his predecessor in office.

Section 4. If at any time, by reason of death or resignation or other cause, a corporation shall have no directors in office, then any officer or any shareholder or an executor, administrator, trustee or guardian of a shareholder, or other fiduciary entrusted with like responsibility for the person or estate of a shareholder, may call a special meeting of shareholders in accordance with the provisions of the Certificate of Incorporation or these Bylaws, or may apply to the Court of Chancery for a decree summarily ordering an election as provided in the Delaware General Corporation Law.

Section 5. If, at the time of filling any vacancy or any newly created directorship, the directors then in office shall constitute less than a majority of the whole Board of Directors (as constituted immediately prior to any such increase), the Court of Chancery may, upon application of any shareholder or shareholders holding at least ten percent (10%) of the total number of the shares at the time outstanding having the right to vote for such directors, summarily order an election to be held to fill any such vacancies or newly created directorships, or to replace the directors chosen by the directors then in office as aforesaid, which election shall be governed by the Delaware General Corporation Law.

Section 6. Unless otherwise provided in the Certificate of Incorporation by these Bylaws, when one (1) or more directors shall resign from the Board of Directors, effective at a future date, a majority of the directors then in office, including those who have so resigned, shall have power to fill such vacancy or vacancies, the vote thereon to take effect when such resignation or resignations shall become effective, and each director so chosen shall hold office for the unexpired term of his predecessor in office.

Section 7. The business and affairs of the corporation shall be managed by or under the direction of its Board of Directors which may exercise all such powers of the corporation and do all such lawful acts and things as are not by statute or by the Certificate of Incorporation or by these Bylaws directed or required to be exercised or done by the shareholders.

Section 8. The Board of Directors may hold its meetings and have an office or offices within or without the State of Delaware.

Section 9. The annual meeting of the Board of Directors for the purpose of electing officers and transacting such other business as may be brought before the meeting shall be held each year immediately following the annual meeting of shareholders. No notice of such meeting shall be necessary in order legally to constitute the meeting, providing a quorum shall be present.

Section 10. Regular meetings of the Board of Directors may be held without notice at such time and at such place as shall from time to time be determined by the Board.

Section 11. Special meetings of the Board of Directors may be called by the Chairman of the Board of Directors or the President, and shall be called by the Secretary on the written request of two (2) directors. Written notice of special meetings of the Board of Directors shall be given to each director at least three (3) days before the date of the meeting. Notice by mail shall be deemed to be given at the time when same shall be mailed, postage prepaid. Notice to directors may also be given by telegram. Neither the business to be transacted at, nor the purpose of, any regular or special meeting of the Board of Directors need be specified in the notice or waiver of notice of such meeting.

Section 12. A majority of the total number of directors shall constitute a quorum for the transaction of business, and the act of the majority of the directors present at a meeting at which a quorum is present shall be the act of the Board of Directors, unless a greater number is required by statute, the Certificate of Incorporation or elsewhere in these Bylaws. If a quorum shall not be present at any meeting of the Board of Directors, the directors present thereat may adjourn the meeting from time to time, without notice other than announcement at the meeting, until a quorum shall be present.

Section 13. No contract or transaction between the corporation and one (1) or more of its directors or officers, or between the corporation and any other corporation, partnership, association or other organization in which one (1) or more of its directors or officers are directors or officers, or have a financial interest, shall be void or voidable solely for this reason, or solely because the director or officer is present at or participates in the meeting of the Board of Directors or committee which authorizes the contract or transaction, or solely because his or their votes are counted for such purpose if such interested director or officer complies with the statutory disclosure requirements. Common or interested directors may be counted in determining the presence of a quorum at a meeting of the Board of Directors or of a committee which authorizes the contract or transaction.

Section 14. The Board of Directors may, by resolution passed by a majority of the Board of Directors, designate one (1) or more committees, each committee to consist of one (1) or more directors. The Board of Directors may designate one (1) or more directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee. In the absence or disqualification of a member of a committee, the member or members present at any meeting and not disqualified from voting, whether or not he or they constitute a quorum, may unanimously appoint another member of the Board of Directors to act at the meeting in the place of any such absent or disqualified member. Any such committee, to the extent provided by the resolution of the Board of Directors, or in these Bylaws, shall have and may exercise all the powers and authority of the Board of Directors in the management of the business and affairs of the corporation, except as otherwise provided by statute.

Section 15. Any action required or permitted to be taken at a meeting of the Board of Directors or any committee may be taken without a meeting if a consent in writing, setting forth the action so taken, is signed by all the members of the Board of Directors or committee, as the case may be, and the writing or writings are filed with the minutes of proceedings of the Board of Directors, or committee.

Section 16. Members of the Board of Directors or any committee may participate in a meeting by means of conference telephone or similar communications equipment by means of

which all persons participating in the meeting can hear each other and participation in such a meeting shall constitute presence in person at the meeting.

Section 17. The Board of Directors shall have the authority to fix the compensation of directors.

#### **ARTICLE IV.**

##### **NOTICES**

Section 1. Whenever any notice is required to be given to any person under the provisions of the statutes or of the Certificate of Incorporation or of these Bylaws, a waiver thereof in writing, signed by the person or persons entitled to such notice, whether before or after the time stated therein shall be equivalent to the giving of such notice.

Section 2. Attendance of a person at a meeting shall constitute a waiver of notice of such meeting, except when a person attends a meeting for the express purpose of objecting at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened.

#### **ARTICLE V.**

##### **OFFICERS**

Section 1. The officers of the corporation shall consist of a President and a Secretary and may include a Chairman of the Board, one or more Vice Presidents and a Treasurer, each of whom shall be elected by the Board of Directors. Any number of offices may be held by the same person unless the Certificate of Incorporation otherwise provides.

Section 2. The officers of the corporation shall be elected by the Board of Directors in such manner and shall hold their offices for such terms as are prescribed herein or determined by the Board of Directors.

Section 3. Such other officers and assistant officers and agents as may be deemed necessary may be elected or appointed by the Board of Directors.

Section 4. Any officer of the corporation may be removed at any time, with or without cause, by the Board of Directors.

Section 5. The salaries of all officers and agents of the corporation shall be fixed by the Board of Directors.

Section 6. Each officer of the corporation shall hold office until his successor is elected and qualified or until his earlier resignation or removal. Any vacancy occurring in any office of the corporation by death, resignation, removal or otherwise shall be filled by the Board of Directors or other governing body.

#### Chairman of the Board

Section 7. The Chairman of the Board, if one has been appointed, shall perform such duties as may be delegated by the Board of Directors. The Board of Directors may designate whether the Chairman of the Board, if such an officer shall have been appointed, or the President, shall be the chief executive officer of the corporation. In the absence of a contrary designation, the President shall be the chief executive officer. The Chairman of the Board, if one has been appointed, or the President shall preside at all meetings of the shareholders and the Board of Directors.

#### President

Section 8. Unless the Board of Directors shall otherwise delegate such duties, the President shall have general and active management of the business of the corporation, and shall see that all orders and resolutions of the Board of Directors are carried into effect. The President shall execute bonds, mortgages and other contracts requiring a seal, under the seal of the corporation, except where required or permitted by law to be otherwise signed and executed, and except where the signing and execution thereof shall be expressly delegated by the Board of Directors to some other officer or agent of the corporation. The President shall have such powers and duties as usually pertain to such office, except as the same may be modified by the Board of Directors.

#### Vice President

Section 9. The Vice Presidents, in the order of their seniority, unless otherwise determined by the Board of Directors, shall, in the absence or disability of the President, perform the duties and exercise the powers of the President. They shall perform such other duties and have such other powers as the Board of Directors may from time to time prescribe or as the President may from time to time delegate.

#### Secretary

Section 10. The Secretary or other officer appointed by the Board of Directors shall attend meetings of the Board of Directors and shareholders, and record all the proceedings of the meetings of the corporation and of the Board of Directors in a book to be kept for that purpose. The Secretary shall give, or cause to be given, notice of all meetings of the shareholders and special meetings of the Board of Directors, and shall perform such other duties as may be prescribed by the Board of Directors or President, under whose supervision he shall be. He shall keep in safe custody the seal of the corporation, and, when authorized by the Board of Directors, affix the same to any instrument requiring it, and, when so affixed, it shall be attested by his signature or by the signature of the Treasurer, an Assistant Secretary, or an Assistant Treasurer.

Section 11. The Assistant Secretaries, in the order of their seniority, unless otherwise determined by the Board of Directors, shall, in the absence or disability of the Secretary, perform the duties and exercise the power of the Secretary. They shall perform such other duties and have such other powers as the Board of Directors may from time to time prescribe or as the President may from time to time delegate.

### Treasurer

Section 12. The Treasurer shall have the custody of the corporate funds and securities, and shall keep full and accurate accounts of receipts and disbursements in books belonging to the corporation, and shall deposit all moneys and other valuable effects in the name and to the credit of the corporation in such depositories as may be designated by the Board of Directors.

Section 13. The Treasurer shall disburse the funds of the corporation as may be ordered by the Board of Directors, taking proper vouchers for such disbursements, and shall render to the President and the Board of Directors at its regular meetings, or when the Board of Directors so requires, an account of all his transactions as Treasurer, and of the financial condition of the corporation. The Treasurer shall perform such other duties and have such other authority and powers as the Board of Directors may from time to time prescribe or as the President may from time to time delegate.

Section 14. If required by the Board of Directors, the Treasurer shall give the corporation a bond in such sum and with such surety or sureties as shall be satisfactory to the Board of Directors for the faithful performance of the duties of his office and for the restoration to the corporation, in case of his death, resignation, retirement or removal from office, of all books, papers, vouchers, money and other property of whatever kind in his possession or under his control belonging to the corporation.

Section 15. The Assistant Treasurers, in the order of their seniority, unless otherwise determined by the Board of Directors, shall, in the absence or disability of the Treasurer, perform the duties and exercise the powers of the Treasurer. They shall perform such other duties and have such other powers as the Board of Directors may from time to time prescribe or the President may from time to time delegate.

## **ARTICLE VI.**

### **CERTIFICATE FOR SHARES**

Section 1. The shares of the corporation shall be represented by certificates, provided that the Board of Directors of the corporation may provide by resolution or resolutions that some or all of any or all classes or series of its stock shall be uncertificated shares. Any such resolution shall not apply to shares represented by a certificate until such certificate is surrendered to the corporation. Notwithstanding the adoption of such a resolution by the Board of Directors, every holder of stock represented by certificates and upon request every holder of uncertificated shares shall be entitled to have a certificate signed by, or in the name of the corporation by the Chairman or Vice Chairman of the Board of Directors, or the President or Vice President, and by the Treasurer or an Assistant Treasurer, or the Secretary or an Assistant Secretary of the corporation representing the number of shares registered in certificate form.

Section 2. Any or all the signatures on the certificate may be a facsimile. In case any officer, transfer agent or registrar who has signed or whose facsimile signature has been placed upon a certificate shall have ceased to be such officer, transfer agent or registrar before such certificate is issued, it may be issued by the corporation with the same effect as if he were such officer, transfer agent or registrar at the date of issue.

Section 3. The corporation may issue a new certificate of stock or uncertificated shares in place of any certificate therefore issued by it, alleged to have been stolen or destroyed, and the corporation may require the owner of the lost, stolen, or destroyed certificate, or his legal representative to give the corporation a bond sufficient to indemnify it against any claim that may be made against it on account of the alleged loss, theft or destruction of any such certificate or the issuance of such new certificate or uncertificated shares.

Section 4. Shares of stock of the corporation shall be transferred only on the books of the corporation upon surrender to the corporation of the certificate or certificates representing the shares to be transferred accompanied by an assignment in writing of such shares properly executed by the shareholder of record of his duly authorized attorney-in-fact and with all taxes on the transfer having been paid. The corporation may refuse any requested transfer until furnished evidence satisfactory to it that such transfer is proper. Upon the surrender of a certificate for transfer of stock, such certificate shall at once be conspicuously marked on its face "Cancelled" and filed with the permanent stock records of the corporation. The Board of Directors may make such additional rules concerning the issuance, transfer and registration of stock and requirements regarding the establishment of lost, destroyed or wrongfully taken stock certificates as it deems appropriate.

Section 5. For the purpose of determining shareholders entitled to notice of or to vote at any meeting of shareholders or any adjournment thereof, or to express consent in writing to corporate action without a meeting, or entitled to receive payment of any dividend or other distribution or allotment of any rights, or entitled to exercise any rights in respect of any change, conversion or exchange of stock, or for the purpose of any other lawful action, the Board of Directors may fix, in advance a record date, which shall not be more than sixty (60) nor less than ten (10) days before the date of such meeting, nor more than sixty (60) days prior to any other action. If no record date is fixed:

(a) The record date for determining shareholders entitled to notice of or to vote at a meeting of shareholders shall be at the close of business on the day next preceding the day on which notice is given, or, if notice is waived, at the close of business on the day next preceding the day on which the meeting is held.

(b) The record date for determining shareholders entitled to express consent to corporate action in writing without a meeting, when no prior action by the Board of Directors is necessary, shall be the day on which the first written consent is expressed.

(c) The record date for determining shareholders for any other purpose shall be at the close of business on the day on which the Board of Directors adopts the resolution relating thereto.

A determination of shareholders of record entitled to notice of or to vote at a meeting of shareholders shall apply to any adjournment of the meeting; provided, however, that the Board of Directors may fix a new record date for the adjourned meeting.

Section 6. The corporation shall be entitled to recognize the exclusive rights of a person registered on its books as the owner of shares to receive dividends, and to vote as such owner, and shall not be bound to recognize any equitable or other claim to or interest in such

share or shares on the part of any other person, whether or not it shall have express or other notice thereof, except as otherwise provided by the laws of the State of Delaware.

Section 7. No shareholder shall have any preemptive right to subscribe to an additional issue of stock or to any security convertible into such stock unless, and except to the extent that, such right is expressly granted in the Certificate of Incorporation.

## **ARTICLE VII.**

### **GENERAL PROVISIONS**

Section 1. The Board of Directors may declare and the corporation may pay dividends upon the shares of its capital stock in cash, property, or shares of the corporation's capital stock pursuant to statute and subject to any restrictions contained in its Certificate of Incorporation. If the dividend is to be paid in shares of the corporation's theretofore unissued capital stock, the Board of Directors shall, by resolution, direct that there be designated as capital in respect of such shares an amount which is not less than the aggregate par value of par value shares being declared as a dividend and, in the case of shares without par value being declared as a dividend, such amount as shall be determined by the Board of Directors. No such designation as capital shall be necessary if shares are being distributed by the corporation pursuant to split-up or division of its stock rather than as payment of a dividend declared payable in stock of the corporation.

Section 2. All checks or demands for money and notes of the corporation shall be signed by such officer or officers or such other person or persons as the Board of Directors may from time to time designate.

Section 3. The fiscal year of the corporation shall be fixed by resolution by the Board of Directors.

Section 4. The corporate seal shall have inscribed thereon the name of the corporation and may be in such form as the Board of Directors may determine, and may be used by causing it or a facsimile thereof to be impressed or affixed or in any other manner reproduced.

Section 5. The corporation shall indemnify to the full extent authorized by law any person made or threatened to be made a party to an action or proceeding, whether criminal, civil, administrative or investigative, by reason of the fact that he, his testator or intestate is or was a director or officer of the corporation or any predecessor of the corporation or serves or served any other enterprise as a director or officer at the request of the corporation or any predecessor of the corporation.

## **ARTICLE VIII.**

### **AMENDMENTS**

The power to alter, amend or repeal the Bylaws of the corporation or adopt new Bylaws shall be vested in the Board of Directors of the corporation.

**EXHIBIT 10.2**

**PIER 1 IMPORTS, INC.**

**SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN**

Effective May 1, 1986

Restated as of December 5, 2002

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**PIER 1 IMPORTS, INC.**

**SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN**

**ARTICLE I —PURPOSE**

The purpose of this Supplemental Executive Retirement Plan (hereinafter referred to as the “Plan”) is to provide supplemental retirement benefits for a select group of management or highly compensated employees of Pier 1 Imports, Inc. It is intended that the Plan will aid in retaining and attracting employees of exceptional ability by providing such individuals with these benefits. This Plan was originally effective as of May 1, 1986. This restatement of the Plan shall only apply with respect to Participants who are actively employed by the Employer after December 5, 2002. The prior provisions of the Plan will continue to apply with respect to Participants who terminated employment with the Employer prior to December 5, 2002.

**ARTICLE II —DEFINITIONS**

For the purposes of this Plan, the following terms shall have the meanings indicated unless the context clearly indicates otherwise:

**2.1 Beneficiary**

“Beneficiary” means the person, persons or entity entitled under Article V to receive Plan benefits after a Participant’s death.

**2.2 Board**

“Board” means the Board of Directors of Pier 1 Imports, Inc.

**2.3 Cause**

“Cause” means that the Participant:

- (a) Has misappropriated, stolen or embezzled funds of the Employer; or
- (b) Has committed an act of deceit, fraud, dereliction of duty, or gross or willful misconduct; or
- (c) Has been convicted of either a felony or a crime involving moral turpitude or entered a plea of *nolo contendere* in response to an indictment for such crime or felony; or
- (d) Has intentionally disclosed confidential information of the Employer except when such disclosure is made pursuant to the direction of the Employer or in accordance with Employer policy; or

(e) Has engaged in competitive behavior against the Employer, has purposely aided a competitor of the Employer or has misappropriated or aided in misappropriating a material opportunity of the Employer.

#### **2.4 Change of Control of the Employer**

“Change of Control of the Employer” shall be deemed to have occurred if:

(a) Any “person” (as defined in Sections 3(a)(9) and 13(d)(3) of the Securities Exchange Act of 1934 (the “Act”)) becomes the “beneficial owner” (as defined in Rules 13(d)-3 and 13(d)-S under the Act) of securities of Pier 1, representing 35% or more of the voting power of the outstanding securities of Pier 1 having the right under ordinary circumstances to vote at an election of the Board of Directors of Pier 1; or

(b) There shall occur a change in the composition of a majority of the Board of Directors within a two (2) year period which change shall not have been affirmatively approved by a majority of the Board of Directors as constituted immediately prior to the commencement of such period; or

(c) At any meeting of the stockholders of Employer called for the purpose of electing directors, a majority of persons nominated by the Board of Directors for election as directors shall fail to be elected.

#### **2.5 Committee**

“Committee” means the Employees Retirement Plan Committee appointed to administer the Employees Retirement Plan for the employees of Pier 1 Imports, Inc. or any successor tax-qualified retirement plan, or any other Committee chosen by the Board.

#### **2.6 Compensation**

“Compensation” for a calendar year means the sum of (i) the rate at which salary is being paid to a Participant as of the last day of that calendar year, (ii) any bonuses actually paid to a Participant during that calendar year excluding bonuses that were first payable during and deferred from a previous calendar year and (iii) any bonuses that were payable to a Participant during that calendar year which were deferred for payment to a subsequent year.

#### **2.7 Deferred Retirement Date**

“Deferred Retirement Date” means the first day of the month coincident with or next following the date that the Participant terminates employment with the Employer after the Participant’s Normal Retirement Date.

#### **2.8 Early Retirement Date**

“Early Retirement Date” means the first day of the month coincidental with or next following the date on which a Participant terminates employment with the Employer, if such

termination date occurs after the Participant's attainment of age fifty-five (55) and completion of ten (10) Years of Plan Participation.

## **2.9 Employer**

"Employer" means any of Pier 1, its subsidiaries, including a trust directly or indirectly owned by Pier 1 and each of their respective successors.

## **2.10 Good Reason**

"Good Reason" means, without the written consent of the Participant:

- (a) A reduction in the Participant's base salary or a reduction in the Participant's benefits received from the Employer (other than in connection with an across-the-board reduction in salaries and/or benefits for similarly situated employees of the Employer or pursuant to the Employer's standard retirement policy), in each case as in effect immediately prior to a Change of Control; or
- (b) The relocation of the Participant's full-time office to a location greater than fifty (50) miles from the Employer's current corporate office; or
- (c) A reduction in the Participant's corporate title as in effect immediately prior to a Change of Control; or
- (d) The failure by the Employer to obtain the assumption of this agreement by any successor as contemplated in this Plan.

## **2.11 Highest Average Compensation**

"Highest Average Compensation" means the sum of the Participant's Compensation for his highest paid three (3) full calendar years of employment with Employer prior to termination of employment (whether or not such years are consecutive) divided by three (3); provided, however, that if the Participant has been employed for less than three (3) full calendar years, the "Highest Average Compensation" shall be determined by using the sum of the Participant's Compensation for his number of completed months of employment divided by the number of his actual completed months of employment multiplied by twelve (12).

## **2.12 Normal Retirement Date**

"Normal Retirement Date" means the first day of the month coincidental with or next following the date on which a Participant attains age sixty-five (65).

## **2.13 Participant**

"Participant" means any individual who is participating or has participated in this Plan pursuant to Article III.

## **2.14 Pier 1**

“Pier 1” means Pier 1 Imports, Inc., a Delaware corporation and its successors.

## **2.15 Retirement**

“Retirement” means separation from employment with the Employer at the Participant’s Normal Retirement Date or Deferred Retirement Date or Early Retirement Date. Retirement shall also mean the date as of which a Participant separates from employment within twenty-four (24) months of a Change of Control of the Employer due to termination of the employment of a Participant without regard to Years of Credited Service unless such separation is:

- (a) By the Employer for Cause; or
- (b) Because of Total and Permanent Disability; or
- (c) Because of the Participant’s death; or
- (d) By the Participant other than:

For Good Reason; or

Upon the Participant’s voluntary separation from employment after his/her Normal Retirement Date, Deferred Retirement Date or Early Retirement Date.

## **2.16 Supplemental Retirement Benefit**

“Supplemental Retirement Benefit” means the benefit determined under Article IV of this Plan.

## **2.17 Termination**

“Termination” means separation from employment with the Employer for any reason other than Retirement, death or Total and Permanent Disability.

## **2.18 Total and Permanent Disability**

“Total and Permanent Disability” means a physical or mental condition which has resulted in the Participant being eligible for benefits under the Employer’s group long-term disability income plan.

## **2.19 Years of Credited Service**

“Years of Credited Service” means the years of credited vesting service with the Employer, determined in accordance with the provisions of The Employees Retirement Plan of the Employer, or any successor tax-qualified retirement plan.

## 2.20 Years of Plan Participation

“Years of Plan Participation” means the total number of full years in which a Participant has participated in the Plan.

## ARTICLE III —PARTICIPATION AND VESTING

### 3.1 Participation

Participation in this Plan shall be limited to those employees of the Employer nominated by the Chief Executive Officer of Pier 1 and approved by the Committee and by the Board, and who elect to participate in this Plan by executing a Participation Agreement in the form designated by the Committee.

### 3.2 Supplemental Retirement Benefit Vesting

(a) Vesting Percentage. Each Participant shall become vested in a Supplemental Retirement Plan Benefit based upon the following schedule:

<b>Years of Credited Service</b>	<b>Vesting Percentage</b>
Less than 1	0%
1 but less than 2	10
2 but less than 3	20
3 but less than 4	30
4 but less than 5	40
5 but less than 6	50
6 but less than 7	60
7 but less than 8	70
8 but less than 9	80
9 but less than 10	90
10 or more	100

(b) Prior Years of Credited Service. For purposes of this Plan, Years of Credited Service earned prior to the May 1, 1986 date of Plan adoption by the Employer shall be limited to five (5),

(c) Conditions for Immediate Vesting. Regardless of a Participant’s actual Years of Credited Service or age, a Participant shall be one hundred percent (100%) vested in a Supplemental Retirement Benefit upon Retirement, termination of employment due to Total and Permanent Disability, or death.

(d) Initial Participants. Notwithstanding anything in this Article to the contrary, any employee of the Employer who becomes a Participant in this Plan within 30 days of the original May 1, 1986 effective date of this Plan shall be at least fifty percent (50%) vested in any Plan Benefits herein upon attaining age fifty-five (55).

#### **ARTICLE IV — SUPPLEMENTAL RETIREMENT BENEFITS**

##### **4.1 Benefit**

Upon separation from employment, a Participant shall receive a Supplemental Retirement Benefit from this Plan which, along with the Participant's benefits from primary Social Security, shall equal approximately fifty percent (50%) of the Participant's Highest Average Compensation. The computation of said Supplemental Retirement Benefit shall be made in accordance with the following provisions of this Article IV.

##### **4.2 Retirement; Disability; Death**

If a Participant separates from employment due to Retirement, Total and Permanent Disability, or death prior to the commencement of benefits under this Plan, the Employer shall pay to the Participant a Supplemental Retirement Benefit calculated as follows:

- (a) Fifty percent (50%) times the Participant's Highest Average Compensation.
- (b) Increase the amount determined in (a) by six percent (6%) compounded annually for fifteen (15) years.
- (c) Sum the annual amounts determined in (b).

(d) The sum of a Participant's primary Social Security benefit determined at the time of and according to the laws in effect at the Participant's Retirement date increased two percent (2%) compounded annually for fifteen (15) years. However, if a Participant separates from employment before the Normal Retirement Date, the primary Social Security benefit shall be determined based upon the primary Social Security benefit the Participant would have received at the Normal Retirement Date based upon the assumption the Participant will receive no future compensation after the date of separation from employment and based upon the relevant Social Security law at the time of separation from employment.

- (e) (c) offset by (d) divided by one hundred eighty (180).

##### **4.3 Adjustments for Deferred Retirement Benefit**

If the Participant separates from employment at a Deferred Retirement Date, the Employer shall pay to the Participant a Supplemental Retirement Benefit as calculated in paragraph 4.2 above, but adjusted as follows:

(a) The percentage of Highest Average Compensation set forth in paragraph 4.2(a) shall be increased by five (5) percentage points for each Year of Credited Service performed past the Participant's Normal Retirement Date, but in no event shall the increase be more than fifteen (15) percentage points;

(b) The calculation of Highest Average Compensation shall not take into consideration any Compensation earned after the Participant attains age 65; and

(c) The Participant shall forfeit twenty percent (20%) of the Supplemental Retirement Benefit otherwise due for each Year of Credited Service performed past the Participant's attained age seventy (70).

#### **4.4 Adjustments for Early Retirement Benefit**

If a Participant separates from employment at an Early Retirement Date but before his Normal Retirement Date, the Employer shall pay to the Participant a Supplemental Retirement Benefit as calculated under Section 4.2 above except:

(a) The sum amount described in subsection 4.2(c) shall be reduced by five-twelfths percent (5/12%) for each full calendar month by which the Participant's Early Retirement Date precedes the Participant's attainment of age sixty-five (65); and

(b) The offset required by subsection 4.2(d) shall be determined using the Social Security Act in effect at Early Retirement Date and assuming zero (0) future earnings from the Participant's Early Retirement Date to his attainment of age sixty-five (65).

#### **4.5 Termination**

If a Participant separates from employment due to Termination, the Employer shall pay to the Participant the Supplemental Retirement Benefit calculated under paragraph 4.2 above, multiplied by the vesting percentage of benefit as provided in paragraph 3.2 above.

#### **4.6 Form of Benefit Payment**

Effective as of December 20, 1991, each Participant shall, upon becoming a Participant, irrevocably elect in writing that his or her benefits under this Plan be paid in one of the following forms:

(a) Equal monthly installments paid over a period of one hundred eighty (180) months;

(b) A lump sum;

(c) An annuity for the life of the Participant; or

(d) A joint and survivor annuity over the lives of Participant and the Participant's Beneficiary.

Those individuals who are already Participants on December 20, 1991, but who are not yet receiving benefits under this Plan, shall within ten (10) days after such date irrevocably elect in writing one of the foregoing forms for the payment of his or her benefits under this Plan. The forms of payment specified in subparagraphs (b), (c) and (d) above shall be the actuarial and financial equivalents of the form of payment specified in subparagraph (a) above.

For purposes of determining actuarial equivalence, the benefits referred to in subparagraphs (b), (c) and (d) above shall be discounted at a rate equal to the lesser of (i) the Pension Benefit Guaranty Corporation interest rate for immediate annuities, as published in Appendix B to Part 2619 of Title 29 of the Code of Federal Regulations, or any successor or replacement rate (the "PBGC rate") in effect on January 1 of each year; or (ii) a twenty-four (24) month rolling average of the PBGC rate, using the current rate as of the beginning of the month in which the calculation is made and the twenty-three (23) previous months.

Beginning January 1, 1996, the vested, accrued benefit shall be calculated as of January 1 of each year for each Participant, and in no event shall the vested, accrued benefit be less than such benefit calculated for a previous year. For example, if a Participant has elected a lump-sum benefit and the lump-sum benefit as of January 1, 1996 is \$750,000 but, due to an increase in the discount rate, drops to \$700,000 as of January 1, 1997, the Participant's vested, accrued lump-sum benefit as of January 1, 1997 would be \$750,000.

#### **4.7 Withholding; Payroll Taxes**

To the extent required by the law in effect at the time payments are made, the Employer shall withhold from payments made hereunder any taxes required to be withheld from a Participant's wages by the federal, state or local government.

#### **4.8 Payments**

Any benefit due under this Article shall be paid as set forth below:

- (a) Supplemental Retirement Benefits due as a result of a Participant's Retirement shall be paid within thirty (30) days of the earlier of the date of such Retirement or death;
- (b) Supplemental Retirement Benefits due as a result of Termination or Total and Permanent Disability shall be paid within thirty (30) days of the earlier of the Participant's attaining age sixty-five (65) or death;
- (c) Supplemental Retirement Benefits due as a result of death shall be paid within thirty (30) days of the death of the Participant.

#### **4.9 Payment to Guardian**

If a Plan benefit is payable to a minor or a person declared incompetent or to a person incapable of handling the disposition of property, the Committee may direct payment of such Plan benefit to the guardian, legal representative or person having the care and custody of such minor, incompetent or person. The Committee may require proof of incompetency, minority,

incapacity or guardianship as it may deem appropriate prior to distribution of the Plan benefit. Such distribution shall completely discharge the Committee and Employer from all liability with respect to such benefit.

#### **4.10 Major Medical and Hospitalization Insurance Coverage**

If a Participant separates from employment by reason of Retirement or Total and Permanent Disability, such Participant (for himself and his dependents) shall have the right to medical benefit coverage to be provided by the Employer until the death of the Participant; provided, however, that if the Participant is survived by a spouse, such spouse shall have the right to continued medical coverage for a period of thirty-six months from the Employer on the same basis as the Participant would have had if he had survived. Such coverage shall be comparable to the Employer-provided major medical and hospitalization insurance coverage, if any, made available generally to the Employer's active employees and their dependents. Such coverage will only be provided if the Participant pays, or reimburses the Employer for, a portion of the total premium for such major medical coverage equal to the amount such Participant would have been required to pay or reimburse the Employer had he been covered as an active employee of the Employer. Premium payments or reimbursements required to be paid by a Participant pursuant to this Section 4.10 shall be made by the Participant at such times and in such form as the Employer shall establish pursuant to reasonable payment methods.

If a Participant separates from employment for any reason other than Retirement or Total and Permanent Disability, such Participant (for the Participant and the Participant's dependents) shall have the right to participate, during the fifteen (15) years immediately after the date such Participant attains age sixty-five (65), in the Employer-provided major medical coverage, if any, made available generally to the Employer's active employees and their dependents; provided, however, that such Participant pays, or reimburses the Employer for, the total premium (i.e., Employer and employee portions) for such major medical coverage at such times as the Employer's active employees pay their respective contributions for such major medical coverage.

### **ARTICLE V—BENEFICIARY DESIGNATION**

#### **5.1 Beneficiary Designation**

Each Participant shall have the right, at any time, to designate any person or persons as his Beneficiary or Beneficiaries (both primary and contingent) to whom payment under this Plan shall be paid in the event of death prior to complete distribution to the Participant of the benefits due under the Plan. Each Beneficiary designation shall be in a written form prescribed by the Committee and will be effective only when filed with the Committee during the Participant's lifetime. If a Participant's Compensation is community property, any Beneficiary designation shall be valid or effective only as permitted under applicable law.

#### **5.2 Amendments**

Any Beneficiary designation may be changed by a Participant without the consent of any designated Beneficiary by the filing of a new Beneficiary designation with the Committee. The

filing of a new Beneficiary designation form will cancel all Beneficiary designations previously filed.

### **5.3 No Beneficiary Designation**

If any Participant fails to designate a Beneficiary in the manner provided above, or if the Beneficiary designated by a deceased Participant predeceases the Participant, the Committee, in its discretion, shall direct the Employer to distribute such Participant's benefits (or the balance thereof) as follows:

- (a) To the Participant's surviving spouse, if any; or
- (b) If the Participant shall have no surviving spouse, then to the Participant's children in equal shares, by right of representation; or
- (c) If the Participant shall have no surviving spouse or children, then to the Participant's estate.

### **5.4 Effect of Payment**

Payment to the Beneficiary shall completely discharge Employer's obligations under this Plan.

### **5.5 Death of Beneficiary**

Following commencement of payment of Plan benefits, if the Beneficiary designated by a deceased Participant dies before receiving complete distribution of the benefits, the Committee shall direct the Employer to distribute the balance of such benefits:

- (a) As designated by the Beneficiary in accordance with the provisions in paragraph 5.1 above; or
- (b) If the Beneficiary shall not have made such designation, then to the Beneficiary's estate.

## **ARTICLE VI—ADMINISTRATION**

### **6.1 Committee; Duties**

This Plan shall be administered by the Committee. Members of the Committee may be Participants under this Plan.

### **6.2 Agents**

The Committee may appoint an individual to be the Committee's agent with respect to the day-to-day administration of the Plan. In addition, the Committee may, from time to time, employ other agents and delegate to them such administrative duties as it sees fit, and may from time to time consult with counsel who may be counsel to the Employer.

### **6.3 Binding Effect of Decisions**

The decision or action of the Committee with respect to any question arising out of or in connection with the administration, interpretation and application of the Plan and the rules and regulations promulgated hereunder shall be final and binding upon all persons having any interest in the Plan.

### **6.4 Indemnity of Committee**

The Company shall indemnify and hold harmless the members of the Committee against any and all claims, loss, damage, expense or liability arising from any action or failure to act with respect to this Plan, except in the case of gross negligence or willful misconduct by the Committee.

## **ARTICLE VII —CLAIMS PROCEDURES**

### **7.1 Claim**

Any person claiming a benefit, requesting an interpretation or ruling under the Plan, or requesting information under the Plan shall present the request in writing to the Committee which shall respond in writing as soon as practicable.

### **7.2 Denial of Claim**

If the claim or request is denied, the written notice of denial shall be made within ninety (90) days of the date of receipt of such claim or request by the Committee and shall state:

- (a) The reason for denial, with specific reference to the Plan provisions on which the denial is based.
- (b) A description of any additional material or information required and an explanation of why it is necessary.
- (c) An explanation of the Plan's claims review procedure.

### **7.3 Review of Claim**

Any person whose claim or request is denied or who has not received a response within ninety (90) days may request review by notice given in writing to the Committee within sixty (60) days of receiving a response or one hundred fifty (150) days from the date the claim was received by the Committee. The claim or request shall be reviewed by the Committee who may, but shall not be required to, grant the claimant a hearing. On review, the claimant may have representation, examine pertinent documents, and submit issues and comments in writing.

### **7.4 Final Decision**

The decision on review shall normally be made within sixty (60) days after the Committee's receipt of a request for review. If an extension of time is required for a hearing or

other special circumstances, the claimant shall be notified and the time shall be one hundred twenty (120) days after the Committee's receipt of a request for review. The decision shall be in writing and shall state the reason and the relevant Plan provisions. All decisions on review shall be final and bind all parties concerned.

## **ARTICLE VIII—TERMINATION, SUSPENSION OR AMENDMENT**

### **8.1 Amendment or Termination**

The Board may, in its sole discretion, amend or terminate this Plan at any time, in whole or in part; provided, however, that no such amendment or termination shall adversely affect the benefits of Participants which have vested in accordance with paragraph 3.2 above prior to such action, the benefits of any Participant who has previously retired, or the benefits of any Beneficiary of a Participant who has died; provided further, however, that the amendment or termination of this Plan shall not alter in any manner the timing or form of benefit payments under this Plan.

### **8.2 Successor Employer**

The provisions of this Plan shall be binding upon and inure to the benefit of any successor or assign of the Employer. If a successor Employer amends or terminates this Plan, no such amendment or termination shall adversely affect the benefits of Participants which have vested in accordance with paragraph 3.2 above prior to such action, the benefits of any Participant who has previously retired, or the benefits of any Beneficiary of a Participant who has previously died.

## **ARTICLE IX—MISCELLANEOUS**

### **9.1 Unsecured General Creditor**

Benefits to be provided under this Plan are unfunded obligations of the Employer. Participants and their Beneficiaries, heirs, successors, and assigns shall have no secured interest or claim in any property or assets of Employer, nor shall they be Beneficiaries of, or have any rights, claims or interests in any life insurance policies, annuity contracts or the proceeds therefrom owned or which may be acquired by Employer ("Policies"). Except as provided in paragraph 9.2, such Policies or other assets of Employer shall not be held under any trust for the benefit of Participants, their Beneficiaries, heirs, successors or assigns, or be considered in any way as collateral security for the fulfilling of the obligations of Employer under this Plan.

### **9.2 Trust Fund**

Employer shall be responsible for the payment of all benefits provided under the Plan. At its discretion, Employer may establish one (1) or more trusts, with such trustees as the Board may approve, for the purpose of providing for the payment of such benefits. Although such a trust shall be irrevocable, its assets shall be held for payment of all Employer's general creditors in the event of insolvency. To the extent any benefits provided under the Plan are paid from any

such trust, Employer shall have no further obligation to pay them. If not paid from the trust, such benefits shall remain the obligation of Employer.

### **9.3 Nonassignability**

Neither a Participant nor any other person shall have any right to commute, sell, assign, transfer, pledge, anticipate, mortgage or otherwise encumber, hypothecate or convey in advance of actual receipt the amounts, if any, payable hereunder, or any part thereof. No part of the amounts payable shall, prior to actual payment, be subject to seizure or sequestration for the payment of any debts, judgments, alimony or separate maintenance owed by a Participant or any other person, nor be transferable by operation of law in the event of a Participant's or any other person's bankruptcy or insolvency.

### **9.4 Not a Contract of Employment**

The terms and conditions of this Plan shall not be deemed to constitute a contract of employment between Employer and the Participant, and the Participant (or his Beneficiary) shall have no rights against the Employer except as may otherwise be specifically provided herein. Moreover, nothing in this Plan shall be deemed to give a Participant the right to be retained in the service of Employer or to interfere with the right of Employer to discipline or discharge him at any time.

### **9.5 Suicide**

Notwithstanding the provisions of Article IV, no benefit shall be paid to a Beneficiary if the Participant's death occurs as a result of suicide during the twelve (12) successive calendar months beginning with the calendar month following the commencement of an individual's participation in this Plan.

### **9.6 Participant's Cooperation**

A Participant will cooperate with Employer by furnishing any and all information requested by Employer in order to facilitate the payment of benefits hereunder, and by taking such physical examinations and such other action as may be requested by Employer.

### **9.7 Terms**

Whenever any words are used herein in the masculine, they shall be construed as though they were used in the feminine in all cases where they would so apply; and wherever any words are used herein in the singular or in the plural, they shall be construed as though they were used in the plural or the singular, as the case may be, in all cases where they would so apply.

### **9.8 Captions**

The captions of the articles, sections and paragraphs of this Plan are for convenience only and shall not control or affect the meaning or construction of any of its provisions.

**9.9 Governing Law**

The provisions of this Plan shall be construed and interpreted according to the laws of the State of Delaware.

**9.10 Validity**

In case any provision of this Plan shall be illegal or invalid for any reason, said illegality or invalidity shall not affect the remaining parts hereof, but this Plan shall be construed and enforced as if such illegal and invalid provision had never been inserted herein.

**9.11 Successors**

The provisions of this Plan shall bind and inure to the benefit of Employer and its successors and assigns. The term successors as used herein shall include any corporate or other business entity which shall, whether by merger, consolidation, purchase or otherwise acquire all or substantially all of the business and assets of Employer, and successors of any such corporation or other business entity.

**9.12 Notice**

Any notice or filing required or permitted to be given to the Committee under the Plan shall be sufficient if in writing and hand delivered, or sent by registered or certified mail, to any member of the Committee, the President of the Employer, or the Employer's Statutory Agent. Such notice shall be deemed given as of the date of delivery or, if delivery is made by mail, as of three (3) days following the date shown on the postmark or on the receipt for registration or certification.

**PIER 1 IMPORTS, INC.**

By:

\_\_\_\_\_

E. Mitchell Weatherly  
Executive Vice President – Human Resources

**EXHIBIT 10.3**

**PIER 1 IMPORTS, INC.**

**SUPPLEMENTAL RETIREMENT PLAN**

Effective September 28, 1995  
Restated as of December 5, 2002

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**PIER 1 IMPORTS, INC.**

**SUPPLEMENTAL RETIREMENT PLAN**

**ARTICLE I — PURPOSE**

The purpose of this Supplemental Retirement Plan (hereinafter referred to as the “Plan”) is to provide supplemental retirement benefits for a select group of management or highly compensated employees of Pier 1 imports, Inc. It is intended that the Plan will aid in retaining and attracting employees of exceptional ability by providing such individuals with these benefits. This Plan was originally effective as of September 28, 1995. This restatement of the Plan is effective as of December 5, 2002. This restatement of the Plan shall only apply with respect to Participants who are actively employed by the Employer after December 5, 2002. The prior provisions of the Plan will continue to apply with respect to Participants who terminated employment with the Employer prior to December 5, 2002.

**ARTICLE II — DEFINITIONS**

For the purposes of this Plan, the following terms shall have the meanings indicated unless the context clearly indicates otherwise:

**2.1 Actuarial Equivalent**

“Actuarial Equivalent” means equivalence in value between two (2) or more forms and/or times of payment based on the mortality table prescribed by the Secretary of the Treasury or his delegate in accordance with Internal Revenue Code Section 412(l)(7)(C)(ii), and an interest rate equal to the twenty-four (24) month rolling average of the Pension Benefit Guaranty Corporation interest rate for immediate annuities, as published in Appendix B to Part 2619 of Title 29 of the Code of Federal Regulations, or any successor or replacement rate (the “PBG rate”), using the current rate as of the beginning of the month in which the calculation is made and the twenty-three (23) previous months.

**2.2 Beneficiary**

“Beneficiary” means the person, persons or entity entitled under Article V to receive Plan benefits after a Participant’s death.

**2.3 Board**

“Board” means the Board of Directors of Pier 1 Imports, Inc.

**2.4 Cause**

“Cause” means that the Participant:

- (a) Misappropriated, stolen or embezzled funds of the Employer; or

(b) Committed an act of deceit, fraud, or willful misconduct or otherwise acted in bad faith, adverse to the best interests of the Employer.

## **2.5 Change of Control of the Employer**

“Change of Control of the Employer” shall be deemed to have occurred if:

(a) Any “person” as defined in Sections 3(a)(9) and 13(d)(3) of the Securities Exchange Act of 1934 (the “Act”) becomes the “beneficial owner” (as defined in Rules 13(d)-3 and 13(d)-5 under the Act) of securities of Pier 1, representing 35% or more of the voting power of the outstanding securities of Pier 1 having the right under ordinary circumstances to vote at an election of the Board of Directors of Pier 1; or

(b) There shall occur a change in the composition of a majority of the Board of Directors within a two (2) year period which change shall not have been affirmatively approved by a majority of the Board of Directors as constituted immediately prior to the commencement of such period; or

(c) At any meeting of the stockholders of Employer called for the purpose of electing directors, a majority of persons nominated by the Board of Directors for election as directors shall fail to be elected.

## **2.6 Committee**

“Committee” means the Employees Retirement Plan Committee appointed to administer the Employees Retirement Plan for the employees of Pier 1 Imports, Inc. or any successor tax-qualified retirement plan, or any other Committee chosen by the Board.

## **2.7 Compensation**

“Compensation” for a calendar year means the sum of (i) the rate at which salary is being paid to a Participant as of the last day of that calendar year, (ii) any bonuses actually paid to a Participant during that calendar year excluding bonuses that were first payable during and deferred from a previous calendar year and (iii) any bonuses that were payable to a Participant during that calendar year which were deferred for payment to a subsequent year.

## **2.8 Early Retirement Date**

“Early Retirement Date” means the first day of the month coincidental with or next following the date on which a Participant terminates employment with Employer, if such termination date occurs on or after such Participant’s attainment of age fifty-five (55) and completion of ten (10) Years of Plan Participation.

## **2.9 Employer**

“Employer” means any of Pier 1, its subsidiaries, including a business trust directly or indirectly wholly owned by Pier 1 and their respective successors.

## **2.10 Good Reason**

“Good Reason” means, without the written consent of the Participant:

- (a) A reduction in the Participant’s base salary or a reduction in the Participant’s benefits received from the Employer (other than in connection with an across-the-board reduction in salaries and/or benefits for similarly situated employees of the Employer or pursuant to the Employer’s standard retirement policy), in each case as in effect immediately prior to a Change of Control; or
- (b) The relocation of the Participant’s full-time office to a location greater than fifty (50) miles from the Employer’s current corporate office; or
- (c) A reduction in the Participant’s corporate title as in effect immediately prior to a Change of Control; or
- (d) The failure by the Employer to obtain the assumption of this agreement by any successor as contemplated in this Plan

## **2.11 Highest Average Compensation**

“Highest Average Compensation” means the sum of the Participant’s Compensation for his highest paid three (3) full calendar years of employment with Employer prior to termination of employment (whether or not such years are consecutive) divided by three (3); provided, however, that if the Participant has been employed for less than three (3) full calendar years, the “Highest Average Compensation” shall be determined by using the sum of the Participant’s Compensation for his number of completed months of employment divided by the number of his actual completed months of employment multiplied by twelve (12).

## **2.12 Normal Retirement Date**

“Normal Retirement Date” means the first day of the month coincidental with or next following the date on which a Participant terminates employment with Employer, if such termination date occurs on or after such Participant’s attainment of age sixty-five (65).

## **2.13 Participant**

“Participant” means any individual who is participating or has participated in this Plan pursuant to Article III.

## **2.14 Pier 1**

“Pier 1” means Pier 1 Imports, Inc., a Delaware corporation and its successors.

## **2.15 Retirement**

“Retirement” means separation from employment with the Employer at the Participant’s Normal Retirement Date or Early Retirement Date. Retirement shall also mean the date as of

which a Participant separates from employment within twenty-four (24) months of a Change of Control of the Employer due to termination of the employment of a Participant without regard to Years of Credited Service unless such separation is:

- (a) By the Employer for Cause; or
- (b) Because of Total and Permanent Disability; or
- (c) Because of the Participant's death; or
- (d) By the Participant other than:  
For Good Reason; or

Upon the Participant's voluntary separation from employment after his/her Normal Retirement Date or Early Retirement Date.

## **2.16 Supplemental Retirement Benefit**

"Supplemental Retirement Benefit" means the benefit determined under Article IV of this Plan.

## **2.17 Target Amount**

"Target Amount" means sixty percent (60%) of Highest Average Compensation multiplied by a fraction, the numerator of which is the Participant's actual Years of Credited Service, not to exceed twenty (20), and the denominator of which is twenty (20).

## **2.18 Termination**

"Termination" means separation from employment with the Employer for any reason other than Retirement, death or Total and Permanent Disability.

## **2.19 Total and Permanent Disability**

"Total and Permanent Disability" means a physical or mental condition which has resulted in the Participant being eligible for benefits under the Employer's group long-term disability income plan.

## **2.20 Years of Credited Service**

"Years of Credited Service" means the years of credited vesting service with the Employer, determined in accordance with the provisions of The Employees Retirement Plan of the Employer, or any successor tax-qualified retirement plan.

## 2.21 Years of Plan Participation

“Years of Plan Participation” means the total number of full years in which a Participant has participated in the Plan.

## ARTICLE III — PARTICIPATION AND VESTING

### 3.1 Participation

Participation in this Plan shall be limited to those employees of the Employer nominated by the Chief Executive Officer of Pier 1 and approved by the Committee and by the Board, and who elect to participate in this Plan by executing a Participation Agreement in the form designated by the Committee.

### 3.2 Supplemental Retirement Benefit Vesting

(a) Vesting Percentage. Each Participant shall become vested in a Supplemental Retirement Benefit based upon Years of Plan Participation under the following schedule:

Years of Plan Participation	Vesting Percentage
Less than 1	0%
1 but less than 2	10
2 but less than 3	20
3 but less than 4	30
4 but less than 5	40
5 but less than 6	50
6 but less than 7	60
7 but less than 8	70
8 but less than 9	80
9 but less than 10	90
10 or more	100

(b) Conditions for Immediate Vesting. Regardless of a Participant’s actual Years of Plan Participation, a Participant shall be one hundred percent (100%) vested in a Supplemental Retirement Benefit upon Retirement, Retirement based on a Change of Control of the Employer, termination of employment due to Total and Permanent Disability, or death.

## ARTICLE IV — SUPPLEMENTAL RETIREMENT BENEFITS

### 4.1 Benefit

Upon separation from employment, a Participant shall receive a Supplemental Retirement Benefit from this Plan which, along with the Participant's benefits from primary Social Security, shall equal approximately sixty percent (60%) of the Participant's Highest Average Compensation. The computation of said Supplemental Retirement Benefit shall be made in accordance with the provisions of Articles IV and V, as applicable, but in no event shall the amount of the Supplemental Retirement Benefit paid annually to any Participant exceed five hundred thousand dollars (\$500,000). Notwithstanding the above, a Participant who is terminated for Cause shall forfeit any right to receive benefits under the Plan.

### 4.2 Normal Retirement Benefit

If a Participant retires at a Normal Retirement Date, Employer shall pay to the Participant a monthly Supplemental Retirement Benefit from this Plan equal to one-twelfth (1/12th) of the following annual amounts:

- (a) The Target Amount; less
- (b) The Participant's primary Social Security benefit payable at Retirement.

### 4.3 Early Retirement Benefit

If a Participant retires at an Early Retirement Date but before his Normal Retirement Date, Employer shall pay to the Participant the monthly Supplemental Retirement Benefit calculated under Section 4.2 above except:

- (a) The Target Amount shall be reduced by five-twelfths percent (5/12%) for each full calendar month by which the Participant's Early Retirement Date precedes the Participant's attainment of age sixty-five (65); and
- (b) The offset required by Subsection 4.2(b) shall be determined using the Social Security Act in effect at Early Retirement Date and assuming zero (0) future earnings from the Participant's Early Retirement Date to the Participant's attainment of age sixty-five (65).

### 4.4 Change of Control Benefit

If a Participant retires as a result of a Change of Control of the Employer, Employer shall pay to the Participant the monthly Supplemental Retirement Benefit calculated under Section 4.2 above except the offset required by Subsection 4.2(b) shall be determined using the Social Security Act in effect at the date of Retirement due to a Change of Control and assuming zero (0) future earnings from the Participant's Retirement date to the Participant's attainment of age sixty-five (65).

#### **4.5 Disability Retirement Benefit**

If a Participant separates from employment with Employer due to Total and Permanent Disability, Employer shall pay to the Participant the monthly Supplemental Retirement Benefit calculated under Section 4.2 or 4.3, as applicable, except that Years of Credited Service shall continue to accrue from the separation date to the Normal Retirement Date, or Early Retirement Date, as the case may be.

#### **4.6 Termination Benefit**

If a Participant terminates employment with Employer prior to Retirement, death or Total and Permanent Disability, Employer shall pay to the Participant the monthly Supplemental Retirement Benefit calculated under Section 4.2 above except:

- (a) The offset required by Subsection 4.2(b) shall be determined using the Social Security Act in effect at Termination and assuming level earnings to the Participant's attainment of age sixty-five (65); and
- (b) The benefit shall be multiplied by the vesting percentage provided in Section 3.2 above.

#### **4.7 Form of Benefit Payment**

The Supplemental Retirement Benefit determined under Article IV shall be paid in the basic form provided below unless the Participant elects an alternative form in the form of payment designation. Any alternative form shall be the Actuarial Equivalent of the basic form of benefit payment. The basic and alternative forms of payments are as follows:

- (a) Basic Form of Benefit Payment. A monthly single life annuity for the Participant's life.
- (b) Alternative Forms of Benefit Payment.
  - (i) A monthly joint and survivor annuity with payment continued to the survivor at one hundred percent (100%); or
  - (ii) A monthly joint and survivor annuity with payment continued to the survivor at fifty percent (50%) of the amount paid to the Participant.

Notwithstanding the above, whenever the lump sum equivalent of the benefit is \$25,000 or less, the benefit shall be paid in a lump sum.

#### **4.8 Commencement of Payments**

Benefits payable to a Participant under Sections 4.2, 4.3, 4.4 and 4.5 shall commence as soon as practicable after the appropriate application for benefits has been made but not later than sixty (60) days after all information necessary to calculate the benefit amount has been received by Employer. Benefits payable to a Participant under Section 4.6 as a result of Termination shall

commence on the first day of the month coincidental with or next following the date on which the Participant attains age sixty-five (65). All payments shall be made as of the first day of the month.

#### **4.9 Withholding; Payroll Taxes**

To the extent required by the law in effect at the time payments are made, the Employer shall withhold from payments made hereunder any taxes required to be withheld from a Participant's wages by the federal, state or local government.

#### **4.10 Payment to Guardian**

If a Plan benefit is payable to a minor or a person declared incompetent or to a person incapable of handling the disposition of property, the Committee may direct payment of such Plan benefit to the guardian, legal representative or person having the care and custody of such minor, incompetent or person. The Committee may require proof of incompetence, minority, incapacity or guardianship as it may deem appropriate prior to distribution of the Plan benefit. Such distribution shall completely discharge the Committee and Employer from all liability with respect to such benefit.

#### **4.11 Major Medical and Hospitalization Insurance Coverage**

If a Participant separates from employment by reason of Retirement or Total and Permanent Disability, such Participant (for himself and his dependents) shall have the right to medical benefit coverage to be provided by the Employer until the death of the Participant provided; however, that if the Participant is survived by a spouse, such spouse shall have the right to continued medical coverage for a period of thirty-six months from the Employer on the same basis as the Participant would have had if he had survived. Such coverage shall be comparable to the Employer-provided major medical and hospitalization insurance coverage, if any, made available generally to the Employer's active employees and their dependents. Such coverage will only be provided if the Participant pays, or reimburses the Employer for, a portion of the premium for such major medical coverage equal to the amount such Participant would have been required to pay or reimburse the Employer had he been covered as an active employee of the Employer. Premium payments or reimbursements required to be paid by a Participant pursuant to this Section 4.11 shall be made by the Participant at such times and in such form as the Employer shall establish pursuant to reasonable payment methods.

If a Participant separates from employment for any reason other than Retirement or Total and Permanent Disability, such Participant (for the Participant and the Participant's dependents) shall have the right to participate, during the fifteen (15) years immediately after the date such Participant attains age sixty-five (65), in the Employer-provided major medical coverage, if any, made available generally to the Employer's active employees and their dependents; provided, however, that such Participant pays, or reimburses the Employer for, the total premium (i.e., Employer and employee portions) for such major medical coverage at such times as the Employer's active employees pay their respective contributions for such major medical coverage.

## ARTICLE V — SURVIVOR BENEFITS

### 5.1 Death Prior to Commencement of Benefits

(a) Death at or After Age 55. If a Participant dies after becoming eligible for Retirement at an Early Retirement Date but prior to Retirement, Employer shall pay a survivor benefit to the Participant's Beneficiary equal to the Retirement benefit that would have been provided had the Participant retired on the day before the Participant's death with a fifty percent (50%) joint and survivor annuity form.

(b) Death Prior to Age 55. If a Participant dies prior to the Early Retirement Date, Employer shall pay a survivor benefit to the Participant's Beneficiary equal to the Termination benefit that would have been provided had the Participant elected a fifty percent (50%) joint and survivor annuity form.

(c) Time of Payment. Any benefits payable to a Beneficiary under this section shall commence as soon as practicable after the appropriate application for benefits has been made but not later than sixty (60) days after all information necessary to calculate the benefit amount has been received by Employer. All payments shall be made as of the first day of the month.

### 5.2 Death After Commencement of Benefits

If a Participant dies after benefit payments have commenced under Article IV, a survivor benefit shall be paid to the Participant's Beneficiary only if, and to the extent, provided for by the form of payment under which the Participant was receiving a Supplemental Retirement Benefit, pursuant to Section 4.7.

### 5.3 Suicide; Misrepresentation

No benefit shall be paid to a surviving spouse if the Participant's death occurs as a result of suicide during the twelve (12) calendar months beginning with the calendar month following commencement of participation in this Plan. The Committee may deny payment if death occurs within twelve (12) months beginning with the calendar month following commencement of participation in this Plan if the Participant has made a material misrepresentation in any form or document provided by the Participant to or for the benefit of Employer.

### 5.4 Effect of Payment

Payment to the surviving spouse shall completely discharge Employer's obligations under this Plan.

## ARTICLE VI — BENEFICIARY DESIGNATION

### 6.1 Death of Beneficiary

Each Participant shall have the right, at any time, to designate any person or persons as his Beneficiary or Beneficiaries (both primary and contingent) to whom payment under this Plan shall be paid in the event of death prior to complete distribution to the Participant of the benefits due under the Plan. Each Beneficiary designation shall be in a written form prescribed by the Committee and will be effective only when filed with the Committee during the Participant's lifetime. If a Participant's Compensation is community property, any Beneficiary designation shall be valid or effective only as permitted under applicable law.

### 6.2 Amendments

Any Beneficiary designation may be changed by a Participant without the consent of any designated Beneficiary by the filing of a new Beneficiary designation with the Committee. The filing of a new Beneficiary designation form will cancel all Beneficiary designations previously filed.

### 6.3 No Beneficiary Designation

If any Participant fails to designate a Beneficiary in the manner provided above, or if the Beneficiary designated by a deceased Participant predeceases the Participant, the Committee, in its discretion, shall direct the Employer to distribute such Participant's benefits (or the balance thereof) as follows:

- (a) To the Participant's surviving spouse, if any; or
- (b) If the Participant shall have no surviving spouse, then to the Participants children in equal shares, by right of representation; or
- (c) If the Participant shall have no surviving spouse or children, then to the Participants estate.

### 6.4 Effect of Payment

Payment to the Beneficiary shall completely discharge Employer's obligations under this Plan.

### 6.5 Death of Beneficiary

Following commencement of payment of Plan benefits, if the Beneficiary designated by a deceased Participant dies before receiving complete distribution of the benefits, the Committee shall direct the Employer to distribute the balance of such benefits:

- (a) As designated by the Beneficiary in accordance with the provisions in Section 6.1 above; or

(b) If the Beneficiary shall not have made such designation, then to the Beneficiary's estate.

## ARTICLE VII — ADMINISTRATION

### 7.1 Committee; Duties

This Plan shall be administered by the Committee. Members of the Committee may be Participants under this Plan.

### 7.2 Agents

The Committee may appoint an individual to be the Committee's agent with respect to the day-to-day administration of the Plan. In addition, the Committee may, from time to time, employ other agents and delegate to them such administrative duties as it sees fit, and may from time to time consult with counsel who may be counsel to the Employer.

### 7.3 Binding Effect of Decisions

The decision or action of the Committee with respect to any question arising out of or in connection with the administration, interpretation and application of the Plan and the rules and regulations promulgated hereunder shall be final and binding upon all persons having any interest in the Plan.

### 7.4 Indemnity of Committee

The Company shall indemnify and hold harmless the members of the Committee against any and all claims, loss, damage, expense or liability arising from any action or failure to act with respect to this Plan, except in the case of gross negligence or willful misconduct by the Committee.

## ARTICLE VIII — CLAIMS PROCEDURE

### 8.1 Claim

Any person claiming a benefit, requesting an interpretation or ruling under the Plan, or requesting information under the Plan shall present the request in writing to the Committee which shall respond in writing as soon as practicable.

### 8.2 Denial of Claim

If the claim or request is denied, the written notice of denial shall be made within ninety (90) days of the date of receipt of such claim or request by the Committee and shall state:

(a) The reason for denial, with specific reference to the Plan provisions on which the denial is based.

(b) A description of any additional material or information required and an explanation of why it is necessary.

(c) An explanation of the Plan's claims review procedure.

### **8.3 Review of Claim**

Any person whose claim or request is denied or who has not received a response within ninety (90) days may request review by notice given in writing to the Committee within sixty (60) days of receiving a response or one hundred fifty (150) days from the date the claim was received by the Committee. The claim or request shall be reviewed by the Committee who may, but shall not be required to, grant the claimant a hearing. On review, the claimant may have representation, examine pertinent documents, and submit issues and comments in writing.

### **8.4 Final Decision**

The decision on review shall normally be made within sixty (60) days after the Committee's receipt of a request for review. If an extension of time is required for a hearing or other special circumstances, the claimant shall be notified and the time shall be one hundred twenty (120) days after the Committee's receipt of a request for review. The decision shall be in writing and shall state the reason and the relevant Plan provisions. All decisions on review shall be final and bind all parties concerned.

## **ARTICLE IX — TERMINATION, SUSPENSION OR AMENDMENT**

### **9.1 Amendment or Termination**

The Board may, in its sole discretion, amend or terminate this Plan at any time, in whole or in part; provided, however, that no such amendment or termination shall adversely affect the benefits of Participants which have vested in accordance with Section 3.2 above prior to such action, the benefits of any Participant who has previously retired, or the benefits of any Beneficiary of a Participant who has died; provided further, however, that the amendment or termination of this Plan shall not alter in any manner the timing or form of benefit payments under this Plan.

### **9.2 Successor Employer**

The provisions of this Plan shall be binding upon and inure to the benefit of any successor or assign of the Employer. If a successor Employer amends or terminates this Plan, no such amendment or termination shall adversely affect the benefits of Participants which have vested in accordance with Section 3.2 above prior to such action, the benefits of any Participant who has previously retired, or the benefits of any Beneficiary of a Participant who has previously died.

## ARTICLE X — MISCELLANEOUS

### 10.1 Unsecured General Creditor

Benefits to be provided under this Plan are unfunded obligations of the Employer. Participants and their Beneficiaries, heirs, successors, and assigns shall have no secured interest or claim in any property or assets of Employer, nor shall they be Beneficiaries of, or have any rights, claims or interests in any life insurance policies, annuity contracts or the proceeds therefrom owned or which may be acquired by Employer ("Policies"). Except as provided in Section 10.2, such Policies or other assets of Employer shall not be held under any trust for the benefit of Participants, their Beneficiaries, heirs, successors or assigns, or be considered in any way as collateral security for the fulfilling of the obligations of Employer under this Plan.

### 10.2 Trust Fund

Employer shall be responsible for the payment of all benefits provided under the Plan. At its discretion, Employer may establish one (1) or more trusts, with such trustees as the Board may approve, for the purpose of providing for the payment of such benefits. Although such a trust shall be irrevocable, its assets shall be held for payment of all Employer's general creditors in the event of insolvency. To the extent any benefits provided under the Plan are paid from any such trust, Employer shall have no further obligation to pay them. If not paid from the trust, such benefits shall remain the obligation of Employer.

### 10.3 Nonassignability

Neither a Participant nor any other person shall have any right to commute, sell, assign, transfer, pledge, anticipate, mortgage or otherwise encumber, hypothecate or convey in advance of actual receipt the amounts, if any, payable hereunder, or any part thereof. No part of the amounts payable shall, prior to actual payment, be subject to seizure or sequestration for the payment of any debts, judgments, alimony or separate maintenance owed by a Participant or any other person, nor be transferable by operation of law in the event of a Participant's or any other person's bankruptcy or insolvency.

### 10.4 Not a Contract of Employment

The terms and conditions of this Plan shall not be deemed to constitute a contract of employment between Employer and the Participant, and the Participant (or his Beneficiary) shall have no rights against the Employer except as may otherwise be specifically provided herein. Moreover, nothing in this Plan shall be deemed to give a Participant the right to be retained in the service of Employer or to interfere with the right of Employer to discipline or discharge him at any time.

### 10.5 Participant's Cooperation

A Participant will cooperate with Employer by furnishing any and all information requested by Employer in order to facilitate the payment of benefits hereunder, and by taking such physical examinations and such other action as may be requested by Employer.

**10.6 Captions**

The captions of the articles, sections and paragraphs of this Plan are for convenience only and shall not control or affect the meaning or construction of any of its provisions.

**10.7 Governing Law**

The provisions of this Plan shall be construed and interpreted according to the laws of the State of Delaware.

**10.8 Validity**

In case any provision of this Plan shall be illegal or invalid for any reason, said illegality or invalidity shall not affect the remaining parts hereof, but this Plan shall be construed and enforced as if such illegal and invalid provision had never been inserted herein.

**10.9 Successors**

The provisions of this Plan shall bind and inure to the benefit of Employer and its successors and assigns. The term successors as used herein shall include any corporate or other business entity which shall, whether by merger, consolidation, purchase or otherwise acquire all or substantially all of the business and assets of Employer, and successors of any such corporation or other business entity.

**10.10 Notice**

Any notice or filing required or permitted to be given to the Committee under the Plan shall be sufficient if in writing and hand delivered, or sent by registered or certified mail, to any member of the Committee, the President of the Employer, or the Employer's Statutory Agent. Such notice shall be deemed given as of the date of delivery or, if delivery is made by mail, as of three (3) days following the date shown on the postmark or on the receipt for registration or certification.

**PIER 1 IMPORTS, INC.**

By: \_\_\_\_\_

E. Mitchell Weatherly  
Executive Vice President – Human Resources

EXHIBIT 10.4.2

**FIRST AMENDMENT  
TO THE  
PIER 1 BENEFIT RESTORATION PLAN**

WHEREAS, PIER 1 IMPORTS, INC. (the "Company") has heretofore adopted the PIER 1 BENEFIT RESTORATION PLAN; and

WHEREAS, such plan was amended and restated effective July 1, 1995 (such amended and restated plan herein the "Plan"); and

WHEREAS, the Company desires to amend the Plan's definition of "Board of Directors" contained in Section 2.02 of the Plan to state the applicable company as Pier 1 Imports, Inc.; and

WHEREAS, the Company desires to amend the Plan's definition of "Company" contained in Section 2.06 of the Plan to include wholly owned non-corporate business trust(s) of the Company;

NOW, THEREFORE pursuant to Section 11.04 of the Plan, effective October 1, 1996, the Plan is amended as follows:

1. Section 2.02 of the Plan is amended to read as follows:

Board of Directors. The term "Board of Directors" shall mean the Board of Directors of Pier 1 Imports, Inc.

2. Section 2.06 of the Plan is amended to read as follows:

Company. "Company" shall mean and include the "Employer" and/or "Participating Affiliate" as such terms are defined in the Pier 1 Associates' 401(k) Plan.

IN WITNESS WHEREOF, the Company has caused this Amendment to be executed as of the stated effective date.

PIER 1 IMPORTS, INC.,  
a Delaware corporation

By:  
E. Mitchell Weatherly  
Senior Vice President

**SECOND AMENDMENT  
TO THE  
PIER 1 BENEFIT RESTORATION PLAN**

WHEREAS, PIER 1 IMPORTS, INC. (the "Company") has heretofore adopted the PIER 1 BENEFIT RESTORATION PLAN; and

WHEREAS, such plan was amended and restated effective July 1, 1995 (such amended and restated plan herein the "Plan"); and

WHEREAS, the Plan was amended effective October 1, 1996, by the First Amendment to the Pier 1 Benefit Restoration Plan; and

WHEREAS, the Plan as amended is hereinafter referred to as the Plan; and

WHEREAS, the Company desires to further amend the Plan with respect to Plan distributions;

NOW, THEREFORE pursuant to Section 11.04 of the Plan, effective July 1, 1997, the Plan is amended as follows:

1. Section 6.01 of the Plan is deleted in its entirety and the following language is substituted in its place:

Section 6.01 Distributions. As soon as practicable following the termination of a Participant's employment with the Company for any reason (i) the value (determined as of the date of termination) of such Participant's vested interest in his Restoration Account balance shall be paid to him, plus interest accrued on such amount through the date of distribution, and (ii) the non-vested portion of a Participant's Restoration Account balance, if any, plus interest earned and accrued on such amount shall be forfeited.

Prior to termination of his employment with the Company, a Participant may at any time elect a "cash-out" distribution equal to ninety percent (90%) of the value (determined as of the last day of the Plan Quarter immediately preceding a "cash-out" distribution request) of such Participant's vested interest in his Restoration Account balance. Such "cash-out" distribution shall be made as soon as administratively practical after the Participant has submitted a request in writing to the Committee that such distribution be made. All other amounts to which Participant shall be entitled including the remaining ten percent (10%) balance of the Participant's vested interest in his Restoration Account balance along with interest earned on such amount and interest on the Restoration Account balance accrued after, and Participant deferred compensation and Company matching contributions made after valuation of such account for purposes of the "cash-out" shall be forfeited, notwithstanding Section 6.02 of the Plan. If a Participant who elects such a "cash-out" distribution is not fully vested in his Restoration Account balance, then in addition to the above forfeitures, the non-vested portion of such account shall be forfeited along with all earned and accrued interest on such account.

Any Participant who elects "cash-out" distribution of his Restoration Account balance pursuant to this Section 6.01 shall not be eligible to participate in the Plan again until the first day of any Plan Quarter following the expiration of twelve (12) full calendar months from the date that such "cash-out" distribution was paid to him.

All capitalized terms herein shall have the meaning set forth in the Plan unless a different meaning is attributed to such term pursuant to this document.

IN WITNESS WHEREOF, the Company has caused this Amendment to be executed as of July 1, 1997.

PIER 1 IMPORTS, INC.,  
a Delaware corporation

By:  
E. Mitchell Weatherly  
Senior Vice President

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**THIRD AMENDMENT TO  
PIER 1  
BENEFIT RESTORATION PLAN**

**WHEREAS**, Pier 1 Imports, Inc. and other affiliates of Pier 1 Imports, Inc. have heretofore adopted the Pier 1 Benefit Restoration Plan (the "Plan"); and

**WHEREAS**, Pier 1 Imports, Inc. desires to amend the Plan on behalf of it and each of its affiliates which has adopted the Plan;

**NOW, THEREFORE**, the Plan shall be amended effective July 1, 1998 as follows:

1. The first sentence of Section 6.01 of the Plan shall be deleted and the following two sentences shall be substituted in its place:

"If a Participant has not elected installment payments pursuant to and in accordance with Section 6.04, then (i) upon the termination of a Participant's employment with the Company for any reason the Participant shall deliver to the Company's Benefits Department an account distribution form for the Participant's Restoration Account, and (ii) the Participant's vested portion of his Restoration Account balance shall be valued and paid to him in accordance with Section 6.04 and the non-vested portion of such Restoration Account balance plus interest earned and accrued on such amount, if any, shall be forfeited."

2. Section 6.04 of the Plan shall be deleted and the following shall be substituted in its place:

"Section 6.04 Time and Form of Distributions. Unless a Participant has elected an installment form of payment and such election satisfies the conditions and provisions of this Section 6.04, the distribution of the vested portion of a Participant's Restoration Account shall be made in cash only in the form of a single lump sum payment equaling the value (determined as of the date of such Participant's termination of employment with the Company) of the Participant's vested portion of his Restoration Account plus interest accrued on such amount through the date of distribution. A Participant's lump sum distribution payment will be made approximately ninety (90) days from the end of the Plan quarter in which the Participant's employment with the Company is terminated regardless of whether an account distribution form is received from the Participant.

The distribution of a Participant's Restoration Account may be made to such Participant in the form of annual installments over a period of five (5) years provided that:

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- (1) Such Participant has attained the age of fifty-five (55) as of the date of his termination of employment with the Company for any reason;
- (2) Such Participant is fully vested in his Restoration Account as of the date of his termination of employment with the Company for any reason; and
- (3) Such Participant makes a non-revocable election in writing on a form prescribed by the Company and filed with the Benefits Department of the Company to receive payment of his Restoration Account in the form of installment payments and such election is made at least three hundred sixty-five (365) days prior to the date that such Participant's employment with the Company is terminated for any reason.

Provided that the above conditions are satisfied, the Participant's Restoration Account will be valued as of the date of such Participant's termination of employment with the Company. The Restoration Account as valued shall be distributed in five (5) equal annual installments to the Participant. The first annual installment will be made approximately ninety (90) days from the end of the Plan quarter in which the Participant's employment with the Company is terminated. Each subsequent annual installment payment will be made approximately ninety (90) days following December 31st of each year beginning with the year of the initial distribution. The undistributed balance of a Participant's Restoration Account shall be credited with interest in accordance with Section 5.02 on the same basis and in the same manner as interest is credited on the Restoration Accounts of Participants who are active employees of the Company, and each annual installment shall include the interest accrued on the undistributed balance through the date of distribution of such payment."

3. As amended hereby, the Plan is specifically ratified and reaffirmed.

Signed effective July 1, 1998.

**PIER 1 IMPORTS, INC.**

By: \_\_\_\_\_  
E. Mitchell Weatherly, Senior Vice President

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**FOURTH AMENDMENT  
TO THE  
PIER 1 BENEFIT RESTORATION PLAN**

WHEREAS, PIER 1 IMPORTS, INC. (the "Company") has heretofore adopted the PIER 1 BENEFIT RESTORATION PLAN; and

WHEREAS, such plan was amended and restated effective July 1, 1995 (such amended and restated plan herein the "Plan"); and

WHEREAS, the Company has previously amended the Plan and desires to further amend the Plan's definition of "Company" contained in Section 2.06 of the Plan;

NOW, THEREFORE pursuant to Section 11.04 of the Plan, effective October 1, 1999, the Plan is amended as follows:

1. Section 2.06 of the Plan is amended to read as follows:

Company. "Company" shall mean and include the "Employer" and/or "Adopting Employers" as such terms are defined in the Pier 1 Associates' 401(k) Plan.

IN WITNESS WHEREOF, the Company has caused this Amendment to be executed as of the stated effective date.

PIER 1 IMPORTS, INC.,  
a Delaware corporation

By:  
E. Mitchell Weatherly  
Senior Vice President

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FIFTH AMENDMENT  
TO THE  
PIER 1 BENEFIT RESTORATION PLAN

WHEREAS, PIER 1 IMPORTS, INC. (the "Company") has heretofore adopted the PIER 1 BENEFIT RESTORATION PLAN; and

WHEREAS, such plan was amended and restated effective July 1, 1995 (such amended and restated plan herein the "P lan"); and

WHEREAS, the Company has previously amended the Plan and desires to further amend the Plan;

NOW, THEREFORE pursuant to Section 11.04 of the Plan, effective July 1, 2002, the Plan is amended as follows:

1. Section 5.02 of the Plan is amended by deleting the two (2) sentences in that section and replacing them with the following text:

"Each Participant's Restoration Account balance shall be credited at least quarterly with an amount of interest at an annual rate equal to Moody's Corporate Bond Index, or comparable index if Moody's Corporate Bond Index is no longer available, plus 1% where the Index is averaged on a daily basis for a period determined by the Committee from time to time."

As amended hereby, the Plan is specifically ratified and reaffirmed. The Company has executed this Amendment as of the stated effective date.

PIER 1 IMPORTS, INC.,  
a Delaware corporation

By: \_\_\_\_\_

E. Mitchell Weatherly  
Executive Vice President

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**SIXTH AMENDMENT TO  
PIER 1 BENEFIT RESTORATION PLAN  
(As Amended and Restated Effective July 1, 1995)**

**WHEREAS**, Pier 1 Imports, Inc. (the "Company") has heretofore adopted the Pier 1 Benefit Restoration Plan; and

**WHEREAS**, such plan was amended and restated effective July 1, 1995 (such amended and restated plan herein being referred to as the "Plan"); and

**WHEREAS**, the Plan has been amended since July 1, 1995 by five (5) separate amendments and the Company now desires to further amend the Plan;

**NOW, THEREFORE**, pursuant to Section 11.04 of the Plan, the Plan is amended as follows:

1. Effective as of January 1, 2004, the second sentence of Section 4.01 of the Plan shall be deleted and the following shall be substituted therefor:

"The dollar amount of Compensation deferred may not exceed twenty percent (20%) of the Participant's Compensation per Plan Year. "

2. As amended hereby, the Plan is specifically ratified and reaffirmed.

**IN WITNESS WHEREOF**, the Company has caused this amendment to be executed this \_\_\_day of \_\_\_, 2003.

**PIER 1 IMPORTS, INC.**,  
a Delaware Corporation

By: \_\_\_\_\_

E. Mitchell Weatherly  
Executive Vice President, Human Resources

EXHIBIT 10.5.2

**FIRST AMENDMENT  
TO THE  
PIER 1 IMPORTS, INC.  
MANAGEMENT RESTRICTED STOCK PLAN**

WHEREAS, PIER 1 IMPORTS, INC. (the "Company") has heretofore adopted the PIER 1 IMPORTS, INC. MANAGEMENT RESTRICTED STOCK PLAN (the "Plan"); and

WHEREAS, the Company desires to amend the Plan's definition of "Subsidiary" contained in Section 2 of the Plan to include wholly owned non-corporate business trust(s) of the Company;

NOW, THEREFORE pursuant to Section 8 of the Plan, effective October 1, 1996, the Plan is amended as follows:

1. The definition of "Subsidiary" set forth in Section 2 of the Plan is amended to read as follows:

"Subsidiary" means any corporation or business trust the majority of the outstanding voting stock of which is owned, directly or indirectly by the Company.

IN WITNESS WHEREOF, the Company has caused this Amendment to be executed as of the stated effective date.

PIER 1 IMPORTS, INC.,  
a Delaware corporation

By:  
E. Mitchell Weatherly  
Senior Vice President

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**SECOND AMENDMENT  
TO THE  
PIER 1 IMPORTS, INC.  
MANAGEMENT RESTRICTED STOCK PLAN**

WHEREAS, Pier 1 Imports, Inc. (the "Company") has adopted the PIER 1 IMPORTS, INC. MANAGEMENT RESTRICTED STOCK PLAN (the "Plan"); and

WHEREAS, the Plan commenced and became effective June 24, 1993; and

WHEREAS, the Plan was amended effective October 1, 1996 and the Company desires to further amend the Plan;

NOW, THEREFORE pursuant to Section 8 of the Plan, the Plan is hereby amended effective December 23, 1997, as follows:

1. Section 6 of the Plan is amended by adding a new subsection (f), which shall read as follows:

(f) Upon termination of the Grantee's employment with the Company or any subsidiary of the Company (or the successor of any such company) for any reason, all Restricted Stock as to which the restrictions thereon shall not have lapsed shall be immediately forfeited to the Company.

In all other respects, the Plan, as amended, is hereby ratified and affirmed.

PIER 1 IMPORTS, INC.,  
a Delaware corporation

By: \_\_\_\_\_  
E. Mitchell Weatherly  
Senior Vice President

EXHIBIT 10.6.1

**PIER 1 IMPORTS, INC.**

**1989 EMPLOYEE STOCK OPTION PLAN**

(Restated as of June 27,1996)

1. *Purpose.* The purpose of this 1989 Stock Option Plan (hereinafter called the "Plan") is to further the success of Pier I Imports, Inc., a Delaware corporation (hereinafter called the "Company"), and certain of its affiliates by making available Common Stock of the Company for purchase by certain officers and employees of the Company and its affiliates, and thus to provide an additional incentive to such individuals to continue in the service of the Company or its affiliates and to give them a greater interest as shareholders in the success of the Company. Subject to compliance with the provisions of the Plan and the Internal Revenue Code of 1986, as amended, Incentive Stock Options as authorized by Section 422 of the Code and stock options which do not qualify under Section 422 of the Code are authorized and may be granted under the Plan.

2. *Definitions.* As used in this Plan the following terms shall have the meanings indicated as follows:

(a) "Board" means the Board of Directors of the Company.

(b) "Code" means the Internal Revenue Code of 1986, as amended.

(c) "Committee" means the Committee administering the Plan described in Paragraph 3 hereof.

(d) "Common Stock" means the Company's Common Stock, par value \$1.00 per share.

(e) "Date of Grant" means the date on which an option is granted under a written option agreement executed by the Company and a Participant pursuant to the Plan.

(f) "Disinterested Person" means a person who qualifies as (i) a "disinterested person" under Rule 16b-3 promulgated under the Exchange Act or any successor provision and (ii) an "outside director" under Treasury Regulations Section 1.162-27 promulgated under Section 162(m) of the Internal Revenue Code of 1986, as amended, or any successor provision.

(g) "Effective Date" means the effective date of this Plan specified in Paragraph 14 hereof.

(h) "Exchange Act" means the Securities Exchange Act of 1934, as it may be amended from time to time.

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(i) "Incentive Stock Option" means an option qualifying under Section 422 of the Code.

(j) "Parent" means a parent corporation of the Company as defined in Section 425(e) of the Code.

(k) "Participants" means the employees and officers of the Company, its Subsidiaries and its Parents and those directors of the Company who are also employees of the Company.

(l) "Subsidiary" means a subsidiary corporation of the Company as defined in Section 425(f) of the Code.

3. *Administration of Plan.* The Board of Directors of the Company shall appoint a committee (the "Committee") comprised of not less than two directors of the Company to administer the Plan. Only Disinterested Persons shall be eligible to serve as members of the Committee. The Committee shall report all action taken by it to the Board which shall review and ratify or approve those actions which are by law required to be so reviewed and ratified or approved by the Board. The Committee shall have full and final authority in its discretion, subject to the provisions of the Plan, to determine the Participants to whom, and the time or times at which, options shall be granted and the number of shares and purchase price of Common Stock covered by each option, provided that no person shall be granted options which in the aggregate exceed fifteen percent (15%) of the shares of Common Stock authorized for issuance from time to time under the Plan; to construe and interpret the Plan and any agreements made pursuant to the Plan; to determine the terms and provisions (which need not be identical or consistent with respect to each Participant) of the respective option agreements and any agreements ancillary thereto including, but without limitation, terms covering the payment of the option price; and to make all other determinations and take all other actions deemed necessary or advisable for the proper administration of the Plan. All such actions and determinations shall be conclusively binding for all purposes and upon all persons.

4. *Options Authorized.* The options granted under this Plan may be Incentive Stock Options or stock options which do not qualify as Incentive Stock Options (sometimes referred to herein as "nonqualified options" or "nonqualified stock options"). The Committee shall have the full power and authority to determine which options shall be nonqualified stock options and which shall be Incentive Stock Options; to grant only Incentive Stock Options or alternatively, only nonqualified stock options; and to, in its sole discretion, grant to the holder of an outstanding option, in exchange for the surrender and cancellation of such option, a new option having a purchase price lower than that provided in the option so surrendered and cancelled and containing such other terms and conditions as the Committee may prescribe in accordance with the provisions of the Plan. Under no circumstances may nonqualified stock options be granted where the exercise of such nonqualified stock options may affect the exercise of Incentive Stock Options granted pursuant to the Plan. No options may be granted under the Plan prior to the Effective Date. In addition to any other limitations set forth herein, the aggregate fair market value (determined in accordance with Paragraph 7(a) of the Plan as of the time the option is granted) of the stock with respect to which Incentive Stock Options are exercisable for the first time by a Participant in any calendar year (under all plans of the Company and of any Parent or Subsidiary) shall not exceed \$100,000.

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5. *Common Stock Subject to Options.* The aggregate number of shares of the Company's Common Stock which may be issued upon the exercise of options shall not exceed three million (3,000,000), subject to adjustment under the provisions of Paragraph 8. The shares of Common Stock to be issued upon the exercise of options may be authorized but unissued shares, or shares issued and reacquired by the Company. In the event any option shall, for any reason, terminate or expire or be surrendered without having been exercised in full, the shares subject to such option shall again be available for options to be granted under the Plan, except that shares for which relinquished options (or portions thereof) are exercisable shall not again be available for options under the Plan.

6. *Participants.* Except as hereinafter provided, options may be granted under the Plan to any Participant. In determining the Participants to whom options shall be granted and the number of shares to be covered by such option, the Committee may take into account the nature of the services rendered by the respective Participants, their present and potential contributions to the Company's success and such other factors as the Committee in its discretion shall deem relevant. A Participant who has been granted an option under the Plan may be granted an additional option or options under the Plan, in the Committee's discretion.

7. *Terms and Conditions of Options.* The grant of an option under the Plan shall be evidenced by a written agreement executed by the Company and the applicable Participant and shall contain such terms and be in such form as the Committee may from time to time approve, subject to the following limitations and conditions:

(a) *Option Price.* The option price per share with respect to each option shall be determined by the Committee, but shall in no instance be less than the par value of the shares subject to the option. In addition, the option price per share with respect to Incentive Stock Options granted hereunder shall in no instance be less than the fair market value of the shares subject to the option. The Committee may permit the option purchase price to be payable in Common Stock owned by the holder of an option. For the purposes of this Paragraph 7(a), fair market value shall be, where applicable, the closing price of the Common Stock on the Date of Grant as reported on the New York Stock Exchange composite tape or, if the Common Stock is not traded on such exchange, as reported on any other national securities exchange on which the Common Stock may be traded. If the Common Stock was not traded on the Date of Grant, the nearest preceding date shall be substituted in the preceding sentence. Notwithstanding the foregoing, however, fair market value shall be determined consistent with Code Section 422(b)(4) or any successor provisions.

(b) *Period of Option.* The expiration date of each option shall be fixed by the Committee, but, notwithstanding any provision of the Plan to the contrary, such expiration date shall not be more than ten years from the Date of Grant.

(c) *Vesting of Shareholder Rights.* Neither an optionee nor his successor in interest shall have any of the rights of a shareholder of the Company until the shares relating to an option hereunder are issued by the Company purchased are properly delivered to such optionee or successor.

(d) *Exercise of Option.* Each option shall be exercisable from time to time (but not less than six (6) months after the Date of Grant) over such period and upon such terms and conditions as the Committee shall determine, but not at any time as to less than 25 shares unless the remaining shares which have become so purchasable are less than 25 shares. After the death of the optionee, an option may be exercised as provided in Paragraph 16 hereof.

(e) *Nontransferability of Option.* No option shall be transferable or assignable by an optionee, otherwise than by will or the laws of descent and distribution and each option shall be exercisable, during the optionee's lifetime, only by him or her or, during periods of legal disability, by his or her legal representative. No option shall be subject to execution, attachment, or similar process.

(f) *Disqualifying Dispositions.* The option agreement evidencing any Incentive Stock Options granted under this Plan shall provide that if the optionee makes a disposition, within the meaning of Section 425(c) of the Code and regulations promulgated thereunder, of any share or shares of Common Stock issued to him or her pursuant to exercise of the option within the two-year period commencing on the day after the Date of Grant of such option or within the one-year period commencing on the day after the date of issuance of the share or shares to him or her pursuant to the exercise of such option, he or she shall, within ten (10) days of such disposition date, notify the Company of the sales price or other value ascribed to or used to measure the disposition of the share or shares thereof and immediately deliver to the Company any amount of federal income tax withholding required by law.

(g) *Limitation on Grants to Certain Shareholders.* An Incentive Stock Option may be granted to a Participant only if such Participant, at the time the option is granted, does not own, after application of the attribution rules of Code Section 425, stock possessing more than 10% of the total combined voting power of all classes of Common Stock of the Company or of its Parent or Subsidiary. The preceding restriction shall not apply if at the time the option is granted the option price is at least 110% of the fair market value (as defined in Paragraph 7(a) above) of the Common Stock subject to the option and such option by its terms is not exercisable after the expiration of five years from the Date of Grant.

(h) *Consistency with Code.* Notwithstanding any other provision in this Plan to the contrary, the provisions of all agreements granting options pursuant to the Plan shall not violate the requirements of the Code applicable to the Incentive Stock Options authorized hereunder.

#### 8. *Adjustments.*

The Committee, in its discretion, may make such adjustments in the option price and the number of shares covered by outstanding options which are required to prevent any dilution or enlargement of the rights of the holders of such options that would otherwise result from any reorganization, recapitalization, stock split, stock dividend, combination of shares, merger,

consolidation, issuance of rights or any other change in the capital structure of the Company. The Committee, in its discretion, may also make such adjustments in the aggregate number of shares which may be the subject of options which are appropriate to reflect any transaction or event described in the preceding sentence.

*9. Relinquishment of Options.*

(a) The Committee, in granting options hereunder, shall have discretion to provide that an optionee, or his heirs or other legal representatives (to the extent entitled to exercise the option under the terms thereof), in lieu of purchasing the entire number of shares subject to purchase thereunder, shall have the right to relinquish all or any part of the unexercised portion of the option for a number of shares of Common Stock equal to the quotient of (A) the excess of (I) the aggregate current fair market value of the shares of Common Stock covered by the unexercised portion of the option over (2) the aggregate purchase price for such shares specified in such option, divided by (B) the then current market value per share of such Common Stock.

(b) The Committee, in granting options hereunder, shall have discretion to determine the terms upon which such options shall be relinquishable, subject to the applicable provisions of the Plan, and including such provisions as deemed advisable to permit the exemption from the operation of Section 16b of the Exchange Act, in whole or in part, of any such transaction involving such relinquishment. Outstanding option agreements may be amended, if necessary, to permit such exemption.

*10. Restrictions on Issuing Shares.* The exercise of each option shall be subject to the condition that if at any time the Company shall determine in its discretion that the satisfaction of withholding tax or other withholding liabilities, or that the listing, registration, or qualification of any shares otherwise deliverable upon such exercise upon any securities exchange or under any state or federal law, or that the consent or approval of any regulatory body, is necessary or desirable as a condition of, or in connection with, such exercise or the delivery or purchase of shares pursuant thereto, then in any such event, such exercise shall not be effective unless such withholding, listing, registration, qualification, consent, or approval shall have been effected or obtained free of any conditions not acceptable to the Company.

*11. Use of Proceeds.* The proceeds received by the Company from the sale of Common Stock pursuant to the exercise of options granted under the Plan shall be added to the Company's general funds and used for general corporate purposes.

*12. Amendment, Suspension, and Termination of Plan.* The Board may at any time suspend or terminate the Plan or may amend it from time to time in such respects as the Board may deem advisable in order that the options granted thereunder may conform to any changes in the law or in any other respect which the Board may deem to be in the best interests of the Company; provided, however, that without approval by the shareholders of the Company voting the proper percentage of its voting power, no such amendment shall make any change in the Plan for which shareholder approval is required of the Company by (i) Rule 16b-3, as amended, promulgated under the Exchange Act, (ii) the Code or regulatory provisions dealing with Incentive Stock Options (iii) any rules for listed companies promulgated by any national stock

exchange on which the Company's stock is traded or (iv) any other applicable rule or law. Unless sooner terminated hereunder, the Plan shall terminate on June 30, 2004. No option may be granted during any suspension or after the termination of the Plan. Except as provided in Paragraph 13, no amendment, suspension, or termination of the Plan shall, without an optionee's consent, impair or negate any of the rights or obligations under any option theretofore granted to such optionee under the Plan.

13. *Tax Withholding.* The Committee may, in its sole discretion, (a) require an optionee to remit to the Company a cash amount sufficient to satisfy, in whole or in part, any federal, state and local withholding tax requirements prior to the delivery of any certificate for shares pursuant to the exercise of an option hereunder; (b) grant, to an optionee the right to satisfy, in whole or in part, any such withholding tax requirements by electing to require that the Company, upon any exercise of the option, withhold from the shares of the Common Stock issuable to the optionee upon the exercise of the option, that number of full shares of Common Stock having a fair market value equal to the amount or portion of the amount required to be withheld; or (c) satisfy such withholding requirements through another lawful method.

14. *Effective Date of Plan.* This Plan shall become effective on the date (the "Effective Date") of the last to occur of (i) the adoption of the Plan by the Board and (ii) the approval, within twelve (12) months of such adoption, by a majority (or such other proportion as may be required by state law) of the outstanding voting shares of stock of the Company, voted either in person or by proxy, at a duly held stockholders meeting.

15. *Termination of Employment.* In the event of the retirement (with the written consent of the Company) or other termination of the employment of an employee to whom an option has been granted under the Plan, other than (a) a termination that is either (i) for cause or (ii) voluntary on the part of the employee and without the written consent of the Company, or (b) a termination by reason of death, the employee may (unless otherwise provided in his option agreement) exercise his option at any time within three months after such retirement or other termination of employment (or within one year after termination of employment due to disability within the meaning of Code Section 22(c)(3)), or within such other time as the Committee shall authorize, but in no event after 10 years from the date of granting thereof (or such lesser period as may be specified in the stock option agreement), but only to the extent of the number of shares for which his options were exercisable by him at the date of the termination of his employment. In the event of the termination of the employment of an employee to whom an option has been granted under the Plan that is either (i) for cause or (ii) voluntary on the part of the employee and without the written consent of the Company, any option held by him under the Plan, to the extent not previously exercised, shall forthwith terminate on the date of such termination of employment. Options granted under the Plan shall not be affected by any change of employment so long as the holder continues to be an employee of the Company, a Subsidiary or a Parent. The option agreement may contain such provisions as the Committee shall approve with respect to the effect of approved leaves of absence. Nothing in the Plan or in any option granted pursuant to the Plan shall confer on any individual any right to continue in the employ of the Company or any of its Subsidiaries or Parents or interfere in any way with the right of the Company or any of its Subsidiaries or Parents to terminate his employment at any time.

16. *Death of Holder of Option.* In the event an employee to whom an option has been granted under the Plan dies during, or within three months after the termination of, his employment by the Company or a Subsidiary or Parent, such option (unless it shall have been previously terminated pursuant to the provisions of the Plan or unless otherwise provided in his option agreement) may be exercised (to the extent of the entire number of shares covered by the option whether or not purchasable by the employee at the date of his death) by the executor or administrator of the optionee's estate or by the person or persons to whom the optionee shall have transferred such option by will or by the laws of descent and distribution, at any time within a period of one year after his death, but not after the exercise termination date set forth in the relevant stock option agreement.

17. *Loans to Assist in Exercise of Options.* If approved by the Board, the Company or any Parent or Subsidiary may lend money or guarantee loans by third parties to an individual to finance the exercise of any option granted under the Plan to carry Common Stock thereby acquired. No such loan to finance the exercise of an Incentive Stock Option shall have an interest rate or other terms that would cause any part of the principal amount to be characterized as interest for purposes of the Code.

EXHIBIT 10.6.2

**FIRST AMENDMENT  
TO THE  
PIER 1 IMPORTS, INC. 1989  
EMPLOYEE STOCK OPTION PLAN**

WHEREAS, PIER 1 IMPORTS, INC. (the "Company") has heretofore adopted the PIER 1 IMPORTS, INC. 1989 EMPLOYEE STOCK OPTION PLAN; and

WHEREAS, the stated plan has been restated and amended as of June 27, 1996 (such restated and amended plan herein the "Plan"); and

WHEREAS, the Company desires to amend the Plan's definition of "Subsidiary" contained in Section 2(l) to include within such definition wholly owned non-corporate business trust(s) of the Company;

NOW, THEREFORE pursuant to Section 12 of the Plan, effective October 1, 1996, the Plan is amended as follows:

1. Section 2(l) of the Plan is amended to read as follows:

"Subsidiary" means a subsidiary corporation of the Company as defined in Section 424(f) of the Code and/or any business trust owned either directly or indirectly by the Company.

IN WITNESS WHEREOF, the Company has caused this Amendment to be executed as of the stated effective date.

PIER 1 IMPORTS, INC.,  
a Delaware corporation

By:

E. Mitchell Weatherly  
Senior Vice President

### FINANCIAL SUMMARY

(\$ in millions except per share amounts)

	4-Year Compound Annual Growth Rate	Year Ended				
		2005	2004	2003	2002	2001 <sup>(1)</sup>
<b>SUMMARY OF OPERATIONS:</b>						
Net sales	7.7%	\$1,897.9	1,868.2	1,754.9	1,548.6	1,411.5
Gross profit	5.2%	\$ 727.3	781.6	753.4	649.8	594.5
Selling, general and administrative expenses	9.4%	\$ 573.2	544.5	502.3	448.1	399.8
Depreciation and amortization	7.8%	\$ 58.3	50.9	46.4	42.8	43.2
Operating income	(10.8%)	\$ 95.8	186.2	204.7	158.8	151.5
Nonoperating (income) and expenses, net		\$ (1.1)	(1.2)	(0.7)	(0.2)	1.3
Income before income taxes	(10.4%)	\$ 96.8	187.3	205.4	159.0	150.2
Net income	(10.6%)	\$ 60.5	118.0	129.4	100.2	94.7
<b>PER SHARE AMOUNTS:</b>						
Basic earnings	(8.4%)	\$ .69	1.32	1.39	1.06	.98
Diluted earnings	(8.5%)	\$ .68	1.29	1.36	1.04	.97
Cash dividends declared	27.8%	\$ .40	.30	.21	.16	.15
Shareholders' equity	8.4%	\$ 7.63	7.66	6.93	6.20	5.52
<b>OTHER FINANCIAL DATA:</b>						
Working capital	2.8%	\$ 371.7	418.3	420.0	396.8	333.0
Current ratio	(8.6%)	2.3	2.5	2.7	2.9	3.3
Total assets	9.8%	\$1,075.7	1,052.2	972.7	867.3	739.7
Long-term debt	(6.6%)	\$ 19.0	19.0	25.0	25.4	25.0
Shareholders' equity	5.7%	\$ 664.4	683.6	643.9	585.7	531.9
Weighted average diluted shares outstanding (millions)		88.8	91.6	95.3	96.2	98.0
Effective tax rate		37.6%	37.0	37.0	37.0	37.0
Return on average shareholders' equity		9.0%	17.8	21.0	17.9	19.5
Return on average total assets		5.7%	11.7	14.1	12.5	13.4
Pre-tax return on sales		5.1%	10.0	11.7	10.3	10.6

(1) Fiscal 2001 consisted of a 53-week year. All other fiscal years presented reflect 52-week years.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### MANAGEMENT OVERVIEW

#### Introduction

Pier 1 Imports, Inc. (together with its consolidated subsidiaries, the "Company") is one of North America's largest specialty retailers of unique decorative home furnishings, gifts and related items. The Company directly imports proprietary merchandise from over 40 countries, and sells a wide variety of furniture collections, decorative accessories, bed and bath products, housewares and other seasonal assortments in its stores. During fiscal year 2005, the Company opened 121 new stores and closed 42 stores, increasing retail square footage 7.6% over the prior year. The Company operates stores in the United States and Canada under the names "Pier 1 Imports" ("Pier 1"), "Cargokids" and "Pier 1 Kids". Pier 1 Kids and Cargokids stores sell children's home furnishings and decorative accessories. During fiscal 2005, the Company began changing the name of Cargokids to Pier 1 Kids, and as of April 2005, all stores have been converted. For purposes of this financial report, both Cargokids stores and Pier 1 Kids stores are referred to together as "Pier 1 Kids" unless the context indicates otherwise. In the United Kingdom, retail locations operate under the name "The Pier." As of February 26, 2005, the Company operated 1,258 stores in the United States, Canada, Puerto Rico, the United Kingdom, Ireland and Mexico.

The following discussion and analysis of financial condition, results of operations, liquidity and capital resources should be read in conjunction with the accompanying audited Consolidated Financial Statements and notes thereto.

#### Overview of Business

Net sales increased 1.6% to \$1,897.9 million in fiscal 2005 compared to \$1,868.2 million in fiscal 2004, but comparable store sales declined 5.8%. Net income declined 48.8% during fiscal 2005, resulting in earnings per share on a diluted basis of \$0.68 compared with \$1.29 for the prior fiscal year. Despite disappointing sales and earnings results during the year, the Company continued to generate positive cash flow from operations and ended the year with \$189.1 million in cash and cash equivalents. Throughout the year, the Company continued to repurchase its common stock and pay cash dividends to shareholders.

The Company's key financial and operational metrics used by management to evaluate the performance of the business include the following: (The trends for these metrics are explained in the comparative sections of Management's Discussion and Analysis.)

<b>Key Performance Metrics</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
Total sales growth	1.6%	6.5%	13.3%
Comparable stores sales growth	(5.8%)	(2.2%)	4.7%
Sales per average retail square foot	\$ 210	\$ 226	\$ 235
Merchandise margins as a % of sales	53.2%	55.2%	55.3%
Gross profit as a % of sales	38.3%	41.8%	42.9%
Selling, general and administrative expenses as a % of sales	30.2%	29.1%	28.6%
Operating income as a % of sales	5.0%	10.0%	11.7%
Net income as a % of sales	3.2%	6.3%	7.4%
Diluted earnings per share	\$ 0.68	\$ 1.29	\$ 1.36
Inventory per retail square foot	\$ 40.73	\$ 43.03	\$ 42.36
Total retail square footage (in thousands)	9,347	8,688	7,870
Total retail square footage growth	7.6%	10.4%	11.0%

## Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Stores included in the comparable store sales calculation are those stores that were opened prior to the beginning of the preceding fiscal year and are still open. Also included are stores that were relocated during the year within a specified distance serving the same market, where there is not a significant change in store size and where there is not a significant overlap or gap in timing between the opening of the new store and the closing of the existing store. Stores that are expanded or renovated are excluded from the comparable store sales calculation during the period they are closed for such remodeling. When these stores re-open for business, they are included in the comparable store sales calculation in the first full month after the re-opening if there is no significant change in store size. If there is a significant change in store size, the store continues to be excluded from the calculation until it meets the Company's established definition of a comparable store. Sales over the Internet are included and clearance stores are omitted from the comparable store sales calculation.

In recognition of decreasing customer traffic and declining sales performance, the Company's management began to analyze and re-assess certain marketing, merchandising and operational strategies during fiscal 2005 in an effort to achieve more consistent sales growth and improve the Company's long-term growth and profitability potential. This analysis resulted in the design of key strategies geared toward differentiating Pier 1 stores from increased competition by reinforcing the uniqueness and value of the Company's merchandise and by improving the overall shopping experience with enhanced visual presentations and improved customer service. Management intends to execute the strategies discussed below in an effort to help the Company achieve improved comparable store sales performance and increased profitability.

The Company named a new advertising agency in October 2004 to develop a new creative marketing campaign. The new campaign launched in March 2005 and includes television, print, radio and direct mail. The Company has also utilized the services of a new media planning and buying agency to help ensure optimal media placement with an expectation that the Company will receive an improved return on its advertising investment. During the fall of 2004, the Company tested a mail order catalog distributed to two select markets. In March 2005, this test was followed by another distribution of almost 600,000 catalogs to six United States markets where the Company currently has 150 stores. The Company plans to distribute approximately 2,000,000 catalogs to all United States markets during the fall of 2005, and by November 2005, the Company's e-commerce website is expected to be fully integrated with future catalogs. In addition, a "Special Finds" book located in all Pier 1 stores allows customers to order featured items, such as larger furniture, upholstered pieces, rugs and other decorative accessories that are available and displayed only in certain larger Pier 1 stores.

Merchandising initiatives include editing the merchandise assortment to phase-out older products and product lines and a 15% to 20% reduction in stock keeping units ("SKU") count, which enables the Company to better highlight and feature new and unique merchandise in a visually appealing manner. Prices have been reduced on certain items within the merchandise assortment to ensure customers perceive Pier 1 stores as a place to purchase unique, stylish merchandise at a reasonable price. Additional merchandising initiatives include reducing the time it takes to develop and deliver new merchandise to stores and broadening the assortment between "good, better and best" categories, so customers will be able to see and appreciate differences in style, design and selection in certain products. The Company will feature new merchandise more frequently and for shorter selling periods to encourage customers to purchase the merchandise while it is in stock and to encourage more frequent visits to the store. In addition, the Company will begin buying merchandise in fiscal 2006 geared towards a more contemporary style that will appeal to a broader range of customers.

Store operations initiatives include an increase in store payroll hours to provide store associates with more time to focus on the customer in an effort to increase sales. Additional store payroll hours allow customer service training for associates and provide store associates with more time to prepare stores for featured merchandise in stronger visual presentations.

## Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

During fiscal 2005, the Company began converting Cargokids stores to Pier 1 Kids stores and as of April 2005, all stores have been converted to take advantage of the recognizable Pier 1 brand. Pier 1 Kids stores now have the ability to accept Pier 1 gift cards as payment, and future plans include the acceptance of the Company's proprietary credit card interchangeably between Pier 1 and Pier 1 Kids.

Despite disappointing sales results, the Company's balance sheet remains strong and management continues to manage inventory levels and control operating expenses prudently. Compared to recent years, the Company's management plans to slow the growth in new stores during fiscal 2006 in order to improve store-level execution and leverage occupancy costs. During fiscal 2006, the Company plans to open 85 new Pier 1 stores and close approximately 25 stores. The Company plans to open four new Pier 1 Kids stores during the year and close two. Management feels that the strategic initiatives discussed above will better position the Company to take advantage of any improvements in the macroeconomic environment. These initiatives should assist the Company by positioning it to achieve better results in sales and earnings during fiscal 2006.

### FISCAL YEARS ENDED FEBRUARY 26, 2005 AND FEBRUARY 28, 2004

#### Net Sales

Net sales consisted almost entirely of sales to retail customers, net of discounts and returns, but also included delivery service revenues and wholesale sales and royalties received from franchise stores and Sears de Mexico, S.A. Sales by retail concept during fiscal years 2005, 2004 and 2003 were as follows (in thousands):

	2005	2004	2003
Pier 1 Imports stores	\$1,782,351	\$1,771,644	\$1,677,050
The Pier stores	72,509	62,151	51,470
Pier 1 Kids stores	25,705	19,320	12,199
Internet	9,793	8,635	6,380
Other <sup>(1)</sup>	7,495	6,493	7,768
	<u>\$1,897,853</u>	<u>\$1,868,243</u>	<u>\$1,754,867</u>

(1) Other sales consisted of wholesale sales and royalties received from franchise stores and from Sears de Mexico S.A., and Pier 1 Kids' contract sales. Also included in amounts from fiscal 2003 were Pier 1 Kids' dealer sales, which were discontinued in fiscal 2003. As of August 2003, Pier 1 Kids no longer sells merchandise under wholesale contracts.

During fiscal 2005, the Company recorded net sales of \$1,897.9 million, an increase of \$29.6 million or 1.6%, over net sales of \$1,868.2 million for the prior fiscal year. Incremental sales growth for the fiscal year was comprised of the following components (in thousands):

	2005
New stores opened during fiscal 2005	\$ 92,312
Stores opened during fiscal 2004	92,378
Comparable stores	(94,673)
Closed stores and other	(60,407)
	<u>\$ 29,610</u>

Comparable store sales for fiscal 2005 decreased 5.8%. The Company believes comparable store sales suffered as a result of a challenging retail environment with weakened discretionary spending among its target consumer group and increased competition from discount retailers. In addition to these external



## Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

factors, the Company recognizes the weak sales performance last year was also attributable to an ineffective marketing campaign, merchandise assortment that lacked uniqueness and value, and stores that had become cluttered and difficult to shop. As a result of the above factors, the Company experienced decreases in customer traffic and conversion rates. Management began to address these issues mid-way through the year with a complete reassessment of the business and began to initiate strategic initiatives to focus on marketing, merchandising and store operations. These initiatives have not had time to fully become effective and impact sales during fiscal 2005, yet management anticipates that sales for fiscal 2006 will benefit from the internal changes of the Company. The Company's net sales from Canada and the United Kingdom are subject to fluctuations in currency conversion rates. These fluctuations had a favorable impact on both total net sales and comparable store sales calculations during fiscal 2005.

Total net sales growth benefited from new store openings during fiscal 2005. The Company opened 104 and closed or relocated 37 North American Pier 1 stores during fiscal 2005, bringing the Pier 1 store count to 1,150 at year-end compared to 1,083 last year. The Company also opened 10 and closed five Pier 1 Kids stores, opened three The Pier stores, and opened four locations with a "store-within-a-store" format in Sears de Mexico S.A. Including all worldwide locations, the Company's store count totaled 1,258 at the end of fiscal 2005, which represents an increase of approximately 7.6% in total retail square footage compared to the end of last fiscal year. During fiscal 2006, the Company expects to open 85 new Pier 1 stores and close approximately 25 stores, and to open approximately four new Pier 1 Kids stores and close two under-performing stores. Additionally, the Company plans to open 12 (nine of which are planned as "store-within-a-store" formats) and close three stores at The Pier, and open three and four new stores in Mexico and Puerto Rico, respectively, as "store-within-a-store" formats. A summary reconciliation of the Company's stores open at the beginning of fiscal 2005, 2004 and 2003 to the number open at the end of each period follows (openings and closings include relocated stores):

	Pier 1 North			Total
	American	International <sup>(1)</sup>	Pier 1 Kids	
Open at March 2, 2002	910	46	18	974
Openings	114	3	8	125
Closings	(24)	—	(1)	(25)
Open at March 1, 2003	1,000	49	25	1,074
Openings	120	7	22	149
Closings	(37)	—	(7)	(44)
Open at February 28, 2004	1,083	56	40	1,179
Openings	104	7	10	121
Closings	(37)	—	(5)	(42)
Open at February 26, 2005	1,150	63	45	1,258

(1) International stores were located in Puerto Rico, the United Kingdom, Ireland and Mexico.

The Company's proprietary credit card generated net sales of \$461.2 million, an increase of \$24.4 million or 5.6% over last year's proprietary credit card sales of \$436.8 million. Sales on the proprietary credit card were 27.1% of U.S. store sales compared to 25.9% last year. Average ticket on the Company's proprietary credit card increased slightly to \$159 during fiscal 2005 from \$158 last year. The Company continues to try to increase total sales on its proprietary credit card by developing customer loyalty through marketing promotions targeted to cardholders, including deferred payment options on larger purchases. Although the proprietary credit card generates modest income, it primarily serves as a tool for marketing and communication to the Company's most loyal customers.

### Gross Profit

Gross profit after related buying and store occupancy costs, expressed as a percentage of sales, was 38.3%, a decrease of 350 basis points compared to 41.8% a year ago. Merchandise margins as a



## Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

percentage of sales declined 200 basis points from 55.2% in fiscal 2004 to 53.2% in fiscal 2005. Decreased merchandise margins were primarily the result of additional promotional discounts offered to customers in an attempt to stimulate sales. The Company also offered increased promotional discounts to reduce inventory levels in connection with planned efforts to reduce overall SKU counts and eliminate merchandise items that have been in the sales mix longer than a year. Store occupancy costs during fiscal 2005 increased 150 basis points to 14.8% of sales over last year's 13.3%, primarily as a result of relatively fixed rental costs on a lower sales base and from an increase in the percentage of sales derived from newer and slightly larger stores for which occupancy costs as a percentage of sales tend to be higher until the stores reach maturity.

### Operating Expenses and Depreciation

As a percentage of sales, selling, general and administrative expenses, including marketing, increased 110 basis points to 30.2% over last year's 29.1% of sales. In total dollars, selling, general and administrative expenses increased \$28.7 million in fiscal 2005 over fiscal 2004. During the fourth quarter of fiscal 2005, the Company revised its accounting practices for operating leases and leasehold improvements to reflect guidance expressed by the Office of the Chief Accountant of the Securities and Exchange Commission to the American Institute of Certified Public Accountants on February 7, 2005. As a result, the Company recorded a pre-tax charge of \$7.5 million ("lease accounting charge") to selling, general and administrative expenses for rent expense attributable to time periods prior to the opening of certain stores. Under this revision, these periods are deemed to constitute a free rent period that should be considered in the straight-line rent expense calculation. Related rent should be charged to the income statement during the free rent period. This lease accounting charge included \$1.2 million related to leases entered into in fiscal 2005 and a cumulative charge of \$6.3 million for leases entered into in years prior to fiscal 2005, which was not material to the consolidated financial statements for any previously reported fiscal year. *See Note 1 of the Notes to Consolidated Financial Statements for additional information regarding the Company's lease accounting policies.* Excluding the \$6.3 million cumulative correction for the lease accounting issue, selling, general and administrative expenses during fiscal 2005 would have been 29.9% of sales, an increase of 80 basis points over fiscal 2004.

Expenses that normally increase proportionately with sales and number of stores, such as marketing, store payroll, supplies and equipment rental, increased \$20.7 million and 80 basis points as a percentage of sales over the prior fiscal year. Store payroll including bonus increased \$19.1 million and 80 basis points as a percentage of sales as comparable store sales were insufficient to leverage store payroll costs arising from the need to maintain sufficient staffing levels to continue to provide an appropriate level of customer service, while transitioning inventories and changing store visual presentations. The Company's decision to discontinue television advertising and terminate its relationship with its previous agency reduced marketing expenses as a percentage of sales for the latter half of the year, almost entirely offsetting higher expense as a percentage of sales through the second quarter. Compared to fiscal 2004, marketing expenses during the year increased \$0.8 million but remained flat at 4.8% of sales. Other variable expenses, including supplies and equipment rental, increased \$0.8 million and were flat as a percentage of sales.

Relatively fixed selling, general and administrative expenses during fiscal 2005 increased \$8.0 million, or 30 basis points as a percentage of sales over fiscal 2004. Excluding the \$6.3 million cumulative impact of the lease accounting charge discussed above, these expenses would have increased \$1.7 million and would have remained flat as a percentage of sales. The current year effect of the lease accounting charge was \$1.2 million, increasing relatively fixed selling, general and administrative expenses by 10 basis points as a percentage of sales. Home office payroll increased \$4.6 million or 20 basis points as a percentage of sales, primarily as a result of annual merit increases and increases in the Company's expense related to retirement plans for officers and other employees. Partially offsetting these increases was a decrease of \$3.6 million or 20 basis points in settlements and bad debts primarily as a result of a non-recurring settlement in fiscal 2004 of a class action lawsuit regarding compensation matters for which the Company recorded a \$2.6 million charge. All other relatively fixed selling, general and administrative expenses decreased \$0.5 million or approximately 10 basis points as a percentage of sales.

## Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Depreciation and amortization for fiscal 2005 was \$58.3 million, representing an increase of \$7.4 million or 35 basis points over last year's depreciation and amortization expense of \$50.9 million. This increase was primarily the result of net new store openings, depreciation on software applications that were launched subsequent to the end of fiscal 2004, and depreciation on the new corporate headquarters that began in August 2004. These increases were partially offset by a reduction in depreciation expense for certain assets that were fully depreciated during the year.

In fiscal 2005, operating income declined to \$95.8 million or 5.0% of sales from \$186.2 million or 10.0% of sales in fiscal 2004, a decrease of 48.6% or \$90.4 million. Excluding the \$6.3 million cumulative effect of the lease accounting charge, operating income during fiscal 2005 would have been \$102.1 million or 5.4% of sales.

The Company's effective tax rate for fiscal 2005 was 37.6% of income before income taxes, an increase from the fiscal 2004 effective tax rate of 37.0%. The increase resulted primarily from higher nondeductible losses reported by a foreign subsidiary, magnified by lower earnings reported by domestic subsidiaries during fiscal 2005.

### Net Income

Net income in fiscal 2005 was \$60.5 million, or \$.68 per share on a diluted basis, a decrease of \$57.5 million or 48.8% as compared to fiscal 2004's net income of \$118.0 million, or \$1.29 per share on a diluted basis. Net income decreased to 3.2% of sales in fiscal 2005 from 6.3% of sales in fiscal 2004. Excluding the cumulative effect of the lease accounting charge, fiscal 2005 net income and earnings per diluted share would have been \$64.4 million and \$.72, respectively.

### Non-GAAP Financial Measures

This Management's Discussion of Analysis of Financial Condition and Results of Operations includes non-GAAP financial measures related to selling, general and administrative expenses, operating income, net income and earnings per diluted share. These measures exclude the \$6.3 million cumulative lease accounting charge discussed above. The Company believes that these non-GAAP financial measures provide meaningful supplemental information for investors regarding the performance of its business operations, and facilitate comparisons to its historical operating results. A reconciliation of the non-GAAP financial measures follows for the year ended February 26, 2005:

	Non-GAAP Financial Measure	Impact of Lease Accounting Charge	GAAP Financial Measure
Selling, general and administrative expenses as a % of sales	29.9%	0.3%	30.2%
Operating income as a % of sales	5.4%	(0.4%)	5.0%
Operating income (millions)	\$ 102.1	\$ (6.3)	\$ 95.8
Net income (millions)	\$ 64.4	\$ (3.9)	\$ 60.5
Diluted earnings per share	\$ 0.72	\$ (0.04)	\$ 0.68

## FISCAL YEARS ENDED FEBRUARY 28, 2004 AND MARCH 1, 2003

### Net Sales

Net sales during fiscal 2004 were \$1,868.2 million, an increase of \$113.4 million, or 6.5%, over net sales of \$1,754.9 million for fiscal year 2003. Incremental sales growth for fiscal 2004 was comprised of the following components (in thousands):

## Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

	2004
New stores opened during fiscal 2004	\$108,685
Stores opened during fiscal 2003	82,728
Comparable stores	(34,013)
Closed stores and other	<u>(44,024)</u>
<b>Net incremental sales</b>	<b><u>\$113,376</u></b>

Comparable store sales for fiscal 2004 decreased 2.2%. Although average ticket increased over fiscal 2003, customer traffic and conversion rates were below 2003's levels. Concerns during the first half of fiscal 2004 regarding uncertain domestic economic conditions and continuing global unrest led the Company to plan inventory and merchandise selections conservatively. Soon thereafter, the Company recognized that this approach may have had a negative impact on sales, and as a result, began increasing its merchandise orders in the latter part of the second quarter. The Company also believed its television advertising had grown somewhat stale, and at the beginning of fiscal 2005 launched a new campaign with a new celebrity spokesperson. The Company's net sales from Canada and the United Kingdom were subject to fluctuations in currency conversion rates. These fluctuations had a favorable impact on both total net sales and comparable store sales calculations during fiscal 2004.

Net sales consisted almost entirely of sales to retail customers, net of discounts and returns, but also included delivery service revenues and wholesale sales and royalties received from franchise stores and Sears de Mexico, S.A. Sales by retail concept during fiscal years 2004, 2003 and 2002 were as follows (in thousands):

	2004	2003	2002
Pier 1 Imports stores	\$1,771,644	\$1,677,050	\$1,478,438
The Pier stores	62,151	51,470	43,445
Pier 1 Kids stores	19,320	12,199	10,672
Internet	8,635	6,380	3,370
Other (1)	<u>6,493</u>	<u>7,768</u>	<u>12,631</u>
<b>Net sales</b>	<b><u>\$1,868,243</u></b>	<b><u>\$1,754,867</u></b>	<b><u>\$1,548,556</u></b>

(1) Other sales consisted of wholesale sales and royalties received from franchise stores and from Sears de Mexico S.A., and Pier 1 Kids' contract sales. Also included in amounts from fiscal 2002 were sales to the Company's franchise stores in Japan, which were discontinued in fiscal 2002, and Pier 1 Kids' dealer sales, which were discontinued in fiscal 2003. As of August 2003, Pier 1 Kids no longer sells merchandise under wholesale contracts.

The Company's continued efforts to expand by opening new stores contributed to the total net sales growth during fiscal 2004. The Company opened 120 and closed 37 North American Pier 1 stores during fiscal 2004, bringing the Pier 1 store count to 1,083 at year-end compared to 1,000 at fiscal 2003 year-end. The Company also opened 22 and closed seven Pier 1 Kids stores, opened three stores and one "store within a store" at The Pier, and opened three locations with a "store within a store" format in Sears de Mexico S.A. Including all worldwide locations, the Company's store count totaled 1,179 at the end of fiscal 2004, which represents an increase of approximately 10.4% in total retail square footage compared to the end of fiscal year 2003. A summary reconciliation of the Company's stores open at the beginning of fiscal 2004, 2003 and 2002 to the number open at the end of each period follows (openings and closings include relocated stores):

## Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

	Pier 1 North			Total
	American	International <sup>(1)</sup>	Pier 1 Kids	
Open at March 3, 2001	826	52	21	899
Openings	104	3	3	110
Closings	(20)	(9)	(6)	(35)
Open at March 2, 2002	910	46	18	974
Openings	114	3	8	125
Closings	(24)	—	(1)	(25)
Open at March 1, 2003	1,000	49	25	1,074
Openings	120	7	22	149
Closings	(37)	—	(7)	(44)
Open at February 28, 2004	1,083	56	40	1,179

(1) International stores were located in Puerto Rico, the United Kingdom, Mexico and Japan for fiscal 2001. All locations in Japan were closed by fiscal 2002 year-end.

Net sales on the Company's proprietary credit card totaled \$436.8 million, an increase of \$14.3 million or 3.4% over fiscal 2003's proprietary credit card sales of \$422.5 million. Sales on the proprietary credit card were 25.9% of U.S. store sales compared to 26.2% last year. Although average ticket on the Company's proprietary credit card increased to \$158 during fiscal 2004 from \$153 in fiscal 2003, the Company continued to experience a decline in the number of new customer accounts opened during fiscal 2004. In addition, the Company continued to try to increase total sales on its proprietary credit card by developing customer loyalty through marketing promotions targeted to cardholders, including deferred payment options on larger purchases. Although the proprietary credit card generates modest income, it primarily served as a tool for marketing and communication to the Company's most loyal customers.

### Gross Profit

Gross profit, after related buying and store occupancy costs, expressed as a percentage of sales, was 41.8% in fiscal 2004 compared to 42.9% in fiscal 2003. Merchandise margins as a percentage of sales declined from 55.3% in fiscal 2003 to 55.2% in fiscal 2004, a decrease of just over 10 basis points. The decline in merchandise margin rates was expected and resulted primarily from a slight increase in promotional activity during fiscal 2004 and a shift in the percentage of total sales from shelf goods to furniture, where margin rates are typically somewhat lower. Store occupancy costs during fiscal 2004 were \$249.2 million or 13.3% of sales, an increase of \$31.5 million and 90 basis points over store occupancy costs of \$217.6 million or 12.4% of sales during fiscal 2003. This increase was the result of negative comparable store sales and the impact of opening a larger number of new stores during fiscal 2004 and 2003 than in past years. Until new stores reach maturity, rental costs tend to be higher as a percentage of sales than in older stores, and comparable store sales have been insufficient to leverage relatively fixed rental costs in older stores.

### Operating Expenses and Depreciation

Selling, general and administrative expenses, including marketing, comprised 29.1% of sales in fiscal 2004, an increase of 50 basis points over fiscal 2003's 28.6% of sales. In total dollars, selling, general and administrative expenses increased \$42.2 million in fiscal 2004 over fiscal 2003, with \$24.8 million of the increase attributable to expenses that normally grow proportionately with sales and number of stores, such as marketing, store payroll, supplies and equipment rental. These variable expenses increased 10 basis points as a percentage of sales for fiscal 2004 compared to fiscal 2003. Store payroll continued to be well controlled, increasing \$11.0 million yet decreasing as a percentage of sales by approximately 20 basis points, largely as a result of decreased store bonuses, which were awarded primarily based upon sales gains from the comparative period a year earlier. In attempts to increase store traffic and conversion rates, marketing expenditures during fiscal 2004 increased \$11.9 million to 4.8% of sales, an increase over fiscal 2003 of more than 30 basis points expressed as a percentage of sales. Marketing



## **Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

expenditures remained on plan yet comparable store sales were not sufficient to provide leverage. Store supplies and equipment rental remained relatively flat as a percentage of sales at 2.5%, increasing \$1.9 million over fiscal 2003.

Relatively fixed selling, general and administrative expenses increased \$17.4 million in fiscal 2004 to 9.0% of sales, an increase of 40 basis points over fiscal 2003's 8.6% of sales. General insurance costs increased \$6.7 million and 30 basis points to 1.0% of sales as the Company continued to experience higher costs associated with workers' compensation and general liability insurance. Additionally, approximately 25 basis points of the increase as a percentage of sales in relatively fixed expenses related to an increase of \$2.9 million in lease termination expenses for lease obligations that extend beyond the closing of a particular store or the exit from a leased facility, and \$2.6 million in a settlement of and legal fees related to a class action lawsuit regarding compensation matters in California. The Company experienced an increase of \$12.9 million and 50 basis points in other various relatively fixed expenses such as technology related costs. These increases were partially offset by a decrease of \$7.7 million, or approximately 65 basis points as a percentage of sales, related to home office payroll including bonus. This decrease was principally the result of lower corporate bonuses in fiscal 2004 because of less favorable performance results when compared to fiscal 2003.

Depreciation and amortization for fiscal 2004 was \$50.9 million, representing an increase of \$4.5 million or 10 basis points over fiscal year 2003 depreciation and amortization expense of \$46.4 million. This increase was primarily the result of an increase in net new store openings and depreciation on software applications that were launched subsequent to the end of fiscal 2003. These increases were partially offset by a reduction in depreciation expense for certain assets that became fully depreciated during fiscal 2004.

In fiscal 2004, operating income declined to \$186.2 million, or 10.0% of sales, from \$204.7 million, or 11.7% of sales, in fiscal 2003, a decrease of 9.0% or \$18.5 million.

The Company's effective tax rate was 37.0% of income before income taxes for both fiscal 2004 and 2003.

### **Net Income**

Net income in fiscal 2004 was \$118.0 million, or \$1.29 per share on a diluted basis, a decrease of \$11.4 million or 8.8% as compared to fiscal 2003's net income of \$129.4 million, or \$1.36 per share on a diluted basis. Net income, as a percentage of sales, decreased to 6.3% in fiscal 2004 from 7.4% in fiscal 2003.

### **LIQUIDITY AND CAPITAL RESOURCES**

The Company's cash and cash equivalents totaled \$189.1 million at the end of fiscal 2005, down \$36.0 million from the fiscal 2004 year-end balance of \$225.1 million. Operating activities generated \$142.2 million of cash versus \$177.7 million last year and served as the Company's primary source of operating cash for the fiscal year. Inventory levels at the end of fiscal 2005 increased \$6.9 million to \$380.7 million from \$373.9 million at the end of fiscal 2004. Inventory per retail square foot decreased 5% to \$41 at fiscal 2005 year-end compared to \$43 per retail square foot at fiscal 2004 year-end. In response to declines in comparable store sales performance, the Company took steps to carefully monitor inventory levels throughout the year and the decrease in inventory per square foot is in line with the Company's planned initiatives to reduce SKU counts and discontinue older products and product lines. Increases in other accounts receivable, prepaid expenses and other current assets used \$11.3 million during fiscal 2005 and decreases in accrued income taxes used \$14.1 million during the year. Increases in accounts payable and accrued expenses provided cash of \$21.6 million and resulted primarily from increased payables related to inventory.

During fiscal 2005, investing activities by the Company used a net \$97.6 million. Capital expenditures were \$99.2 million and consisted primarily of \$42.2 million for fixtures and leasehold improvements related to new and existing stores for Pier 1, Pier 1 Kids and The Pier, \$34.6 million to complete

## Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

construction of the new corporate headquarters and for other home office expenditures, \$19.5 million for information systems enhancements and \$2.9 million in expenditures for the Company's distribution centers. The Company received \$3.9 million from the disposition of properties, including \$2.8 million received from the sale of two Pier 1 stores. Fiscal 2006 capital expenditures are projected to be approximately \$65 to \$75 million.

Restricted cash increased \$10.8 million due to the transfer of cash to a consolidated trust that was established for the purpose of setting aside funds to be used to settle pension obligations upon the retirement or death of certain of the Company's executive officers. In the future, the assets of the trust may be invested in financial instruments other than the short-term money market funds currently held. *See Note 8 of the Notes to Consolidated Financial Statements for additional information regarding the restricted assets and pension obligations.*

During fiscal 2005, the Company's beneficial interest in securitized receivables decreased \$8.6 million to \$35.7 million from \$44.3 million at the end of fiscal 2004. This decrease resulted primarily from a decrease in the total proprietary credit card receivables portfolio from \$142.2 million at fiscal 2004 year-end to \$134.3 million at February 26, 2005. Lower total sales on the proprietary credit card during the fourth quarter of fiscal 2005 versus the same quarter last year accounted for the majority of the decrease in receivables at fiscal 2005 year-end. The Company continued to have \$100 million of these beneficial interests held by outside parties, and all proprietary credit card receivables were securitized throughout fiscal 2005 and fiscal 2004. *See Note 2 of the Notes to Consolidated Financial Statements for additional information regarding the beneficial interest in securitized receivables.*

Fiscal 2005 financing activities used a net \$80.7 million of the Company's cash. The Company paid \$58.2 million to repurchase 3,225,000 shares of its common stock under the Board of Directors-approved stock buyback program at a weighted average price of \$18.05, including fees. As of April 12, 2005, approximately \$110.0 million remains available for share repurchases, which are expected to be made in open market or private transactions over the next two to three years depending on prevailing market conditions, the Company's available cash, loan agreement restrictions and consideration of its corporate credit ratings. The Company paid dividends totaling \$34.8 million during fiscal 2005, an increase of \$8.0 million over dividends paid during fiscal 2004. Subsequent to the end of fiscal 2005, the Company declared a quarterly cash dividend of \$.10 per share payable on May 18, 2005 to shareholders of record on May 4, 2005. The Company may continue to pay cash dividends and repurchase its common stock in fiscal 2006, but expects to retain most of its future earnings for expansion of the Company's business. Other financing activities, primarily the exercise of stock options by employees, provided cash of \$12.3 million during fiscal 2005.

The Company's sources of working capital for fiscal 2005 were cash flow from operations, sales of proprietary credit card receivables and bank lines of credit. The bank facilities include a \$125 million credit facility, which expires August 2006, all of which was available at fiscal 2005 year-end. The Company had no borrowings on this facility during fiscal 2005. Additionally, the Company has a \$120 million short-term line of credit, which is used primarily to issue merchandise letters of credit. At fiscal 2005 year-end, approximately \$62.5 million had been utilized, leaving \$57.5 million available. The Company also has \$42.9 million in credit lines used to issue other special-purpose letters of credit, all of which were fully utilized at fiscal 2005 year-end. Of the \$42.9 million in special-purpose letters of credit, \$19.4 million related to the Company's industrial revenue bonds. The remaining \$23.5 million in special-purpose letters of credit related primarily to the Company's workers' compensation and general liability insurance policies. *See Note 7 of the Notes to Consolidated Financial Statements.* The Company's primary loan agreements require the Company to maintain certain financial ratios, limit certain investments, and in some instances, limit repurchases of common stock. The Company was in compliance with all debt covenants at fiscal 2005 year-end.

From time to time, the Company purchases auction rate securities with the intention to hold them for short periods of time and considers them to be trading securities. Therefore, the cash flows from the purchases and sales of these securities are reported net in cash provided by operating activities. The Company had no auction rate securities outstanding at either February 26, 2005 or February 28, 2004.

## **Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

The American Jobs Creation Act of 2004 (the "Jobs Act"), enacted on October 22, 2004, provides for a temporary 85% dividends received deduction on certain foreign subsidiary earnings repatriated during a one-year period. The deduction would result in an approximate 5.25% federal tax rate on the repatriated earnings. There are numerous requirements that must be satisfied for the repatriated earnings to qualify for the reduced rate of taxation. The one-year period during which the Company can make qualifying distributions is fiscal 2006.

The Company is in the process of evaluating whether it will repatriate foreign earnings under the provisions of the Jobs Act and is awaiting further regulatory guidance and statutory technical corrections with respect to certain provisions of the Jobs Act. The amount of the possible repatriation ranges from zero to approximately \$39 million.

The Company is not yet in a position to definitely determine the impact of a qualifying repatriation. However, if the maximum amount were repatriated, the Company estimates it would accrue additional tax expense of no more than \$2.1 million for fiscal 2006. The Company expects to determine the amount of foreign earnings, if any, to be repatriated during the third quarter of fiscal 2006.

A summary of the Company's contractual obligations and other commercial commitments as of February 26, 2005 is listed below (in thousands):

## Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

	Total	Amount of Commitment Per Period			
		Less Than 1 Year	1 to 3 Years	3 to 5 Years	More Than 5 Years
Operating leases	\$1,539,777	\$231,765	\$ 425,767	\$352,249	\$529,996
Purchase obligations <sup>(1)</sup>	347,025	347,025	—	—	—
Standby letters of credit <sup>(2)</sup>	23,442	23,442	—	—	—
Long-term debt	19,000	—	—	—	19,000
Interest and related fees on long-term debt <sup>(3)</sup>	12,504	807	1,259	1,113	9,325
Other long-term obligations <sup>(4)</sup>	<u>82,407</u>	<u>812</u>	<u>35,499</u>	<u>3,938</u>	<u>42,158</u>
<b>Total <sup>(5)</sup></b>	<b><u>\$2,024,155</u></b>	<b><u>\$603,851</u></b>	<b><u>\$ 462,525</u></b>	<b><u>\$357,300</u></b>	<b><u>\$600,479</u></b>
Liabilities recorded on the balance sheet			\$ 123,279		
Commitments not recorded on the balance sheet			<u>1,900,876</u>		
<b>Total</b>			<b><u>\$2,024,155</u></b>		

(1) As of February 26, 2005, the Company had approximately \$347.0 million of outstanding purchase orders, which were primarily related to merchandise inventory. Such orders are generally cancelable at the discretion of the Company until the order has been shipped. The table above excludes certain immaterial executory contracts for goods and services that tend to be recurring in nature and similar in amount year over year and includes \$62.5 million in merchandise letters of credit.

(2) The Company also has outstanding standby letters of credit totaling \$19.4 million related to the Company's long-term debt. This amount is excluded from the table above as it is not incremental to the Company's total outstanding commitments.

(3) The interest rates on the Company's long-term debt are variable and reset weekly. The estimated interest payments included in the table include commitment fees and were calculated based upon the rate in effect at fiscal 2005 year-end.

(4) Other long-term obligations represent the Company's liability under various unfunded retirement plans and certain deferred compensation agreements. See Note 8 of the Notes to Consolidated Financial Statements for further discussion of the Company's employee benefit plans.

(5) The above amounts do not include payments that may be due under post-employment consulting agreements with certain employees. The terms and amounts under such agreements are disclosed in the Proxy Statement for the Company's 2005 Annual Meeting of Shareholders.

The present value of total existing minimum operating lease commitments discounted at 10% was \$1,034.1 million at fiscal 2005 year-end. The Company plans to continue to fund these commitments from cash generated from the operations of the Company.

During fiscal 2006, the Company plans to open 85 new Pier 1 stores and close approximately 25 stores as leases expire or otherwise end. Many of the store closings are planned relocations within the same markets. In addition, the Company will continue with expansion plans for Pier 1 Kids and expects to open approximately four locations and close approximately two locations. New store buildings and land will be financed primarily through operating leases. Total capital expenditures for fiscal 2006 are expected to be in the range of \$65 to \$75 million. Of this amount, the Company expects to spend approximately \$35 to \$40 million on store development for Pier 1, Pier 1 Kids and The Pier, \$20 million on information systems enhancements and approximately \$10 million related to the Company's distribution centers. The Company plans to construct a new distribution center under a build-to-suit arrangement and lease the facility under an operating lease. This distribution center will be located in the Northwest United States and is scheduled to begin operations in early fiscal 2007.

In summary, the Company's primary uses of cash in fiscal 2005 were to fund operating expenses and inventory requirements; provide for new and existing store development; fund capital additions related to the new corporate headquarters construction, distribution centers and information systems development;

## Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

and pay dividends and repurchase common stock of the Company. Historically, the Company has financed its operations primarily from internally generated funds and borrowings under the Company's credit facilities. The Company believes that the funds provided from operations, available lines of credit and sales of its proprietary credit card receivables will be sufficient to finance working capital and capital expenditure requirements throughout fiscal year 2006.

### OFF-BALANCE SHEET ARRANGEMENTS

Other than the operating leases and letters of credit discussed above, the Company's only other off-balance sheet arrangement relates to the securitization of the Company's proprietary credit card receivables. On a daily basis, the Company sells its proprietary credit card receivables that meet certain eligibility criteria to a special-purpose, wholly owned subsidiary, Pier 1 Funding, LLC ("Funding"), which transfers the receivables to Pier 1 Imports Credit Card Master Trust (the "Master Trust"). The Master Trust has issued \$100 million face amount of debt securities (the Class A Certificates) to a third party. This securitization of receivables provides the Company with a portion of its funding. However, neither Funding nor the Master Trust is consolidated in the Company's financial statements, and the Company has no obligation to reimburse Funding, the Master Trust or purchasers of Class A Certificates for credit losses from the receivables. Should the balance of the underlying credit card receivables held by the Master Trust decline to a level that the Class A Certificates become insufficiently collateralized, the Master Trust would be contractually required to repay a portion of the Class A Certificates from daily collections, thereby reducing funds available for purchases of newly generated proprietary credit card receivables. At the end of fiscal 2005, the underlying credit card receivables held by the Master Trust were \$134.3 million and would have had to fall below \$117.5 million before a repayment would have been required. This repayment would only be to the extent necessary to maintain the required ratio of receivables to the Class A Certificates as set forth in the securitization agreement. In addition, failure of the Master Trust to comply with its required performance measures, such as payment rate, returns and fraud, portfolio yield and minimum transferor's interest, or other material adverse changes in the Company's credit quality, would trigger an early amortization event. Such an event would eliminate the securitization as a source of funding for the Company. These performance measures would have to deteriorate significantly from their current levels to result in such an early amortization event. If either an early amortization event had occurred, or the Company had been required to consolidate the Master Trust due to a change in accounting rules, the Company's statement of operations for fiscal 2005 would not have been materially different from its reported results. An early amortization event would require the repayment of the Class A Certificates by the Master Trust, thereby reducing funds available for purchases of newly generated proprietary credit card receivables. The consolidation of the Master Trust would result in an increase of approximately \$100 million in both the Company's assets and liabilities as of February 26, 2005. *See Note 2 of the Notes to Consolidated Financial Statements for additional information regarding the beneficial interest in securitized receivables.*

### CRITICAL ACCOUNTING POLICIES

The preparation of the Company's consolidated financial statements in accordance with accounting principles generally accepted in the United States requires the use of estimates that affect the reported value of assets, liabilities, revenues and expenses. These estimates are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for the Company's conclusions. The Company continually evaluates the information used to make these estimates as the business and the economic environment changes. Historically, actual results have not varied materially from the Company's estimates and the Company does not currently anticipate a significant change in its assumptions related to these estimates. Actual results may differ from these estimates under different assumptions or conditions. The Company's significant accounting policies can be found in *Note 1 of the Notes to Consolidated Financial Statements*. The policies and estimates discussed below include the financial statement elements that are either judgmental or involve the selection or application of alternative accounting policies and are material to our financial statements. Unless specifically addressed below, the Company does not believe that its critical accounting policies are subject to market risk exposure that would be considered material and as a result, has not provided a sensitivity analysis. The use of estimates is

## Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

pervasive throughout the consolidated financial statements, but the accounting policies and estimates considered most critical are as follows:

**Revenue recognition** – The Company recognizes revenue from retail sales upon customer receipt or delivery of merchandise, including sales under deferred payment promotions on its proprietary credit card. Primarily, credit card receivable deferrals are for approximately 90 days and have historically resulted in no significant increases in bad debt losses arising from such receivables. Revenue from gift cards and gift certificates is deferred until redemption. The Company records an allowance for estimated merchandise returns based on historical experience and other known factors. Should actual returns differ from the Company's estimates and current provision for merchandise returns, revisions to the estimated merchandise returns may be required.

**Beneficial interest in securitized receivables** – The Company securitizes its entire portfolio of proprietary credit card receivables. During fiscal 2005, 2004 and 2003, the Company sold all of its proprietary credit card receivables, except an immaterial amount of those that failed certain eligibility requirements, to a special-purpose wholly owned subsidiary, Pier 1 Funding, LLC ("Funding"), which transferred the receivables to the Pier 1 Imports Credit Card Master Trust (the "Master Trust"). Neither Funding nor the Master Trust is consolidated by the Company, and the Master Trust meets the requirements of a qualifying special-purpose entity under Statement of Financial Accounting Standards No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." The Master Trust issues beneficial interests that represent undivided interests in the assets of the Master Trust consisting of the transferred receivables and all cash flows from collections of such receivables. The beneficial interests include certain interests retained by Funding, which are represented by Class B Certificates, and the residual interest in the Master Trust (the excess of the principal amount of receivables held in the Master Trust over the portion represented by the certificates sold to third-party investors and the Class B Certificates).

Gain or loss on the sale of receivables depends in part on the previous carrying amount of the financial assets involved in the transfer, allocated between the assets sold and the retained interests based on their relative fair value at the date of transfer. A servicing asset or liability was not recognized in the Company's credit card securitizations (and thus was not considered in the gain or loss computation) since the Company received adequate compensation relative to current market pricing to service the receivables sold.

The beneficial interest in the Master Trust is accounted for as an available-for-sale security. The Company estimates fair value of its beneficial interest in the Master Trust, both upon initial securitization and thereafter, based on the present value of future expected cash flows using management's best estimates of key assumptions including credit losses and payment rates. As of February 26, 2005 and February 28, 2004, the Company's assumptions used to calculate the present value of the future cash flows included estimated credit losses of 5% and 5.75%, respectively, of the outstanding balance, expected payment within a six-month period and a discount rate representing the average market rate the Company would expect to pay if it sold securities representing ownership in the excess receivables not required to collateralize the Class A Certificates. A sensitivity analysis performed assuming a hypothetical 20% adverse change in both interest rates and credit losses resulted in an immaterial impact on the fair value of the Company's beneficial interest. Although not anticipated by the Company, a significant deterioration in the financial condition of the Company's credit card holders, interest rates or other economic conditions could result in other than temporary losses on the beneficial interest in future periods.

**Inventories** – The Company's inventory is comprised of finished merchandise and is stated at the lower of average cost or market, cost being determined on a weighted average inventory method. Cost is calculated based upon the actual landed cost of an item at the time it is received in the Company's warehouse using actual vendor invoices, the cost of warehousing and transporting product to the stores and other costs associated with purchasing products. Carrying values of inventory are analyzed and to the extent that the cost of inventory exceeds the expected selling prices less reasonable costs to sell, provisions are made to reduce the carrying amount of the inventory. The Company reviews its inventory levels in order to identify slow-moving merchandise and uses merchandise markdowns to sell such merchandise. Markdowns are recorded to reduce the value of such slow-moving merchandise as needed. Since the determination of

## Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

carrying values of inventory involves both estimation and judgment with regard to market values and reasonable costs to sell, differences in these estimates could result in ultimate valuations that differ from the recorded asset.

The Company recognizes known inventory losses, shortages and damages when incurred and makes a provision for estimated shrinkage. The amount of the provision is estimated based on historical experience from the results of its physical inventories. Inventory is physically counted at substantially all locations at least once in each 12-month period, at which time actual results are reflected in the financial statements. Physical counts were taken at substantially all stores and distribution centers during fiscal 2005. Although inventory shrink rates have not fluctuated significantly in recent years, should actual rates differ from the Company's estimates, revisions to the inventory shrink expense may be required. Most inventory purchases and commitments are made in U.S. dollars.

**Insurance provision** – The Company is self-insured with respect to medical coverage offered to eligible employees except that claims in excess of \$150,000 per occurrence per year are covered by a purchased insurance policy. The Company records a provision for estimated claims that have been incurred but not reported. Such claim amounts are estimated based on historical average claims per covered individual per month and on the average historical lag time between the covered event and the time it is paid by the Company. The liability for estimated medical claims incurred but not reported at February 26, 2005 was \$3.8 million.

During fiscal 2005, the Company maintained insurance for workers' compensation and general liability claims with a deductible of \$1,000,000 and \$750,000, respectively, per claim. The liability recorded for such claims is determined by estimating the total future claims cost for events that occurred prior to the balance sheet date. The estimates consider historical claims development factors as well as information obtained from and projections made by the Company's insurance carrier and underwriters. The recorded liabilities for workers' compensation and general liability claims at February 26, 2005 were \$13.7 million and \$4.7 million, respectively.

The assumptions made in determining the above estimates are reviewed continually and the liability adjusted accordingly as new facts are revealed. Changes in circumstances and conditions affecting the assumptions used in determining the liabilities could cause actual results to differ from the Company's recorded amounts.

**Income taxes** – The Company records income tax expense using the liability method for taxes. The Company is subject to income tax in many jurisdictions, including the United States, various states and localities, and foreign countries. At any point in time, multiple tax years are subject to audit by various jurisdictions and the Company records reserves for estimates of probable tax exposures of foreign and domestic tax audits. The results and timing of these audits and negotiations with taxing authorities may affect the ultimate settlement of these issues. The process of determining tax expense by jurisdiction involves the calculation of actual current tax expense, together with the assessment of deferred tax expense resulting from differing treatment of items for tax and financial accounting purposes. Deferred tax assets and liabilities are recorded in the Company's consolidated balance sheets and are classified as current or noncurrent based on the classification of the related assets or liabilities for financial reporting purposes. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets unless it is more likely than not that such assets will be realized. If different assumptions had been used, the Company's tax expense, assets and liabilities could have varied from recorded amounts. If actual results differ from estimated results or if the Company adjusts these assumptions in the future, the Company may need to adjust its deferred tax assets or liabilities, which could impact its effective tax rate.

## MARKET RISK DISCLOSURES

Market risks relating to the Company's operations result primarily from changes in foreign exchange rates and interest rates. The Company has only limited involvement with derivative financial instruments, does not use them for trading purposes and is not a party to any leveraged derivatives.

## **Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

The Company periodically enters into forward foreign currency exchange contracts. The Company uses such contracts to hedge exposures to changes in foreign currency exchange rates associated with purchases denominated in foreign currencies, primarily euros. The Company also uses contracts to hedge its exposure associated with repatriation of funds from its Canadian operations. Changes in the fair value of the derivatives are included in the Company's consolidated statements of operations as such contracts are not designated as hedges under Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities." Forward contracts that hedge merchandise purchases generally have maturities not exceeding six months. Changes in the fair value and settlement of these forwards are included in cost of sales. Contracts which hedge the repatriation of Canadian funds have maturities not exceeding 18 months and changes in the fair value and settlement of these contracts are included in selling, general and administrative expenses. At February 26, 2005, the notional amount of the Company's forward foreign currency exchange contracts totaled approximately 3.8 million euros. There were no outstanding contracts to hedge exposure associated with the repatriation of Canadian funds.

The Company manages its exposure to changes in interest rates by optimizing the use of variable and fixed rate debt. The Company had \$19.0 million of variable rate borrowings at February 26, 2005. A hypothetical 10% adverse change in interest rates would have a negligible impact on the Company's earnings and cash flows.

Collectively, the Company's exposure to these market risk factors is not significant and has not materially changed from February 28, 2004.

### **IMPACT OF INFLATION AND CHANGING PRICES**

Inflation has not had a significant impact on the operations of the Company during the preceding three years.

### **IMPACT OF NEW ACCOUNTING STANDARDS**

In January 2003, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"). This interpretation requires certain variable interest entities ("VIEs"), commonly referred to as special purpose entities, to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 was effective for all new VIEs created or acquired after January 31, 2003. During December 2003, the FASB issued a revision to FIN 46 ("FIN 46R"). Under the new provisions, public entities were required to apply the guidance if the entity has interests in VIEs for the periods ending after December 15, 2003. Application of this guidance by public companies was required for all other types of entities for periods ending after March 15, 2004. The adoption of FIN 46R did not have a material effect on the Company's consolidated balance sheets or its statements of operations, shareholders' equity and cash flows.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs" ("SFAS 151"), an amendment of Accounting Research Bulletin No. 43, Chapter 4. SFAS 151 clarifies that abnormal amounts of idle facility expense, freight, handling costs and wasted materials (spoilage) should be recognized as current-period charges and requires the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. The statement will be effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company has evaluated the provisions of SFAS 151 and does not anticipate that adoption will have an impact on its consolidated balance sheets or statements of operations, shareholders' equity and cash flows.

In December 2004, the FASB issued SFAS No. 123 (Revised 2004), "Share-Based Payment" ("SFAS 123R"). This statement replaces FASB Statement No. 123, "Accounting for Stock-Based Compensation," and supercedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS 123R requires all companies to measure compensation cost for all share-based payments, including stock options, at fair value. The statement will be effective for public companies no later than the beginning of the first fiscal year

## **Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

commencing after June 15, 2005, which for the Company is the beginning of fiscal 2007. The Company is currently evaluating the effect that SFAS 123R will have on its consolidated balance sheets and its statements of shareholders' equity and cash flows. SFAS 123R also requires that the benefits associated with the tax deductions in excess of recognized compensation cost be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce operating cash flows and increase net financing cash flows in periods after the effective date. These future amounts cannot be estimated, because they depend on, among other things, when employees exercise stock options. However, the amount of operating cash flows recognized for such excess tax deductions for the years ended February 26, 2005, February 28, 2004 and March 1, 2003 was not material.

### **FORWARD-LOOKING STATEMENTS**

Certain matters discussed in this annual report, other than historical information, may constitute "forward-looking statements" that are subject to certain risks and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements. The Company may also make forward-looking statements in other reports filed with the Securities and Exchange Commission and in material delivered to the Company's shareholders. Forward-looking statements provide current expectations of future events based on certain assumptions. These statements encompass information that does not directly relate to any historical or current fact and often may be identified with words such as "anticipates," "believes," "expects," "estimates," "intends," "plans," "projects" and other similar expressions. Management's expectations and assumptions regarding planned store openings, financing of Company obligations from operations, results from its new marketing, merchandising and store operations strategies, and other 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. Risks and uncertainties that may affect Company operations and performance include, among others, the effects of terrorist attacks or other acts of war, conflicts or war involving the United States or its allies or trading partners, labor strikes, weather conditions that may affect sales, volatility of fuel and utility costs, the general strength of the economy and levels of consumer spending, consumer confidence, the availability of new sites for expansion along with sufficient labor to facilitate growth, the strength of new home construction and sales of existing homes, the availability and proper functioning of technology and communications systems supporting the Company's key business processes, the ability of the Company to import merchandise from foreign countries without significantly restrictive tariffs, duties or quotas and the ability of the Company to source, ship and deliver items from foreign countries to its U.S. distribution centers at reasonable prices and rates and in a timely fashion. The foregoing risks and uncertainties are in addition to others discussed elsewhere in this annual report. The Company assumes no obligation to update or otherwise revise its forward-looking statements even if experience or future changes make it clear that any projected results expressed or implied will not be realized.

## REPORT OF MANAGEMENT

Management is responsible for the preparation and the integrity of the accompanying consolidated financial statements and related notes, which have been prepared in accordance with U.S. generally accepted accounting principles and include amounts based upon our estimates and judgments, as required. The consolidated financial statements have been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their accompanying report on the fairness of presentation of management's financial statements.

## REPORT OF MANAGEMENT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is also responsible for establishing and maintaining a system of internal controls over financial reporting designed to provide reasonable assurance that transactions are executed in accordance with management authorization and that such transactions are properly recorded and reported in the financial statements, and that records are maintained so as to permit preparation of the financial statements in accordance with U.S. generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Management has assessed the effectiveness of the Company's internal control over financial reporting utilizing the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control—Integrated Framework*. Management concluded that based on its assessment, Pier 1 Imports, Inc.'s internal control over financial reporting was effective as of February 26, 2005. Management's assessment of the effectiveness of the Company's internal control over financial reporting as of February 26, 2005 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report which is included in this Annual Report to Shareholders.

/s/ Marvin J. Girouard

Marvin J. Girouard  
Chairman of the Board and  
Chief Executive Officer

/s/ Charles H. Turner

Charles H. Turner  
Executive Vice President, Finance,  
Chief Financial Officer and Treasurer

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors of Pier 1 Imports, Inc.

We have audited the accompanying consolidated balance sheets of Pier 1 Imports, Inc. as of February 26, 2005 and February 28, 2004, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended February 26, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Pier 1 Imports, Inc. at February 26, 2005 and February 28, 2004, and the consolidated results of its operations and its cash flows for each of the three years in the period ended February 26, 2005, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Pier 1 Imports, Inc.'s internal control over financial reporting as of February 26, 2005, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated April 18, 2005 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Fort Worth, Texas  
April 18, 2005

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON INTERNAL CONTROL OVER FINANCIAL REPORTING

To the Board of Directors of Pier 1 Imports, Inc.

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that Pier 1 Imports, Inc. maintained effective internal control over financial reporting as of February 26, 2005, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Pier 1 Imports, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Pier 1 Imports, Inc. maintained effective internal control over financial reporting as of February 26, 2005, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Pier 1 Imports, Inc. maintained, in all material respects, effective internal control over financial reporting as of February 26, 2005, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Pier 1 Imports, Inc. as of February 26, 2005 and February 28, 2004, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended February 26, 2005 and our report dated April 18, 2005 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Fort Worth, Texas

April 18, 2005

**Pier 1 Imports, Inc.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(in thousands except per share amounts)

	Year Ended		
	2005	2004	2003
Net sales	\$1,897,853	\$1,868,243	\$1,754,867
Operating costs and expenses:			
Cost of sales (including buying and store occupancy costs)	1,170,588	1,086,623	1,001,462
Selling, general and administrative expenses	573,213	544,536	502,319
Depreciation and amortization	58,290	50,927	46,432
	<u>1,802,091</u>	<u>1,682,086</u>	<u>1,550,213</u>
Operating income	95,762	186,157	204,654
Nonoperating (income) and expenses:			
Interest and investment income	(2,723)	(2,851)	(3,047)
Interest expense	1,644	1,692	2,327
	<u>(1,079)</u>	<u>(1,159)</u>	<u>(720)</u>
Income before income taxes	96,841	187,316	205,374
Provision for income taxes	36,384	69,315	75,988
Net income	<u>\$ 60,457</u>	<u>\$ 118,001</u>	<u>\$ 129,386</u>
Earnings per share:			
Basic	\$ .69	\$ 1.32	\$ 1.39
Diluted	\$ .68	\$ 1.29	\$ 1.36
Dividends declared per share:	\$ .40	\$ .30	\$ .21
Average shares outstanding during period:			
Basic	<u>87,037</u>	<u>89,294</u>	<u>92,871</u>
Diluted	<u>88,838</u>	<u>91,624</u>	<u>95,305</u>

The accompanying notes are an integral part of these financial statements.

**Pier 1 Imports, Inc.**  
**CONSOLIDATED BALANCE SHEETS**  
(in thousands except share amounts)

	2005	2004
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents, including temporary investments of \$178,289 and \$208,984, respectively	\$ 189,081	\$ 225,101
Beneficial interest in securitized receivables	35,690	44,331
Other accounts receivable, net of allowance for doubtful accounts of \$82 and \$111, respectively	11,744	14,226
Inventories	380,730	373,870
Prepaid expenses and other current assets	43,445	40,623
Total current assets	660,690	698,151
Properties, net	337,630	290,420
Other noncurrent assets	77,429	63,602
	<b>\$1,075,749</b>	<b>\$1,052,173</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 113,502	\$ 100,640
Gift cards and other deferred revenue	61,347	59,385
Accrued income taxes payable	11,866	25,982
Other accrued liabilities	102,294	93,881
Total current liabilities	289,009	279,888
Long-term debt	19,000	19,000
Other noncurrent liabilities	103,371	69,654
Shareholders' equity:		
Common stock, \$1.00 par, 500,000,000 shares authorized, 100,779,000 issued	100,779	100,779
Paid-in capital	141,850	145,384
Retained earnings	656,692	630,997
Cumulative other comprehensive (loss) income	(1,426)	1,667
Less - 14,459,000 and 12,473,000 common shares in treasury, at cost, respectively	(233,526)	(195,196)
	664,369	683,631
Commitments and contingencies	—	—
	<b>\$1,075,749</b>	<b>\$1,052,173</b>

The accompanying notes are an integral part of these financial statements.

**Pier 1 Imports, Inc.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands)

	Year Ended		
	2005	2004	2003
<b>Cash flow from operating activities:</b>			
Net income	\$ 60,457	\$ 118,001	\$129,386
<b>Adjustments to reconcile to net cash provided by operating activities:</b>			
Depreciation and amortization	75,624	64,606	57,934
Loss on disposal of fixed assets	1,056	143	980
Deferred compensation	7,710	6,573	5,043
Lease termination expense	2,243	3,258	395
Deferred income taxes	2,035	184	18,748
Tax benefit from options exercised by employees	3,668	4,897	6,867
Other	(222)	4,894	949
<b>Change in cash from:</b>			
Inventories	(6,860)	(40,520)	(57,917)
Other accounts receivable, prepaid expenses and other current assets	(11,302)	(16,927)	(14,362)
Accounts payable and accrued expenses	21,572	34,410	33,364
Accrued income taxes payable	(14,116)	184	(3,940)
Other noncurrent assets	336	(2,027)	(759)
Net cash provided by operating activities	<u>142,201</u>	<u>177,676</u>	<u>176,688</u>
<b>Cash flow from investing activities:</b>			
Capital expenditures	(99,239)	(121,190)	(99,042)
Proceeds from disposition of properties	3,852	34,450	6,330
Net change in restricted cash	(10,807)	(8,752)	(500)
Beneficial interest in securitized receivables	8,641	(5,143)	4,082
Net cash used in investing activities	<u>(97,553)</u>	<u>(100,635)</u>	<u>(89,130)</u>
<b>Cash flow from financing activities:</b>			
Cash dividends	(34,762)	(26,780)	(19,520)
Purchases of treasury stock	(58,210)	(76,009)	(78,474)
Proceeds from stock options exercised, stock purchase plan and other, net	12,304	15,125	17,305
Repayments of long-term debt and notes payable	—	(6,390)	(364)
Net cash used in financing activities	<u>(80,668)</u>	<u>(94,054)</u>	<u>(81,053)</u>
Change in cash and cash equivalents	(36,020)	(17,019)	6,505
Cash and cash equivalents at beginning of year	<u>225,101</u>	<u>242,114</u>	<u>235,609</u>
Cash and cash equivalents at end of year	<u>\$189,081</u>	<u>\$ 225,101</u>	<u>\$242,114</u>
<b>Supplemental cash flow information:</b>			
Interest paid	<u>\$ 868</u>	<u>\$ 1,791</u>	<u>\$ 2,065</u>
Income taxes paid	<u>\$ 45,655</u>	<u>\$ 63,788</u>	<u>\$ 54,711</u>

The accompanying notes are an integral part of these financial statements.



**Pier 1 Imports, Inc.**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
(in thousands except per share amounts)

	Common Stock		Paid-in Capital	Retained Earnings	Cumulative Other Comprehensive Income (Loss)	Treasury Stock	Total Shareholders' Equity
	Outstanding Shares	Amount					
Balance March 2, 2002	93,389	\$100,779	\$140,190	\$429,910	\$ (4,702)	\$ (80,521)	\$ 585,656
Comprehensive income:							
Net income	—	—	—	129,386	—	—	129,386
Other comprehensive income:							
Minimum pension liability adjustments, net of tax	—	—	—	—	(909)	—	(909)
Currency translation adjustments	—	—	—	—	3,401	—	3,401
Comprehensive income							131,878
Purchases of treasury stock	(4,397)	—	—	—	—	(78,474)	(78,474)
Exercise of stock options, stock purchase plan and other	1,693	—	4,057	—	—	20,339	24,396
Cash dividends (\$.21 per share)	—	—	—	(19,520)	—	—	(19,520)
Balance March 1, 2003	90,685	100,779	144,247	539,776	(2,210)	(138,656)	643,936
Comprehensive income:							
Net income	—	—	—	118,001	—	—	118,001
Other comprehensive income:							
Minimum pension liability adjustments, net of tax	—	—	—	—	(1,033)	—	(1,033)
Currency translation adjustments	—	—	—	—	4,910	—	4,910
Comprehensive income							121,878
Purchases of treasury stock	(3,758)	—	—	—	—	(76,009)	(76,009)
Exercise of stock options, stock purchase plan and other	1,300	—	1,137	—	—	19,469	20,606
Cash dividends (\$.30 per share)	—	—	—	(26,780)	—	—	(26,780)
Balance February 28, 2004	88,227	100,779	145,384	630,997	1,667	(195,196)	683,631
Comprehensive income:							
Net income	—	—	—	60,457	—	—	60,457
Other comprehensive income, net of tax:							
Minimum pension liability adjustments	—	—	—	—	(4,780)	—	(4,780)
Currency translation adjustments	—	—	—	—	1,687	—	1,687
Comprehensive income							57,364
Purchases of treasury stock	(3,225)	—	—	—	—	(58,210)	(58,210)

Exercise of stock options, stock purchase plan and other	1,238	—	(3,534)	—	—	19,880	16,346
Cash dividends (\$.40 per share)	—	—	—	(34,762)	—	—	(34,762)
Balance February 26, 2005	<u>86,240</u>	<u>\$100,779</u>	<u>\$141,850</u>	<u>\$656,692</u>	<u>\$ (1,426)</u>	<u>\$(233,526)</u>	<u>\$ 664,369</u>

The accompanying notes are an integral part of these financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Organization** – Pier 1 Imports, Inc. is one of North America's largest specialty retailers of imported decorative home furnishings, gifts and related items, with retail stores located primarily in the United States, Canada, Puerto Rico, the United Kingdom, Ireland and Mexico.

**Basis of consolidation** – The consolidated financial statements of Pier 1 Imports, Inc. and its consolidated subsidiaries (the "Company") include the accounts of all subsidiary companies except Pier 1 Funding, LLC, which is a non-consolidated, bankruptcy remote, securitization subsidiary. *See Note 2 of the Notes to Consolidated Financial Statements.* Material intercompany transactions and balances have been eliminated.

**Segment information** – The Company is a specialty retailer that offers a broad range of products in its stores and conducts business as one operating segment. The Company's domestic operations provided 90.1%, 91.0% and 92.5% of its net sales, with 5.8%, 5.5% and 4.3% provided by stores in Canada, 3.8%, 3.3% and 2.9% provided by stores in the United Kingdom and Ireland, and the remainder from royalties received from Sears de Mexico S.A. during fiscal 2005, 2004 and 2003, respectively. As of February 26, 2005 and February 28, 2004, \$27,298,000 and \$22,529,000, respectively, of the Company's long-lived assets were located outside the United States. Of this amount, \$8,888,000 and \$7,666,000 were located in Canada and \$18,410,000 and \$14,864,000 were located in the United Kingdom and Ireland at February 26, 2005 and February 28, 2004, respectively. Long-lived assets in Mexico were not significant during either period.

**Use of estimates** – Preparation of the financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

**Reclassifications** – Certain reclassifications have been made in the prior years' consolidated financial statements to conform to the fiscal 2005 presentation. These reclassifications had no effect on net income and shareholders' equity with minimal effects on total assets and total liabilities.

**Fiscal periods** – The Company utilizes 5-4-4 (week) quarterly accounting periods with the fiscal year ending on the Saturday nearest the last day of February. Fiscal 2005 ended February 26, 2005, fiscal 2004 ended February 28, 2004 and fiscal 2003 ended March 1, 2003, all of which contained 52 weeks.

**Cash and cash equivalents** – The Company considers all highly liquid investments with an original maturity date of three months or less to be cash equivalents. As of February 26, 2005 and February 28, 2004, the Company's short-term investments classified as cash equivalents included investments in money market mutual funds totaling \$178,289,000 and \$208,984,000, respectively. The effect of foreign currency exchange rate fluctuations on cash is not material.

**Translation of foreign currencies** – Assets and liabilities of foreign operations are translated into U.S. dollars at fiscal year-end exchange rates. Income and expense items are translated at average exchange rates prevailing during the year. Translation adjustments arising from differences in exchange rates from period to period are included as a separate component of shareholders' equity and are included in other comprehensive income. As of February 26, 2005, February 28, 2004 and March 1, 2003, the Company had cumulative other comprehensive income (loss) balances of \$5,296,000, \$3,609,000 and (\$1,301,000), respectively, related to cumulative translation adjustments. The adjustments for currency translation during fiscal 2005, 2004 and 2003 resulted in other comprehensive income of \$1,687,000, \$4,910,000, and \$3,401,000, respectively. During fiscal 2005, the Company provided deferred taxes of \$703,000 on the portion of its cumulative currency translation adjustment considered not to be permanently reinvested abroad. Taxes on this portion of cumulative currency translation adjustments were insignificant in fiscal 2004 and 2003.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**Concentrations of risk** – The Company has some degree of risk concentration with respect to sourcing the Company's inventory purchases. However, the Company believes alternative sources of products could be procured over a relatively short period of time. The Company sells merchandise imported from over 40 different countries, with 38% of its sales derived from merchandise produced in China, 13% derived from merchandise produced in the United States, 13% derived from merchandise produced in India and 29% derived from merchandise produced in Indonesia, Thailand, Brazil, the Philippines, Italy and Mexico. The remaining 7% of sales was from merchandise produced in various Asian, European, Central American, South American and African countries.

**Financial instruments** – The fair value of financial instruments is determined by reference to various market data and other valuation techniques as appropriate. There were no assets or liabilities with a fair value significantly different from the recorded value as of February 26, 2005 and February 28, 2004.

From time to time, the Company purchases auction rate securities with the intention to hold them for short periods of time and considers them to be trading securities. Therefore, the cash flows from the purchases and sales of these securities are reported net in cash provided by operating activities. The Company had no auction rate securities outstanding at either February 26, 2005 or February 28, 2004.

*Risk management instruments:* The Company may utilize various financial instruments to manage interest rate and market risk associated with its on- and off-balance sheet commitments.

The Company hedges certain commitments denominated in foreign currencies through the purchase of forward contracts. The forward contracts are purchased only to cover specific commitments to buy merchandise for resale. The Company also uses contracts to hedge its exposure associated with the repatriation of funds from its Canadian operations. At February 26, 2005, the notional amount of the Company's forward foreign currency exchange contracts totaled approximately 3.8 million euros. There were no outstanding contracts to hedge exposure associated with repatriation of Canadian funds. For financial accounting purposes, the Company has not designated such contracts as hedges. Thus, changes in the fair value of both types of forward contracts are included in the Company's consolidated statements of operations. Both the changes in fair value and settlement of these contracts are included in cost of sales for forwards related to merchandise purchases and in selling, general and administrative expense for the contracts associated with the repatriation of Canadian funds.

The Company enters into forward foreign currency exchange contracts with major financial institutions and continually monitors its positions with, and the credit quality of, these counterparties to such financial instruments. The Company does not expect non-performance by any of the counterparties, and any losses incurred in the event of non-performance would not be material.

**Beneficial interest in securitized receivables** – The Company securitizes its entire portfolio of proprietary credit card receivables. During fiscal 2005, 2004 and 2003, the Company sold all of its proprietary credit card receivables, except those that failed certain eligibility requirements, to a special-purpose wholly owned subsidiary, Pier 1 Funding, LLC ("Funding"), which transferred the receivables to the Pier 1 Imports Credit Card Master Trust (the "Master Trust"). Neither Funding nor the Master Trust is consolidated by the Company and the Master Trust meets the requirements of a qualifying special-purpose entity under Statement of Financial Accounting Standards ("SFAS") No. 140. The Master Trust issues beneficial interests that represent undivided interests in the assets of the Master Trust consisting of the transferred receivables and all cash flows from collections of such receivables. The beneficial interests include certain interests retained by Funding, which are represented by Class B Certificates, and the residual interest in the Master Trust (the excess of the principal amount of receivables held in the Master Trust over the portion represented by the certificates sold to a third-party investor and the Class B Certificates).

Gain or loss on the sale of receivables depends in part on the previous carrying amount of the financial assets involved in the transfer, allocated between the assets sold and the retained interests based on their relative fair value at the date of transfer. A servicing asset or liability was not recognized in the Company's

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

credit card securitizations (and thus was not considered in the gain or loss computation) since the Company received adequate compensation relative to current market pricing to service the receivables sold.

The beneficial interest in the Master Trust is accounted for as an available-for-sale security. The Company estimates fair value of its beneficial interest in the Master Trust, both upon initial securitization and thereafter, based on the present value of future expected cash flows using management's best estimates of key assumptions including credit losses and payment rates. As of February 26, 2005 and February 28, 2004, the Company's assumptions used to calculate the present value of the future cash flows included estimated credit losses of 5% and 5.75%, respectively, of the outstanding balance, expected payment within a six-month period and a discount rate representing the average market rate the Company would expect to pay if it sold securities representing ownership in the excess receivables not required to collateralize the Class A Certificates. A sensitivity analysis performed assuming a hypothetical 20% adverse change in both interest rates and credit losses resulted in an immaterial impact on the fair value of the Company's beneficial interest. Although not anticipated by the Company, a significant deterioration in the financial condition of the Company's credit card holders, interest rates, or other economic conditions could result in other than temporary losses on the beneficial interest in future periods. *See Note 2 of the Notes to Consolidated Financial Statements for further discussion.*

**Inventories** – Inventories are comprised of finished merchandise and are stated at the lower of average cost or market, cost being determined on a weighted average inventory method. Cost is calculated based upon the actual landed cost of an item at the time it is received in the Company's warehouse using actual vendor invoices, the cost of warehousing and transporting product to the stores and other costs associated with purchasing products.

The Company recognizes known inventory losses, shortages and damages when incurred and maintains a provision for estimated shrinkage. The shrink provisions at the end of fiscal years 2005 and 2004 were \$4,711,000 and \$4,442,000, respectively.

**Properties, maintenance and repairs** – Buildings, equipment, furniture and fixtures, and leasehold improvements are carried at cost less accumulated depreciation. Depreciation is computed using the straight-line method over estimated remaining useful lives of the assets, generally thirty years for buildings and three to ten years for equipment, furniture and fixtures. Depreciation of improvements to leased properties is based upon the shorter of the remaining primary lease term or the estimated useful lives of such assets. Depreciation costs were \$56,932,000, \$49,572,000 and \$45,011,000 in fiscal 2005, 2004 and 2003, respectively.

Expenditures for maintenance, repairs and renewals that do not materially prolong the original useful lives of the assets are charged to expense as incurred. In the case of disposals, assets and the related depreciation are removed from the accounts and the net amount, less proceeds from disposal, is credited or charged to income.

**Goodwill and intangible assets** – The Company applies the provisions of SFAS No. 142, "Goodwill and Intangible Assets." Under SFAS No. 142, goodwill and intangible assets with indefinite useful lives are not amortized, but instead are tested for impairment at least annually. In accordance with SFAS No. 142, the Company's reporting units were identified as components, and the goodwill assigned to each represents the excess of the original purchase price over the fair value of the net identifiable assets acquired for that component. The Company completed the annual impairment tests as of February 26, 2005 and February 28, 2004 for fiscal 2005 and 2004, respectively. The impairment tests were conducted by performing analyses of discounted future cash flows for the applicable reporting units. The resulting fair value of each reporting unit was greater than the respective carrying values, and as such, no impairment loss was recognized. *See Note 4 of the Notes to Consolidated Financial Statements for additional discussion of goodwill and intangible assets.*

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**Revenue recognition** – Revenue is recognized upon customer receipt or delivery for retail sales, including sales under deferred payment promotions on the Company's proprietary credit card. A provision has been established for estimated merchandise returns based upon historical experience and other known factors. The provisions for estimated merchandise returns at the end of fiscal years 2005 and 2004 were \$3,595,000 and \$2,501,000, respectively. Revenue from sales of gift cards and gift certificates is deferred until redemption. The Company's revenues are reported net of discounts and returns, and include wholesale sales and royalties received from franchise stores and Sears de Mexico S.A. Amounts billed to customers for shipping and handling are included in net sales and the costs incurred by the Company for these items are recorded in cost of sales.

**Leases** – The Company leases certain property consisting principally of retail stores, warehouses, and material handling and office equipment under leases expiring through fiscal 2021. Most retail store locations are leased for primary terms of 10 to 15 years with varying renewal options and rent escalation clauses. Escalations occurring during the primary terms of the leases are included in the calculation of the minimum lease payments, and the rent expense related to these leases is recognized on a straight-line basis over this lease term. Prior to fiscal 2005, the Company recognized straight-line rent expense for store leases beginning on the earlier of the rent commencement date or the store opening date, which had the effect of excluding the build-out period of its stores from the calculation of the period over which it expenses rent. During the fourth quarter of fiscal 2005, the Company revised its accounting practices to extend the lease term to include this free rent period prior to the opening of its stores. This revision in practice resulted in a cumulative pre-tax charge of \$6.3 million for leases entered into prior to fiscal 2005, which was not material to any previously reported fiscal year. This cumulative adjustment will have no effect on historical or future cash flows from operations or the timing of payments under the related leases. The portion of rent expense applicable to a store before opening is included in selling, general and administrative expenses. Once opened for business, rent expense is included in cost of sales. Certain leases provide for additional rental payments based on a percentage of sales in excess of a specified base. This additional rent is accrued when it appears that the sales will exceed the specified base. The Company's lease obligations are considered operating leases under SFAS 13.

Prior to fiscal 2005, the Company's consolidated balance sheets have reflected the unamortized portion of construction allowances received from landlords of leased stores as a reduction of properties instead of as lease liabilities. Further, the Company's consolidated statements of cash flows have reflected these construction allowances as a reduction of capital expenditures in investing activities, rather than as an increase in liabilities in operating activities. During the fourth quarter of fiscal 2005, the Company recorded an adjustment to classify the remaining unamortized portion of these construction allowances as a lease liability on its consolidated balance sheet as of February 26, 2005. This adjustment resulted in an increase of \$14.3 million in net properties with an offsetting increase in its lease liability. In addition, the consolidated statement of cash flows for fiscal 2005 includes the construction allowances received during the year as lease liabilities and not as a reduction of capital expenditures. This change did not have a material impact on the consolidated financial statements for any previously reported fiscal year.

**Advertising costs** – Advertising production costs are expensed the first time the advertising takes place. Advertising costs were \$83,106,000, \$82,809,000 and \$72,256,000 in fiscal 2005, 2004 and 2003, respectively. Prepaid advertising at the end of fiscal years 2005 and 2004 was \$2,853,000 and \$3,921,000, respectively, consisting primarily of production costs for television commercials and related fees for advertisements planned to air in late spring and early fall.

**Income taxes** – The Company records income tax expense using the liability method for taxes. Under this method, deferred tax assets and liabilities are recognized based on differences between financial statement and tax bases of assets and liabilities using presently enacted tax rates. Deferred tax assets and liabilities are classified as current or noncurrent based on the classification of the related assets or liabilities for financial reporting purposes. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets unless it is more likely than not that such assets will be realized. Deferred federal income taxes, net of applicable foreign tax credits, are not provided on the undistributed earnings of foreign subsidiaries to

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

the extent the Company intends to permanently reinvest such earnings abroad. At any point in time, multiple tax years are subject to audit by various jurisdictions and the Company records reserves for estimates of probable tax exposures of foreign and domestic tax audits. The results and timing of these audits and negotiations with taxing authorities may affect the ultimate settlement of these issues.

**Earnings per share** – Basic earnings per share amounts were determined by dividing net income by the weighted average number of common shares outstanding for the period. Diluted earnings per share amounts were similarly computed, but included the effect, when dilutive, of the Company’s weighted average number of stock options outstanding.

Earnings per share amounts are calculated as follows (in thousands except per share amounts):

	2005	2004	2003
Net income (basic and diluted)	<u>\$60,457</u>	<u>\$118,001</u>	<u>\$129,386</u>
Average shares outstanding:			
Basic	87,037	89,294	92,871
Plus assumed exercise of stock options	<u>1,801</u>	<u>2,330</u>	<u>2,434</u>
Diluted	<u>88,838</u>	<u>91,624</u>	<u>95,305</u>
Earnings per share:			
Basic	<u>\$ .69</u>	<u>\$ 1.32</u>	<u>\$ 1.39</u>
Diluted	<u>\$ .68</u>	<u>\$ 1.29</u>	<u>\$ 1.36</u>

Stock options for which the exercise price was greater than the average market price of common shares were not included in the computation of diluted earnings per share as the effect would be antidilutive. At the end of fiscal years 2005, 2004 and 2003, there were 5,210,600, zero and 3,036,300, respectively, stock options outstanding with exercise prices greater than the average market price of the Company’s common shares.

**Stock-based compensation** – The Company grants stock options and restricted stock for a fixed number of shares to employees with stock option exercise prices equal to the fair market value of the shares on the date of grant. The Company accounts for stock option grants and restricted stock grants under the intrinsic value method in accordance with Accounting Principles Board (“APB”) Opinion No. 25, “Accounting for Stock Issued to Employees,” and, accordingly, recognizes no compensation expense for the stock option grants.

The following table illustrates the effect on net income and earnings per share if the fair value-based method had been applied to all outstanding awards in each period (in thousands except per share amounts):

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

	2005	2004	2003
Net income, as reported	\$ 60,457	\$ 118,001	\$ 129,386
Less total stock-based employee compensation expense determined under fair value-based method, net of related tax effects	<u>(11,485)</u>	<u>(8,907)</u>	<u>(6,275)</u>
Pro forma net income	<u>\$ 48,972</u>	<u>\$ 109,094</u>	<u>\$ 123,111</u>
Earnings per share:			
Basic — as reported	<u>\$ .69</u>	<u>\$ 1.32</u>	<u>\$ 1.39</u>
Basic — pro forma	<u>\$ .56</u>	<u>\$ 1.22</u>	<u>\$ 1.33</u>
Diluted — as reported	<u>\$ .68</u>	<u>\$ 1.29</u>	<u>\$ 1.36</u>
Diluted — pro forma	<u>\$ .55</u>	<u>\$ 1.19</u>	<u>\$ 1.30</u>

See Note 9 of the Notes to Consolidated Financial Statements for additional discussion related to the accounting for stock-based employee compensation.

**Adoption of new accounting standards** – In January 2003, the FASB issued FASB Interpretation No. 46, “Consolidation of Variable Interest Entities” (“FIN 46”). This interpretation requires certain variable interest entities (“VIEs”), commonly referred to as special purpose entities, to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 was effective for all new VIEs created or acquired after January 31, 2003. During December 2003, the FASB issued a revision to FIN 46 (“FIN 46R”). Under the new provisions, public entities were required to apply the guidance if the entity has interests in VIEs for the periods ending after December 15, 2003. Application of this guidance by public companies was required for all other types of entities for periods ending after March 15, 2004. The adoption of FIN 46R did not have a material effect on the Company’s consolidated balance sheets or its statements of operations, shareholders’ equity and cash flows.

In November 2004, the FASB issued SFAS No. 151, “Inventory Costs” (“SFAS 151”), an amendment of Accounting Research Bulletin No. 43, Chapter 4. SFAS 151 clarifies that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges and requires the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. The statement will be effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company has evaluated the provisions of SFAS 151 and does not anticipate that adoption will have an impact on its consolidated balance sheets or statements of operations, shareholders’ equity and cash flows.

In December 2004, the FASB issued SFAS No. 123 (Revised 2004), “Share-Based Payment” (“SFAS 123R”). This statement replaces FASB Statement No. 123, “Accounting for Stock-Based Compensation,” and supercedes APB Opinion No. 25, “Accounting for Stock Issued to Employees.” SFAS 123R requires all companies to measure compensation cost for all share-based payments, including stock options, at fair value. The statement will be effective for public companies no later than the beginning of the first fiscal year commencing after June 15, 2005, which for the Company is the beginning of fiscal 2007. The Company is currently evaluating the effect that SFAS 123R will have on its consolidated balance sheets and its statements of shareholders’ equity and cash flows. SFAS 123R also requires that the benefits associated with the tax deductions in excess of recognized compensation cost be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce operating cash flows and increase net financing cash flows in periods after the effective date. These future amounts cannot be estimated, because they depend on, among other things, when employees exercise stock options. However, the amount of operating cash flows recognized for such excess tax



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

deductions for the years ended February 26, 2005, February 28, 2004 and March 1, 2003 was not material.

### NOTE 2 – PROPRIETARY CREDIT CARD INFORMATION

The Company's proprietary credit card receivables were generated under open-ended revolving credit accounts issued by its subsidiary, Pier 1 National Bank, to finance purchases of merchandise and services offered by the Company. These accounts have various billing and payment structures, including varying minimum payment levels. The Company has an agreement with a third party to provide certain credit card processing and related credit services, while the Company maintains control over credit policy decisions and customer service standards.

As of fiscal 2005 year-end, the Company had approximately 5,300,000 proprietary cardholders and approximately 1,212,000 customer credit accounts considered active (accounts with a purchase within the previous 12 months). Net proprietary credit card income was included in selling, general and administrative expenses on the Company's statements of operations. The following information presents a summary of the Company's proprietary credit card results for each of the last three fiscal years on a managed basis (in thousands):

	2005	2004	2003
<b>Income:</b>			
Finance charge income, net of debt service costs	\$ 25,118	\$ 25,396	\$ 25,344
Insurance and other income	114	105	230
	<u>25,232</u>	<u>25,501</u>	<u>25,574</u>
<b>Costs:</b>			
Processing fees	14,982	14,540	14,324
Bad debts	7,026	8,200	8,570
	<u>22,008</u>	<u>22,740</u>	<u>22,894</u>
<b>Net proprietary credit card income</b>	<b>\$ 3,224</b>	<b>\$ 2,761</b>	<b>\$ 2,680</b>
<b>Proprietary credit card sales</b>	<b>\$461,191</b>	<b>\$436,809</b>	<b>\$422,489</b>
<b>Costs as a percent of proprietary credit card sales</b>	<b>4.77%</b>	<b>5.21%</b>	<b>5.42%</b>
<b>Gross proprietary credit card receivables at year-end</b>	<b>\$134,326</b>	<b>\$142,228</b>	<b>\$136,331</b>
<b>Proprietary credit card sales as a percent of total U.S. store sales</b>	<b>27.1%</b>	<b>25.9%</b>	<b>26.2%</b>

The Company began securitizing its entire portfolio of proprietary credit card receivables (the "Receivables") in fiscal 1997. On a daily basis during all periods presented above, the Company sold all of its proprietary credit card receivables, except an immaterial amount of those that failed certain eligibility criteria, to a special-purpose wholly owned subsidiary, Pier 1 Funding, LLC ("Funding"). The Receivables were then transferred from Funding to the Pier 1 Imports Credit Card Master Trust (the "Master Trust"). In exchange for the Receivables, the Company received cash and retained a residual interest in the Master Trust. These cash payments were funded from undistributed principal collections on the Receivables that were previously sold to the Master Trust.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Funding was capitalized by the Company as a special-purpose wholly owned subsidiary and is subject to certain covenants and restrictions, including a restriction from engaging in any business or activity unrelated to acquiring and selling interests in receivables. The Master Trust issues beneficial interests that represent undivided interests in the assets of the Master Trust. Neither Funding nor the Master Trust is consolidated in the Company's financial statements. Under generally accepted accounting principles, if the structure of a securitization meets certain requirements, such transactions are accounted for as sales of receivables. As the Company's securitizations met such requirements, they were accounted for as sales. Gains or losses resulting from the sales of Receivables were not material during fiscal 2005, 2004 or 2003. The Company's exposure to deterioration in the performance of the Receivables is limited to its retained beneficial interest in the Master Trust. As such, the Company has no corporate obligation to reimburse Funding, the Master Trust or purchasers of any certificates issued by the Master Trust for credit losses from the Receivables.

As a result of the securitization, the Master Trust has \$100 million of outstanding 2001-1 Class A Certificates issued to a third party. The 2001-1 Class A Certificates bear interest at a floating rate equal to the rate on commercial paper issued by the third party plus a credit spread. As of February 26, 2005 and February 28, 2004, these rates were 3.0% and 1.5%, respectively. Funding continues to retain the residual interest in the Master Trust and \$9.3 million in 2001-1 Class B Certificates, which are subordinated to the 2001-1 Class A Certificates and do not bear interest.

The 2001-1 Class A Certificates have a revolving period of 364 days, which can be extended by mutual consent of Funding and the third-party holder, and expire in August 2005. The Company does not provide recourse to the third-party investor that purchased these debt securities issued by the Master Trust. However, should the balance of the underlying Receivables held by the Master Trust decline to a level that the Class A Certificates were insufficiently collateralized, the Master Trust would be contractually required to repay a portion of the Class A Certificates from daily collections, thereby reducing funds available for purchases of newly generated Receivables. At the end of fiscal 2005, the underlying Receivables held by the Master Trust were \$134.3 million and would have had to fall below \$117.5 million before a repayment would have been required. This repayment would only be to the extent necessary to maintain the required ratio of receivables to the Class A Certificates as set forth in the securitization agreement. In addition, should the Master Trust be out of compliance with its required performance measures, such as payment rate, returns and fraud, excess portfolio yield, and minimum transferor's interest, or other material adverse change in the Company's credit quality, this would trigger an early amortization event. Such an event would require the Master Trust to repay the Class A Certificates, thereby reducing funds available for purchases of newly generated Receivables. These performance measures would have to deteriorate significantly to result in such an early amortization event.

Cash flows received by the Company from the Master Trust for each of the last three fiscal years are as follows (in thousands):

	2005	2004	2003
Proceeds from collections reinvested in revolving securitizations	<u>\$494,580</u>	<u>\$454,444</u>	<u>\$448,151</u>
Servicing fees received	<u>\$ 2,186</u>	<u>\$ 2,186</u>	<u>\$ 2,186</u>
Cash flows received on retained interests	<u>\$170,671</u>	<u>\$145,325</u>	<u>\$139,084</u>

As of February 26, 2005 and February 28, 2004, the Company had \$35.7 million and \$44.3 million, respectively, in beneficial interests (comprised primarily of principal and interest related to the underlying Receivables) in the Master Trust. In addition, if the Company was required to consolidate the Master Trust due to a change in accounting rules, the Company's operations for fiscal 2005 and 2004 would not have been materially different than its reported results and both its assets and liabilities would have increased by approximately \$100 million as of February 26, 2005 and February 28, 2004. The Company expects no material impact on net income in future years as a result of the sales of Receivables, although the precise amounts will be dependent on a number of factors such as interest rates and levels of securitization.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

### NOTE 3 – PROPERTIES

Properties are summarized as follows at February 26, 2005 and February 28, 2004 (in thousands):

	<u>2005</u>	<u>2004</u>
Land	\$ 19,627	\$ 21,986
Buildings	98,184	36,067
Equipment, furniture and fixtures	297,034	269,040
Leasehold improvements	253,601	212,447
Computer software	63,515	50,165
Projects in progress	<u>6,394</u>	<u>63,650</u>
	738,355	653,355
Less accumulated depreciation and amortization	<u>400,725</u>	<u>362,935</u>
Properties, net	<u>\$337,630</u>	<u>\$290,420</u>

### NOTE 4 – GOODWILL AND OTHER INTANGIBLE ASSETS

The Company's intangible assets at February 26, 2005 and February 28, 2004 included the right to do business within certain geographical markets where franchise stores were previously granted exclusive rights to operate, favorable operating leases acquired from a third party and goodwill related primarily to the acquisition of Pier 1 Kids. These intangible assets were included in other noncurrent assets in the Company's consolidated balance sheets. Amortization expense for fiscal 2005, 2004 and 2003 was \$1,656,000, \$1,493,000 and \$1,496,000, respectively. The following is a summary of the Company's intangible assets at February 26, 2005 and February 28, 2004 (in thousands):

	<u>2005</u>	<u>2004</u>
Geographic market rights, gross	\$ 15,023	\$ 15,020
Accumulated amortization	<u>(11,639)</u>	<u>(10,192)</u>
Geographic market rights, net	<u>\$ 3,384</u>	<u>\$ 4,828</u>
Acquired operating leases, gross	\$ 1,975	\$ 1,975
Accumulated amortization	<u>(257)</u>	<u>(48)</u>
Acquired operating leases, net	<u>\$ 1,718</u>	<u>\$ 1,927</u>
Goodwill, not amortized	<u>\$ 5,006</u>	<u>\$ 5,006</u>

Estimated future amortization expense related to intangible assets at February 26, 2005 is as follows (in thousands):

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

Fiscal Year	Amortization Expense
2006	\$ 1,658
2007	1,658
2008	697
2009	209
2010	207
Thereafter	<u>673</u>
<b>Total future amortization expense</b>	<b><u>\$ 5,102</u></b>

**NOTE 5 – OTHER ACCRUED LIABILITIES AND NONCURRENT LIABILITIES**

The following is a summary of other accrued liabilities and noncurrent liabilities at February 26, 2005 and February 28, 2004 (in thousands):

	2005	2004
Accrued payroll and other employee-related liabilities	\$ 37,034	\$37,597
Accrued taxes, other than income	22,929	21,675
Other	<u>42,331</u>	<u>34,609</u>
Other accrued liabilities	<u>\$102,294</u>	<u>\$93,881</u>
Rent-related liabilities	\$ 42,587	\$22,014
Retirement benefits	51,994	38,425
Other	<u>8,790</u>	<u>9,215</u>
Other noncurrent liabilities	<u>\$103,371</u>	<u>\$69,654</u>

**NOTE 6 – LEASE TERMINATION OBLIGATION**

Although the Company typically does not terminate leases before the end of their primary term, periodically certain stores or storage facilities with relatively short terms remaining on the leases are closed or relocated to more favorable locations within the same market. These decisions are based on lease renewal obligations, relocation space availability, general economic conditions and prospects for future profitability. In connection with these lease terminations, the Company recorded estimated liabilities in accordance with SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." The estimated liabilities were recorded based upon the Company's remaining lease obligations less estimated subtenant rental income. Expenses related to lease termination obligations are included in selling, general and administrative expenses in the Company's consolidated statements of operations. The write-off of fixed assets has not been material and there has been no write-down of inventory or employee severance costs associated with these closures. The following table represents a reconciliation of the liability balances from March 2, 2002 to February 26, 2005 (in thousands):

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

	Lease Termination Obligation
Balance at March 2, 2002	\$ 623
Original charges	—
Revisions	395
Cash payments	<u>(236)</u>
Balance at March 1, 2003	782
Original charges	2,971
Revisions	287
Cash payments	<u>(2,292)</u>
Balance at February 28, 2004	1,748
Original charges	1,480
Revisions	763
Cash payments	<u>(2,516)</u>
Balance at February 26, 2005	<u>\$ 1,475</u>

**NOTE 7 – LONG-TERM DEBT AND AVAILABLE CREDIT**

Long-term debt is summarized as follows at February 26, 2005 and February 28, 2004 (in thousands):

	2005	2004
Industrial revenue bonds	\$19,000	\$19,000
Less — portion due within one year	<u>—</u>	<u>—</u>
Long-term debt	<u>\$19,000</u>	<u>\$19,000</u>

In fiscal 1987, the Company entered into industrial revenue bond loan agreements aggregating \$25 million. Proceeds were used to construct three warehouse/distribution facilities. The loan agreements and related tax-exempt bonds mature in the year 2026. Subsequent to the sale of the old distribution center located in Savannah, Georgia, the Company exercised its right to repay the related \$6.0 million outstanding balance in industrial revenue bonds on December 1, 2003. The extinguishment of these bonds did not have a material impact on the Company's consolidated statement of operations. The Company's interest rates on the loans are based on the bond interest rates, which are market driven, reset weekly and are similar to other tax-exempt municipal debt issues. The Company's weighted average effective interest rates, including commitment fees of 1%, were 2.9% and 2.6% for fiscal 2005 and 2004, respectively.

In November 2001, the Company executed a note payable in the original principal amount of £500,000. The note bore interest at 4.0% per annum and had a maturity date of April 2003. Interest was payable in semiannual installments and principal was payable in two installments; the first payment was made June 2002 and the final payment was made April 2003.

Long-term debt matures as follows (in thousands):

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Fiscal Year	Long-term Debt
2006	\$ —
2007	—
2008	—
2009	—
2010	—
Thereafter	<u>19,000</u>
<b>Total long-term debt</b>	<b><u>\$ 19,000</u></b>

In August 2003, the Company replaced its five-year \$125 million revolving credit facility with a comparable three-year \$125 million revolving credit facility, all of which was available at fiscal 2005 year-end. Proceeds of borrowings under the credit facility may be used for working capital of the Company and for general corporate purposes. The new agreement matures in August 2006 and has certain restrictive covenants requiring, among other things, the maintenance of certain financial ratios including debt to net cash flow, fixed charge coverage and minimum tangible net worth. The new credit facility bears a floating interest rate (currently LIBOR plus 1.0%) based on the Company's corporate debt rating, and through the end of fiscal 2005, there were no borrowings under the credit agreement. The Company pays a commitment fee of 0.2% on unused amounts. The Company had no borrowings under the five-year facility during fiscal 2004.

The Company has a \$120 million short-term line of credit, which is primarily used to issue merchandise letters of credit. At fiscal 2005 year-end, approximately \$62.5 million had been utilized for letters of credit, leaving \$57.5 million available. The Company also has \$42.9 million in special-purpose letters of credit, all of which were fully utilized at fiscal 2005 year-end. Of the \$42.9 million in special-purpose letters of credit, \$19.4 million related to the Company's industrial revenue bonds. The remaining \$23.5 million in special-purpose letters of credit related primarily to the Company's workers' compensation and general liability insurance policies.

The Company's primary loan agreements require that the Company maintain certain financial ratios, limit certain investments and, in some instances, limit repurchases of common stock. The Company was in compliance with all debt covenants at fiscal 2005 year-end.

### NOTE 8 – EMPLOYEE BENEFIT PLANS

The Company offers a qualified, defined contribution employee retirement plan to all its full- and part-time personnel who are at least 18 years old and have been employed for a minimum of six months. Employees contributing 1% to 5% of their compensation receive a matching Company contribution of up to 3%. Company contributions to the plan were \$2,729,000, \$2,349,000 and \$1,760,000 in fiscal 2005, 2004 and 2003, respectively.

In addition, the Company offers non-qualified retirement savings plans for the purpose of providing deferred compensation for certain employees whose benefits under the qualified plan may be limited under Section 401(k) of the Internal Revenue Code. The Company's expense for these non-qualified plans was \$1,498,000, \$1,356,000 and \$1,061,000 for fiscal 2005, 2004 and 2003, respectively.

The Company maintains supplemental retirement plans (the "Plans") for certain of its executive officers. The Plans provide that upon death, disability or reaching retirement age, a participant will receive benefits based on highest compensation and years of service. The Company recorded expenses related to the Plans of \$4,378,000, \$3,306,000 and \$2,689,000 in fiscal 2005, 2004 and 2003, respectively.

The Plans are not funded and thus have no plan assets. However, a trust has been established for the purpose of setting aside funds to be used to settle the pension obligations upon retirement or death of certain



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

participants. The trust assets are consolidated in the Company's financial statements and consist of investments in short-term money market funds in the amounts of \$21,386,000 and \$10,417,000 at February 26, 2005 and February 28, 2004, respectively, and earned average rates of return of 1.4%, 0.9% and 1.7% in fiscal 2005, 2004 and 2003, respectively. These investments are restricted and may be used only to satisfy retirement obligations to certain participants and are classified in the financial statements as noncurrent assets. These funds will be used to pay benefit payments through fiscal year 2015 that are expected to total approximately \$32,745,000. Of this amount, the Company expects to pay \$28,377,000 during fiscal 2008, \$3,624,000 during fiscal 2010 and \$744,000 during fiscal years 2011 through 2015. In addition to these investments, at the end of fiscal 2004 the trust owned and was the beneficiary of various increasing whole life insurance contracts on some of the participants in the Plans. At February 28, 2004, the trust owned life insurance contracts with cash surrender values of \$8,034,000. Any future contributions would be made at the discretion of the Compensation Committee of the Board of Directors.

Measurement of obligations for the Plans is calculated as of each fiscal year-end. The following provides a reconciliation of benefit obligations and funded status of the Plans as of February 26, 2005 and February 28, 2004 (in thousands):

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

	2005	2004
Change in projected benefit obligation:		
Projected benefit obligation, beginning of year	\$ 23,073	\$ 20,242
Service cost	1,932	701
Interest cost	1,442	1,414
Actuarial loss	<u>9,895</u>	<u>716</u>
Projected benefit obligation, end of year	<u>\$ 36,342</u>	<u>\$ 23,073</u>

Reconciliation of funded status:		
Funded status	\$(36,342)	\$(23,073)
Unrecognized net loss	13,997	4,276
Unrecognized prior service cost	<u>4,532</u>	<u>5,362</u>
Accrued pension cost	(17,813)	(13,435)
Additional minimum liability	<u>(15,222)</u>	<u>(8,450)</u>
Accrued benefit liability/accumulated benefit obligation	<u>\$(33,035)</u>	<u>\$(21,885)</u>

Amounts recognized in the balance sheets:		
Accrued benefit liability	\$(33,035)	\$(21,885)
Intangible asset	4,531	5,362
Accumulated other comprehensive loss, pre-tax	<u>10,691</u>	<u>3,088</u>
Net amount recognized	<u>\$(17,813)</u>	<u>\$(13,435)</u>

Increase in minimum liability included in comprehensive income, net of tax	<u>\$ 4,780</u>	<u>\$ 1,033</u>
--	-----------------	-----------------

Minimum liability included in cumulative comprehensive income, net of taxes of \$3,970 and \$1,146, respectively	<u>\$ 6,721</u>	<u>\$ 1,942</u>
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Weighted average assumptions used to determine:

	2005	2004
Benefit obligation, end of year:		
Discount rate	4.50%	6.25%
Lump-sum conversion discount rate	3.00%	3.25%
Rate of compensation increase	5.00%	5.00%
Net periodic benefit cost for years ended:		
Discount rate	6.25%	6.75%
Lump-sum conversion discount rate	3.25%	4.00%
Rate of compensation increase	5.00%	5.00%

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Net periodic benefit cost included the following actuarially determined components during fiscal 2005, 2004 and 2003 (in thousands):

	2005	2004	2003
Service cost	\$ 1,932	\$ 701	\$ 631
Interest cost	1,442	1,414	1,196
Amortization of unrecognized prior service cost	830	862	862
Amortization of net actuarial loss	174	329	—
Net periodic benefit cost	<u>\$ 4,378</u>	<u>\$ 3,306</u>	<u>\$ 2,689</u>

### NOTE 9 – MATTERS CONCERNING SHAREHOLDERS' EQUITY

**Stock purchase plan** - Substantially all employees are eligible to participate in the Pier 1 Imports, Inc. Stock Purchase Plan under which the Company's common stock is purchased on behalf of employees at market prices through regular payroll deductions. Each participant may contribute up to 10% of the eligible portions of compensation. The Company contributes from 10% to 100% of the participants' contributions, depending upon length of participation and date of entry into the plan. Company contributions to the plan were \$1,266,000, \$1,174,000 and \$1,078,000 in fiscal years 2005, 2004 and 2003, respectively.

**Restricted stock grant plan** - In fiscal 1998, the Company issued shares of its common stock to key officers pursuant to a Management Restricted Stock Plan. The fiscal 1998 restricted stock grant vested over a four-year period of continued employment. The fair value at the date of grant of these restricted stock shares was expensed over the aforementioned vesting period. There was no compensation expense for the restricted stock grant plan in fiscal 2005, 2004 or 2003. As of fiscal 2005 year-end, 268,594 shares were available for future grants.

**Stock plans** - In June 1999, the Company adopted the Pier 1 Imports, Inc. 1999 Stock Plan (the "Plan"). The Plan will replace the Company's two previous stock option plans, which were the 1989 Employee Stock Option Plan (the "Employee Plan") and the 1989 Non-Employee Director Stock Option Plan (the "Director Plan").

The Plan provides for the granting of options to directors and employees with an exercise price not less than the fair market value of the common stock on the date of the grant. Options may be either Incentive Stock Options authorized under Section 422 of the Internal Revenue Code or nonqualified options, which do not qualify as Incentive Stock Options. Current director compensation provides for nonqualified options covering 6,000 shares to be granted once each year to each non-employee director. Additionally, the Plan authorizes a Director Deferred Stock Program. As the program is currently implemented by the Board of Directors, each director must defer a minimum of 50% and may defer up to 100% of the director's cash fees into a deferred stock account. The amount deferred receives a 50% matching contribution from the Company. The Plan provides that a maximum of 14,500,000 shares of common stock may be issued under the Plan, of which not more than 250,000 shares may be issued under the Directors Deferred Stock Program. Options issued to employees vest equally over a period of four years while non-employee directors' options are fully vested at the date of issuance. Employee options will fully vest upon retirement or, under certain conditions, such as a change in control of the Company. As of February 26, 2005 and February 28, 2004, respectively, there were 1,451,504 and 346,290 shares available for grant under the Plan, of which 106,049 and 128,860 may be used for deferred stock issuance. Additionally, outstanding options covering 4,321,225 and 3,038,150 shares were exercisable under the Plan and 137,774 and 114,964 shares were issuable under the Directors Deferred Stock Program at fiscal years ended 2005 and 2004, respectively. The Plan will expire in June 2009, and the Board of Directors may at any time suspend or terminate the Plan or amend the Plan, subject to certain limitations.

Under the Employee Plan, options may be granted to qualify as Incentive Stock Options under Section 422 of the Internal Revenue Code or as nonqualified options. Most options issued under the Employee Plan vest over a period of four to five years and have a contractual life of ten years. As of February 26, 2005 and

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

February 28, 2004, outstanding options covering 1,398,225 and 1,495,879 shares were exercisable, respectively. As a result of the expiration of the Employee Plan during fiscal 2005, no shares are available for future grant. As of February 28, 2004, options covering 283,359 shares were available for grant. The Director Plan expired in fiscal 2000. As of February 26, 2005 and February 28, 2004, outstanding options covering 27,000 and 34,088 shares, respectively, were exercisable under the Director Plan. As a result of the expiration of the Director Plan during fiscal 2000, no shares are available for future grants. Both plans were subject to adjustments for stock dividends and certain other changes to the Company's capitalization.

A summary of stock option transactions related to the stock option plans during the three fiscal years ended February 26, 2005 is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Fair Value at Date of Grant	Exercisable Shares	
				Number of Shares	Weighted Average Exercise Price
Outstanding at March 2, 2002	8,176,737	\$ 8.74		3,245,662	\$ 8.81
Options granted	2,814,000	20.39	\$ 9.70		
Options exercised	(1,469,450)	8.66			
Options cancelled or expired	<u>(275,250)</u>	9.56			
Outstanding at March 1, 2003	9,246,037	12.27		3,472,387	8.96
Options granted	2,984,000	19.41	8.67		
Options exercised	(1,033,370)	9.73			
Options cancelled or expired	<u>(235,550)</u>	16.32			
Outstanding at February 28, 2004	10,961,117	14.37		4,568,117	10.46
Options granted	3,030,000	17.25	6.16		
Options exercised	(994,517)	7.86			
Options cancelled or expired	<u>(723,275)</u>	17.84			
Outstanding at February 26, 2005	<u>12,273,325</u>	15.40		5,746,450	12.76

For shares outstanding at February 26, 2005:

Ranges of Exercise Prices	Total Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Shares Currently Exercisable	Weighted Average Exercise Price - Exercisable Shares
\$4.22 - \$12.83	4,228,475	\$ 8.72	5.02	3,684,725	\$ 8.78
\$12.84 - \$19.40	5,631,225	18.29	8.81	857,850	19.12
\$20.35 - \$21.00	2,413,625	20.39	7.59	1,203,875	20.39

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The Company accounts for its stock options using the intrinsic value-based method of accounting prescribed by APB Opinion No. 25, but is required to disclose the pro forma effect on net income and earnings per share as if the options were accounted for using a fair value-based method of accounting. For purposes of computing pro forma net income and earnings per share, the fair value of the stock options is amortized on a straight-line basis as compensation expense over the vesting periods of the options. The fair values for options issued in fiscal 2005, 2004 and 2003 have been estimated as of the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	2005	2004	2003
Weighted average fair value of options granted	\$ 6.16	\$ 8.67	\$ 9.70
Risk-free interest rates	3.95%	3.00%	2.82%
Expected stock price volatility	40.00%	55.03%	56.98%
Expected dividend yields	1.5%	1.5%	1.5%
Weighted average expected lives	5 years	5 years	5 years

Option valuation models are used in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility and the average life of options. Because the Company's stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its stock options.

**Share purchase rights plan** – On December 9, 1994, the Board of Directors adopted a Share Purchase Rights Plan and declared a dividend of one common stock purchase right (a "Right") payable on each outstanding share of the Company's common stock on December 21, 1994, and authorized the issuance of Rights for subsequently issued shares of common stock. The Rights expired on December 21, 2004. Prior to its expiration, the Company's Board of Directors decided not to renew or extend the Share Purchase Rights Plan.

**Shares reserved for future issuances** – As of February 26, 2005, the Company had approximately 14,131,000 shares reserved for future issuances under the stock plans.

### NOTE 10 – INCOME TAXES

The provision for income taxes for each of the last three fiscal years consists of (in thousands):

	2005	2004	2003
Federal:			
Current	\$24,615	\$60,995	\$50,069
Deferred	2,414	152	17,555
State:			
Current	3,958	6,871	6,067
Deferred	(383)	9	1,068
Foreign:			
Current	5,776	1,265	1,104
Deferred	4	23	125
Provision for income taxes	<u>\$36,384</u>	<u>\$69,315</u>	<u>\$75,988</u>

Deferred tax assets and liabilities at February 26, 2005 and February 28, 2004 are comprised of the following (in thousands):

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

	2005	2004
<b>Deferred tax assets:</b>		
Deferred compensation	\$ 17,760	\$ 15,271
Accrued average rent	13,351	9,971
Losses of a foreign subsidiary	5,467	4,445
Self insurance reserves	6,679	5,236
Minimum pension liability adjustment	3,970	1,147
Other	2,851	3,962
	<u>50,078</u>	<u>40,032</u>
Valuation allowance	(5,619)	(4,593)
Total deferred tax assets	<u>44,459</u>	<u>35,439</u>
<b>Deferred tax liabilities:</b>		
Fixed assets, net	(13,038)	(9,087)
Inventory	(24,441)	(21,064)
Total deferred tax liabilities	<u>(37,479)</u>	<u>(30,151)</u>
Net deferred tax assets	<u>\$ 6,980</u>	<u>\$ 5,288</u>

The Company has settled and closed all Internal Revenue Service (“IRS”) examinations of the Company’s tax returns for all years through fiscal 1999. The IRS is currently auditing fiscal years 2000 and 2001. The Company has recorded a valuation allowance at February 26, 2005 and February 28, 2004 to offset the net deferred tax asset relating to the losses of a foreign subsidiary.

The difference between income taxes at the statutory federal income tax rate of 35% in fiscal 2005, 2004 and 2003, and income tax reported in the consolidated statements of operations is as follows (in thousands):

	2005	2004	2003
Tax at statutory federal income tax rate	\$33,894	\$65,561	\$71,881
State income taxes, net of federal benefit	2,147	3,878	4,277
Increase/(decrease) in valuation allowance	1,026	(85)	730
Net foreign income taxed at lower rates, net of foreign tax credits	(986)	(344)	(1,095)
Other, net	<u>303</u>	<u>305</u>	<u>195</u>
Provision for income taxes	<u>\$36,384</u>	<u>\$69,315</u>	<u>\$75,988</u>

The American Jobs Creation Act of 2004 (the “Jobs Act”), enacted on October 22, 2004, provides for a temporary 85% dividends received deduction on certain foreign subsidiary earnings repatriated during a one-year period. The deduction would result in an approximate 5.25% federal tax rate on the repatriated earnings. There are numerous requirements that must be satisfied for the repatriated earnings to qualify for the reduced rate of taxation. The one-year period during which the Company can make qualifying distributions is fiscal 2006.

The Company is in the process of evaluating whether it will repatriate foreign earnings under the provisions of the Jobs Act and is awaiting further regulatory guidance and statutory technical corrections

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

with respect to certain provisions of the Jobs Act. The amount of the possible repatriation ranges from zero to approximately \$39,000,000.

The Company is not yet in a position to definitely determine the impact of a qualifying repatriation. However, if the maximum amount were repatriated, the Company estimates it would accrue additional tax expense of no more than \$2,100,000 for fiscal 2006. The Company expects to determine the amount of foreign earnings, if any, to be repatriated during the third quarter of fiscal 2006.

### NOTE 11 – COMMITMENTS AND CONTINGENCIES

**Leases** – At February 26, 2005, the Company had the following minimum lease commitments and future subtenant receipts in the years indicated (in thousands):

Fiscal Year	Operating Leases	Subtenant Income
2006	\$ 231,765	\$ 652
2007	221,143	277
2008	204,624	150
2009	185,791	63
2010	166,458	6
Thereafter	<u>529,996</u>	<u>18</u>
Total lease commitments	<u>\$1,539,777</u>	<u>\$ 1,166</u>

Rental expense incurred was \$255,190,000, \$221,406,000 and \$188,615,000, including contingent rentals of \$391,000, \$801,000 and \$816,000, based upon a percentage of sales, and net of sublease incomes totaling \$262,000, \$348,000 and \$507,000 in fiscal 2005, 2004 and 2003, respectively.

During fiscal 2004, the Company completed a sale-leaseback transaction related to its distribution facility located in Savannah, Georgia. The resulting 15-year lease qualified for operating lease treatment. The Company received \$23.5 million in proceeds in fiscal 2004, which approximated the net book value of the facility at the time of the sale.

**Legal matters** – There are various claims, lawsuits, investigations and pending actions against the Company and its subsidiaries incident to the operations of its business. The Company considers them to be ordinary and routine in nature. The Company maintains liability insurance against most of these claims. While certain of the lawsuits involve substantial amounts, it is the opinion of management, after consultation with counsel, that the ultimate resolution of such litigation will not have a material adverse effect on the Company's financial position, results of operations or liquidity. During fiscal 2004, the Company recorded a pre-tax charge of \$2.6 million in a settlement of and legal fees related to a class action lawsuit in California regarding compensation matters. Cash outlays related to the settlement were completed in fiscal 2005.

### NOTE 12 – SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

Summarized quarterly financial data for the years ended February 26, 2005 and February 28, 2004 are set forth below (in thousands except per share amounts):

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

Fiscal 2005	Three Months Ended			
	5/29/2004	8/28/2004	11/27/2004	2/26/2005
Net sales	\$432,027	452,271	487,729	525,826
Gross profit	\$171,982	169,039	191,078	195,166
Net income <sup>(1)</sup>	\$ 11,737	10,446	19,475	18,799
Basic earnings per share	\$ .13	.12	.23	.22
Diluted earnings per share	\$ .13	.12	.22	.21

Fiscal 2004	Three Months Ended			
	5/31/2003	8/30/2003	11/29/2003	2/28/2004
Net sales	\$402,712	427,831	482,444	555,256
Gross profit	\$168,197	169,112	208,098	236,213
Net income	\$ 19,062	18,436	32,194	48,309
Basic earnings per share	\$ .21	.21	.36	.55
Diluted earnings per share	\$ .21	.20	.35	.53

(1) Net income for the fourth quarter and fiscal year ended February 26, 2005 included the pre-tax effect of a \$6.3 million charge related to operating leases for years prior to fiscal 2005. See Note 1 of the Notes to Consolidated Financial Statements for further discussion of this charge.

## MARKET PRICE AND DIVIDEND INFORMATION

The Company's common stock is traded on the New York Stock Exchange (the "NYSE"). The following tables show the high and low closing sale prices on the NYSE, as reported in the consolidated transaction reporting system, and the dividends paid per share, for each quarter of fiscal 2005 and 2004.

Fiscal 2005	Market Price		Cash Dividends per Share
	High	Low	
First quarter	\$ 25.00	\$ 18.30	\$ .10
Second quarter	18.80	15.43	.10
Third quarter	19.74	17.10	.10
Fourth quarter	19.78	17.61	.10

Fiscal 2004	Market Price		Cash Dividends per Share
	High	Low	
First quarter	\$ 20.76	\$ 14.85	\$ .06
Second quarter	21.80	17.52	.08
Third quarter	26.15	18.56	.08
Fourth quarter	26.19	20.15	.08

EXHIBIT 21

ROSTER OF SUBSIDIARIES OF THE COMPANY

Pier 1 Assets, Inc., a Delaware corporation

Pier 1 Kids, Inc., a Delaware corporation

Pier 1 Licensing, Inc., a Delaware corporation

Pier 1 Imports (U.S.), Inc., a Delaware corporation

Pier 1 Funding, LLC, a Delaware limited liability company

Pier 1 Value Services, LLC, a Virginia limited liability company

Pier Lease, Inc., a Delaware corporation

Pier-SNG, Inc., a Delaware corporation

PIR Trading, Inc., a Delaware corporation

Pier International Limited, a Hong Kong private company

Pier Alliance Ltd., a Bermuda company

The Pier Retail Group Limited, a United Kingdom company

The Pier (Retail) Limited, a United Kingdom company

Pier Direct Limited, a United Kingdom company

The Pier (Retail) Ireland Limited, a United Kingdom company

Pier Group, Inc., a Delaware corporation

Pier 1 Holdings, Inc., a Delaware corporation

Pier 1 Services Company, a Delaware statutory trust

Pier 1 National Bank, a national banking association

Exhibit 23

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in this Annual Report (Form 10-K) of Pier 1 Imports, Inc. of our reports dated April 18, 2005, with respect to the consolidated financial statements of Pier 1 Imports, Inc., Pier 1 Imports, Inc. management's assessment of the effectiveness of the internal control over financial reporting, and the effectiveness of internal control over financial reporting of Pier 1 Imports, Inc. included in the 2005 Annual Report to Shareholders of Pier 1 Imports, Inc.

We also consent to the incorporation by reference in the following:

- 1) Registration Statement (Forms S-8 No. 333-118395, No. 333-108454, No. 333-99731, and No. 333-88323) pertaining to the 1999 Stock Plan of Pier 1 Imports, Inc.,
- 2) Registration Statement (Forms S-8 No. 333-105768 and No. 333-34100) pertaining to the Stock Purchase Plan of Pier 1 Import, Inc.,
- 3) Registration Statement (Form S-8 No. 333-13491) pertaining to the 1989 Employee Stock Option Plan of Pier 1 Imports, Inc.,
- 4) Registration Statement (Form S-8 No. 333-32166) pertaining to the 1989 Non-employee Director Stock Plan of Pier 1 Imports, Inc. and
- 5) Registration Statement (Form S-3 No. 333-61155) of Pier 1 Imports, Inc.

of our reports dated April 18, 2005, with respect to the consolidated financial statements of Pier 1 Imports, Inc., Pier 1 Imports, Inc. management's assessment of the effectiveness of the internal control over financial reporting, and the effectiveness of internal control over financial reporting of Pier 1 Imports, Inc. incorporated by reference in the Annual Report (Form 10-K) for the year ended February 26, 2005.

/s/ Ernst & Young LLP

Fort Worth, Texas

May 6, 2005

EXHIBIT 31.1

CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER PURSUANT TO EXCHANGE ACT RULE 13A-14(A)/15D-14(A)

I, Marvin J. Girouard, certify that:

1. I have reviewed this annual report on Form 10-K of Pier 1 Imports, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 4, 2005

By: /s/ Marvin J. Girouard

Marvin J. Girouard, Chairman of the Board  
and Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION OF THE CHIEF FINANCIAL OFFICER PURSUANT TO EXCHANGE ACT RULE 13A-14(A)/15D-14(A)

I, Charles H. Turner, certify that:

1. I have reviewed this annual report on Form 10-K of Pier 1 Imports, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 4, 2005

By: /s/ Charles H. Turner

Charles H. Turner, Executive Vice President, Finance,  
Chief Financial Officer and Treasurer

EXHIBIT 32.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER PURSUANT TO 18 U.S.C.  
SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

Each of the undersigned officers of Pier 1 Imports, Inc., hereby certifies that:

1. The annual report of Pier 1 Imports, Inc. for the period ended February 26, 2005 fully complies with the requirements of sections 13(a) and 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the above-mentioned report fairly presents, in all material respects, the financial condition and results of operations of Pier 1 Imports, Inc. for the period covered by the report.

Date: May 4, 2005

By: /s/ Marvin J. Girouard

Marvin J. Girouard, Chairman of the Board  
and Chief Executive Officer

Date: May 4, 2005

By: /s/ Charles H. Turner

Charles H. Turner, Executive Vice President, Finance,  
Chief Financial Officer and Treasurer

A signed original of this written statement required by section 906 of the Sarbanes-Oxley Act of 2002 has been provided to Pier 1 Imports, Inc. and will be retained by Pier 1 Imports, Inc. and furnished to the Securities and Exchange Commission, or its staff, upon request.