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# EDITED TRANSCRIPT

PIR - Q1 2014 Pier 1 Imports, Inc. Earnings Conference Call

EVENT DATE/TIME: JUNE 20, 2013 / 3:00PM GMT

## OVERVIEW:

Management discussed 1Q14 results, reporting net income of \$20.3m or \$0.19 per share on total sales of \$395m. Guidance was for FY14 EPS of \$1.27-1.32 on comp store sales growth in mid single digits vs. 2013.



JUNE 20, 2013 / 3:00PM, PIR - Q1 2014 Pier 1 Imports, Inc. Earnings Conference Call

## CORPORATE PARTICIPANTS

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

**Cary Turner** *Pier 1 Imports, Inc. - Senior EVP, CFO*

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

**Bryan Hanley** *Pier 1 Imports, Inc. - Director of Investor Relations*

## CONFERENCE CALL PARTICIPANTS

**Budd Bugatch** *Raymond James & Associates - Analyst*

**Matt Nemer** *Wells Fargo Securities, LLC - Analyst*

**Adam Sindler** *Deutsche Bank - Analyst*

**Alan Rifkin** *Barclays Capital - Analyst*

**Brian Nagel** *Oppenheimer & Co. - Analyst*

**Curtis Nagle** *BofA Merrill Lynch - Analyst*

**Cristina Fernandez** *Telsey Advisory Group (TAG) - Analyst*

**John Marrin** *Jefferies & Company - Analyst*

## PRESENTATION

### Operator

Good morning, ladies and gentlemen, and welcome to the Pier 1 Imports first-quarter fiscal 2014 fiscal 2014 earnings call. At the request of Pier 1 Imports, today's conference call is being recorded. (Operator instructions).

I would now like to introduce Alex Smith, President and Chief Executive Officer.

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

Thank you, Felicia, and good morning, everybody. With me today is Cary Turner, our Senior Executive Vice President and Chief Financial Officer.

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**Cary Turner** - *Pier 1 Imports, Inc. - Senior EVP, CFO*

Good morning.

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

As is Kelley Buchhorn.

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

Good morning, everyone.

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## JUNE 20, 2013 / 3:00PM, PIR - Q1 2014 Pier 1 Imports, Inc. Earnings Conference Call

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

And our new Director of Investor Relations, Bryan Hanley.

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**Bryan Hanley** - *Pier 1 Imports, Inc. - Director of Investor Relations*

Good morning.

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

Brian is our Assistant Treasurer and has been with Pier 1 Imports for three years now. We are delighted to have him in his new role.

Kelley will be concentrating on her financial planning and analysis responsibilities, which are taking up much more of her time as we build out our 1 Pier 1 vision. She will of course be helping Brian with the transition behind the scenes. So many thanks, Kelley, for all of your hard work in our investor relation efforts past, present, and future.

Also in the room with us today, providing energy and moral support, are members of our executive team. We have Cathy, and Michael, and Laura, and Mike, and Donna.

Okay, Brian, let's go.

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**Bryan Hanley** - *Pier 1 Imports, Inc. - Director of Investor Relations*

Thank you, Alex, and good morning, everyone. I'm looking forward to working in this new capacity and getting to know all of you in the coming weeks and months.

Prior to market open today we issued a press release which included the detailed financial results for the first quarter ended June 1, 2013. In just a few moments Alex and Cary will discuss the Company's financial results and growth initiatives, followed by a question-and-answer period.

Before we begin, I need to remind you that certain comments made during this call may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, and can be identified by the use of words such as may, will, expect, anticipate, believe, and other similar words and phrases. Our actual results and future financial condition may differ materially from those expressed in any such forward-looking statements as a result of many factors that may be outside of our control.

Please refer to our SEC filings, including our annual report on Form 10-K, for a complete discussion of the major risks, uncertainties that may affect our business. The forward-looking statements made today as of the date of this call, and we do not undertake any obligation to update our forward-looking statements.

The Company will also discuss non-GAAP financial measures on this conference call. Pursuant to the requirements of Regulation G and Item 10E of Regulation S-K, the Company has provided reconciliations of the non-GAAP financial measures to the most directly comparable GAAP financial measures in our earnings press release that was issued earlier this morning.

If you do not have a copy of today's press release, you may obtain one, along with copies of prior press releases and all SEC filings, by linking through to our Investor Relations page of our website, Pier1.com. I will now turn the call back over to Alex.

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

Thanks, Brian. Well, we're pleased that the start to our new fiscal year, both in terms of our performance during the first quarter and especially, especially the progress we are making against our multi-channel strategy, which as many of you know we call 1 Pier 1.

Looking first at the headline results, we delivered our 15th consecutive quarter of sales and profit growth. Throughout the period customers responded positively to our spring assortments, including our Easter, Mother's Day, and outdoor merchandise; and this is reflected in both our total sales growth of 9.3% and our comp store sales gain of 5.9%.

The effective execution of our robust merchandising and customer engagement strategies, strong full-price selling, and expense leverage drove higher year-over-year profitability. We controlled expenses, improved operating margins 8.4%, achieved a 20% growth in EBITDA, and a 19% growth in earnings per share.

Importantly, we continue to deliver profitability ratios at the high end of the home furnishings industry. Also, as you will hear from Cary, we have been active under our share repurchase program and remain committed to the return of capital to our shareholders.

Let's take a quick look at this year's marketing plan. We are certainly engaging with quite customers more frequently. We are increasing our presence on air by 30% with our distinctive, find what speaks to you television spots. These are whimsical and fun. Our existing customers love them, and they broaden awareness of the Pier 1 Imports brand, attracting new customers to our Pier 1 Imports stores and Pier1.com.

A second area of particular focus is direct mail, another important driver of traffic and conversion both in-store and online. As we've previously discussed, we are increasing our direct-mail program by approximately 25% in fiscal 2014, with more pages and increased distribution.

This includes our new large-format outdoor book that arrived in homes in April. The response has been terrific. Indeed, outdoor was among our strongest performers in the first quarter, and we anticipate that will continue to be an important business opportunity on a year-round basis. In early Fall we will introduce another large-format book featuring furniture and decor.

Moving now to the advancements we are making with our 1 Pier 1 strategy. We are, as you know, focused on the seamless integration of our two mutually supportive and inter-dependent businesses — our wonderful Pier 1 Imports stores and our beautiful website, Pier1.com.

I'm proud to note that we are approaching the one-year anniversary of the successful launch of our new e-Commerce-enabled site. Even at this early stage of our growth trajectory, we can sense how powerful Pier1.com is going to be for us as we expand our assortments, broaden our reach, and raise awareness of the Pier 1 Imports brand. But we are not rushing this. We believe our crawl, walk, run approach to scaling the business is serving us well, ensuring high-quality execution.

Since the launch of Pier1.com last July, we have seen progressive increases in the e-Com business as a percentage of total Company sales. Traffic to the site continues to trend upwards, now averaging 1.2 million visitors per week, and conversion rates are also moving up. This traffic, combined with our increasingly powerful rewards cardholder base, is allowing us to build our customer list and round it out with timely data covering shopping patterns and preferences.

We're seeing nice growth in a number of online-only customers, especially those not within the Pier 1 Imports store trade area. We are also seeing a positive trend in customers returning to the site to make further purchases.

This summer we will be executing major site upgrades, which will enhance our customers' interaction with our brand. We will be unveiling an improved site landing page and introducing a redesigned check out process to simplify the transaction experience. In addition, we will also be offering her the opportunity to utilize coupons and other discounts online.

Aside from the planned technical improvements, we are beginning to leverage our ability to offer customers much broader assortments beyond what is in store. This is already driving strong performance in important categories such as curtains, cushions, and outdoor, and rugs. We expect to see other categories gain online strength as our new online-only SKUs flow into the business over the coming months.



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Beginning in August, our special request program, which is driving a lot of incremental business for us, will be rebranded as express request to coincide with the rollout of the initial phase of our e-Commerce home delivery program.

If you recall from our Investor Day presentation, our home delivery service will make larger items currently not shippable available for direct delivery to our customer's home. This service is yet another example of how through our multi-channel approach we can offer that next level of convenience to our customer.

You may have noticed that we tested various permutations of free shipping offers throughout the quarter. The cost of which is being carefully factored into our overall promotional plans. We have been analyzing the results of these various offers to better define what level of free shipping is appropriate for our business model. We're also learning more and more about the behaviors and shopping patterns of our online customers, and going forward, you will see us continue to experiment to drive optimal performance in our online business.

In support of our efforts to expand our multichannel strategies and execute our 1 Pier 1 vision, we are adding headcount in key areas, including buying, planning, allocations, marketing, and IT. In short, we are investing today, and building our teams, and strengthening our organizational capabilities in preparation for our next phase of growth.

We have done a good job in balancing these investment needs without disrupting our profitability. However, the quarter we are in, Q2, will be the hardest for us to maintain our ratios as we have new headcounts without the sales benefit we will see in the back half.

We are nearing completion of the rollout of our new POS system, and I'm pleased to report we now have over 90% of our Pier 1 Imports stores operating on the new system. The insulation has been near flawless. The teams have done an outstanding job. The feedback from our associates and customers alike as been extremely positive. The new system is nimble and easy for our Associates to use and integrates real-time customer data that will facilitate a significant enhanced shopping experience, no matter which channel she shops. By summer's end we expect to begin the integration process between e-Commerce and stores, an important component of our 1 Pier 1 strategy.

Our Pier 1 Imports store portfolio continues to be increasingly productive. During the first quarter we opened 6 new stores, 1 of which was in Walnut Creek, California, and 1 within Marina del Rey, a market we previously had to exit, but one we're pleased to return to.

We also completed 1 full store remodel in White Plains, New York. Here at the start of the second quarter we have just opened 2 additional stores, 1 in Woburn, Massachusetts, which was a remodel; and the second in Staten Island, New York, which was a relocation within the market. We're very pleased with how our customers have responded to the new space.

We remain on track to open 30 new locations and close or relocate 14 stores this fiscal year. We will also invest in additional store refurbishments, which have proven to increase sales productivity and generate strong double-digit returns.

Our store teams are executing well on all fronts. We're seeing consistent levels in our customer conversion rate, which tells us that our merchandising and engagement strategies are resonating with our customers. Our store Associates are highly customer-centric and have earned a well-deserved reputation for strong service levels and deep product knowledge.

All of us that Pier 1 Imports are energized by our achievements thus far and by the myriad opportunities for growth that we have before us. Our ability to deliver on both our short and long-term plans is a strength that we continue to reinforce and build on. The powerful combination of our expansive store portfolio and e-Commerce business create what we deem to be an unparalleled opportunity. The creative work of our merchants, the dedication and hard work of all of our talented associates, our commitment to flawless execution have enabled us to succeed for 15 consecutive quarters. We of the commitment of our team, brand vibrancy, and financial strength to continue the momentum.

So thanks for your attention this morning. Now I will ask Cary to review our first-quarter financial results and discuss our outlook for fiscal 2014. Cary?



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### **Cary Turner** - Pier 1 Imports, Inc. - Senior EVP, CFO

Thank you, Alex, and good morning, everyone. We're pleased to report another quarter of solid top- and bottom-line performance. Total sales for the quarter rose 9.3% to \$395 million, while comp store sales increased 5.9% on top of last year's 7.2% gain, reflecting increases in both traffic and average ticket.

The delta between total sales and comp store sales growth is primarily attributable to two factors. First, sales from our new and intermediate stores, or stores that have not been not been open for a full fiscal year as of the beginning of fiscal 2014; and second, the sales from our e-Commerce business. Beginning in the first quarter of fiscal 2015, we will provide a comparable sales calculation that includes direct-to-customer sales as well as a separate comparable sales calculation for stores only.

On a trailing 12-month basis at the end of the quarter, sales per retail square foot were \$201, up from \$187 at the end of last year's first quarter. At the end of the first quarter sales on the Pier 1 rewards card accounted for 27% of US store sales on a trailing 12 month basis compared to 25.7% at the end of last year. This program continues to be an increasingly important part of our business and remains a key driver of growth.

First-quarter gross profit increased 11.5% to \$168 million compared to \$150 million a year ago; and as a percentage of sales, gross profit expanded 80 basis points to 42.4% versus 41.6% last year. Store occupancy costs were \$71 million compared to \$67 million last year and as a percentage of sales declined by 70 basis points to 17.9%. The year-over-year gross profit improvement can be traced to occupancy leverage as well as strong full-price selling from the quarter.

Looking at expenses, we continue to exercise prudence in managing our overall cost structure while ensuring we are investing appropriately in support of 1 Pier 1.

SG&A for the first quarter leveraged 40 basis points, coming in at \$125 million or 31.8% of sales. That compares to \$116 million, or 32.2% of sales, for the same period last year.

Variable expenses were \$87 million or 22% of sales compared to \$83 million or 22.9% of sales last year. The 90 basis point improvement was primarily related to the leveraging of store payroll.

For the quarter, marketing expenses were in line with our expectations at 5.2% of sales, up 20 basis points from the first quarter of last year. That level of spending reflects our expanded presence on television, increased volume in our direct-mail program, and the distribution of our new large-format outdoor furniture book, as well as investments in digital and social media. We continue to expect that the full-year marketing spend will be approximately 5% of sales.

Fixed expenses during the quarter were \$39 million or 9.8% of sales, compared to \$34 million or 9.3% of sales last year. The increase is primarily attributable to the investments Alex mentioned for additional headcount to scale our e-Commerce business and expand our organizational capabilities.

Looking at expenses for the balance of the year, as Alex mentioned, we plan to continue to prudently invest an additional headcount. To that end in the second quarter we expect fixed expenses will be slightly higher than the first quarter. Additionally, we believe that the higher sales volumes in the third and fourth quarters will allow us to achieve slightly better expense leverage in the back half of the year.

First-quarter EBITDA was \$42.3 million compared to \$35.2 million a year ago, reflecting a 20% growth. Operating income was up 21% to \$33 million versus \$27 million last year, while operating margin expanded 80 basis points to 8.4% of sales from 7.6% a year ago.

We delivered net income of \$20.3 million or \$0.19 per share, which compared to \$17.8 million or \$0.16 per share last year.

Moving to the balance sheet, inventory at the end of the first quarter was in line with our expectations and totaled \$383 million, up 14.9% versus a year ago. The planned increase is primarily related to additional inventory in support of our e-Commerce business, the broadening assortments under our special request program; and slightly larger purchases of merchandise in certain categories to support higher sales.



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At the end of the second quarter and at year end, inventories are planned to be up comparable to the increase in sales.

The Company remains in strong financial condition, ending the quarter with \$242 million of cash and cash equivalents and no cash borrowings outstanding under our credit facility. As we reported in our press release earlier today, we amended and extended our asset-based revolving credit facility subsequent to quarter end effectively increasing our borrowing capacity at a lower cost.

The size of the facility was expanded from \$300 million to \$350 million, and the maturity date was extended from April 2016 to June 2018. While the facility may be used for general corporate purposes, we expect to continue funding working capital requirements with our cash flow from operations.

The Company paid \$5.3 million in cash dividends during the quarter and utilized a total of \$17 million to repurchase 727,000 shares of common stock at an average cost of \$23.36 per share. Since the end of the quarter, we have repurchased an additional 239,000 shares for \$5.7 million.

Therefore to date, this year we have repurchased a total of 966,000 shares at a weighted average cost of \$23.49 and a total cost of \$22.7 million. Under the \$100 million share repurchase plan, \$77.3 million remains available for repurchase. Currently there are approximately 107 million shares of common stock outstanding.

Capital expenditures in the first quarter totaled \$14.1 million. Of that amount, \$9.3 million was deployed toward the opening of 6 new Pier 1 Imports stores and 1 remodeled store; new merchandise fixtures and lighting; other leasehold improvements; and equipment. The remaining \$4.8 million was utilized for technology and infrastructure initiatives, including e-Commerce and our new point-of-sale system. For fiscal 2014 we remain on track with our plan for capital expenditures of approximately \$75 million.

During the first quarter we opened 6 stores and closed 3, ending the quarter with 1,065 Pier 1 Imports stores. That includes 985 locations in the US and 80 in Canada, for a total of 8.4 million retail square feet.

And finally, as we noted in our press release earlier today, we are slightly raising our expectations for full-year EPS. Our financial guidance for fiscal 2014 on a comparable 52-week basis is as follows.

Comp store sales growth in the mid single-digit range; EBITDA growth in the range of 15% to 18%; depreciation and amortization expense of approximately \$38 million; an annual effective income tax rate of approximately 38%; and earnings per share in the range of \$1.27 to \$1.32, representing year-over-year growth of 9% to 13%.

Thank you for your continued interest in our Company, and I will now ask Felicia to please open the call to questions at this time.

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## QUESTIONS AND ANSWERS

### Operator

(Operator instructions) Budd Bugatch, Raymond James.

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### Budd Bugatch - Raymond James & Associates - Analyst

Congratulations on a very solid and good quarter. It's always good to see this progress. And Cary, thank you very much for the color on it. You have taken most of my questions away.

I really wanted to just — if you would, could you give us — on that spread between comps and total sales, you did say the two issues that were the reason for the spread. Can you tell us, maybe give us a little bit of color of which is more important today between the intermediate and the e-Commerce?



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**Cary Turner** - *Pier 1 Imports, Inc. - Senior EVP, CFO*

I would say right now the new and intermediate stores are more important. But we see that changing over time.

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**Budd Bugatch** - *Raymond James & Associates - Analyst*

Okay. And we look forward to the new way of reporting comps beginning of next year.

And I guess my last question, since you have answered most of them, is that payables also grew pretty markedly in the quarter, and I would suspect that's just a timing issue.

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**Cary Turner** - *Pier 1 Imports, Inc. - Senior EVP, CFO*

Yes, that is just the inventory in transit.

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**Budd Bugatch** - *Raymond James & Associates - Analyst*

Got you. Okay, congratulations, and I will cede to others who may have other questions. Thank you very much.

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**Operator**

Matt Nemer, Wells Fargo.

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**Matt Nemer** - *Wells Fargo Securities, LLC - Analyst*

This is Omer filling in for Matt, actually. What does the seasonality look like related to when loyalty members are added? And then what role do you see the website playing with respect to the addition of new members?

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

So seasonality in terms of our ability to get new — sign up people for the rewards card, is that your question?

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**Unidentified Participant**

Yes.

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

It's really not impacted seasonally. It's all — it's really just only in the sense that it is a function of the traffic flow into the stores, and the stores have targets to convert a certain percentage of their traffic. So in that respect, I guess there is some seasonality to it, but we don't really think of it like that. We just think of the — in terms of the number of new card holders that we open per day.

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**Unidentified Participant**

Got it. Thank you.

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**Cary Turner** - Pier 1 Imports, Inc. - Senior EVP, CFO

And then your question about e-Commerce — currently the amount of people using the card on the website is a little lower than in the stores. But again, as that becomes more and more useful, we expect that number to grow as well.

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

But it has also moved up.

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**Cary Turner** - Pier 1 Imports, Inc. - Senior EVP, CFO

Significantly.

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

Since the site was launched.

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**Unidentified Participant**

Perfect, perfect. Thank you very much.

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

You're welcome.

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**Operator**

Adam Sindler, Deutsche Bank.

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**Adam Sindler** - Deutsche Bank - Analyst

Just wanted to dig into the comp a little bit. It slowed a little bit from the end of last year, especially when you look at X the impact of Sandy, and then any potential disruption from payroll taxes and refunds, things like that. I wanted to see if the extra week last year and the change in the calendar this year had any impact on the comp, and how you look at that.

And then secondly, just to see if anything from a weather standpoint — obviously very rainy this year relative to last year — maybe negatively impacted any of your outdoor business?

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

Thanks for the question. As far as the weather is concerned, you have never heard us ever use weather as a reason for good business or poor business, and we certainly wouldn't do it this quarter. But your comments are absolutely right; we have had really very disrupted weather patterns throughout the Spring, and actually in many, many markets. And that is, of course, bound to have some impact.



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**Adam Sindler** - *Deutsche Bank - Analyst*

Okay. And then on the calendar shift with the extra week last year, did that impact the way that you guys report comps? Or how did you look at that? Was it the same 14 or 13 weeks this year versus last year? Or just Q1 last year versus Q1 this year?

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

No, it is 13 versus 13. And the weeks are — they are offset by one week because of the 53rd week NOI, of course. But it is pretty much — on a weekly basis you notice the shift, but through a quarter it really evens itself out.

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**Adam Sindler** - *Deutsche Bank - Analyst*

Okay. And then just one follow-up related to that. To get to the previous goal of \$225 in sales per foot, the new goal of \$250 per foot — one, I just wanted to see — just clarify, that only is what is sold in the store and excludes Pier 1 To-Go?

And then just following up on that, the old goal of \$225 a foot would suggest some acceleration or the need for comps to accelerate this year and next year, closer to somewhere 6.5%, 7% to get to that type of number. Are we looking at that the right way? And do you still think you could get to \$225 by fiscal 2015?

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

Well, the answer is yes to the \$225. And you can do the math as well as we can.

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**Adam Sindler** - *Deutsche Bank - Analyst*

Right. But just to confirm, that is only what goes through the stores, not including To-Go?

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**Cary Turner** - *Pier 1 Imports, Inc. - Senior EVP, CFO*

It excludes the direct-to-consumer business.

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**Adam Sindler** - *Deutsche Bank - Analyst*

Great. And finish with housekeeping — how much did Pier 1 To-Go help the comp this quarter?

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

That is not housekeeping; that is proprietary information.

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**Adam Sindler** - *Deutsche Bank - Analyst*

You guys used to give that in the past. Just wondering if it's still in that 1% range.

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**Cary Turner** - *Pier 1 Imports, Inc. - Senior EVP, CFO*

You will start seeing it next year.

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**Adam Sindler** - *Deutsche Bank - Analyst*

Okay. Thank you.

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**Operator**

Alan Rifkin, Barclays.

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**Alan Rifkin** - *Barclays Capital - Analyst*

It was mentioned that full-price selling improved in the quarter and was a contributor to gross margin. I was wondering, Alex, your opinion on the sustainability of that.

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

Well, as we always tell you, the merchandise margin is a function of a number of things. It is a function of the import margin which our buyers achieve, and that is certainly completely sustainable. They continue to do a great job with our import margins.

It is a function of our markdown. And we've done a really nice job in moving our markdown percentages down over time. There will come a point, of course, when it's not going to go much lower, because we're always going to have things we need to tidy up and merchandise that doesn't resonate quite as well as we thought it would. But it is certainly sustainable.

And then the third component, of course, is our safe pricing and our couponing. And that is a function of, as much as anything, the outside market, Alan. So we respond there to the market pressures to make sure that we can keep our sales momentum going.

So if the economy stays broadly as it is, then our margins are going to say broadly where they are. If the economy gets worse, then we will certainly have to pump up our promotional pricing.

But we have a really good handle on all of that. I don't think we're going to get any major surprises.

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**Alan Rifkin** - *Barclays Capital - Analyst*

Okay, thank you. Last quarter, Cary, I believe you had quantified the difference between the EBIT margins on the retail versus the e-Commerce side. Are you at liberty to give an update on those margins today?

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**Cary Turner** - *Pier 1 Imports, Inc. - Senior EVP, CFO*

No, I think we'll update everybody as it becomes a little bit more significant.

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**Alan Rifkin** - *Barclays Capital - Analyst*

Okay. And one last question, if I may. Cary, you said variable expenses were leveraged because of lower payroll; (technical difficulty) expenses were deleveraged because of higher headcount. Can you just help me understand the difference between payroll and variable expenses and the headcount and fixed?



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**Cary Turner** - Pier 1 Imports, Inc. - Senior EVP, CFO

No, the variable expense was the store payroll.

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**Alan Rifkin** - Barclays Capital - Analyst

Okay.

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**Cary Turner** - Pier 1 Imports, Inc. - Senior EVP, CFO

And what we did was we were able to leverage those expenses as a percentage of sales. The fixed expenses I am referring to are in the home office — the additional staff in the marketing, IT, et cetera.

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**Alan Rifkin** - Barclays Capital - Analyst

So that's where all the headcount is being added. There's no additional headcount being added at the store level?

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**Cary Turner** - Pier 1 Imports, Inc. - Senior EVP, CFO

We add headcount at the store level, but we manage that that the increase in total hours and rate will be less than the increase in sales.

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**Alan Rifkin** - Barclays Capital - Analyst

Okay. Thank you very much.

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**Cary Turner** - Pier 1 Imports, Inc. - Senior EVP, CFO

Yes.

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

Thanks.

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**Operator**

Brian Nagel, Oppenheimer.

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**Brian Nagel** - Oppenheimer & Co. - Analyst

Congrats on a nice quarter. So the first question I have, and I don't want to get too granular here, but you did call out the expense trajectory as we go from Q1 to Q2. Alex, you mentioned; then Cary, you followed up. But I want to make sure — first, I want to make sure I heard it clearly. So in Q2 — and we're looking — is it SG&A expenses will be slightly higher than what it was in Q1?

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

Cary, and you want to talk to that?

**Cary Turner** - *Pier 1 Imports, Inc. - Senior EVP, CFO*

Yes, it will.

**Brian Nagel** - *Oppenheimer & Co. - Analyst*

Okay. And then related to that — so as we look at that uptick, should we think about this more as a new run rate going forward, given some of the investments you're making in the business? Or are there some type of one-time expenses we're going to see here in Q2 that will moderate over time?

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

No, these are not one-time costs, Brian. It's really just as we are building out the organization. And as we said in the prepared remarks, I think we've done a really very nice job in terms of phasing in the incremental costs to build out the business and not getting ahead of ourselves. So we have been able to get some leverage. And that's still our intention on the 12-month basis.

What we are really calling out is that we have got incremental heads coming in in Q2. And of course, you know our Q2 sales number is not as big as our Q3 and our Q4 sales number. So it's just going to be really hard to leverage this in Q2, that's all. So we want you guys to get the phasing right throughout the quarter. And not expect it to be even each quarter. How do you think I did?

**Brian Nagel** - *Oppenheimer & Co. - Analyst*

Got it.

**Cary Turner** - *Pier 1 Imports, Inc. - Senior EVP, CFO*

Okay, Brian?

**Brian Nagel** - *Oppenheimer & Co. - Analyst*

That's perfect. And then the second question, maybe a little bigger picture — we have talked about the new POS system. You mentioned in your press release; you talked about it in your prepared comments. It seems like we are getting much closer in the rollout. Just maybe help me understand — how mechanically, when you put the new POS system, how is that going to facilitate then a better integration of the online and in-store businesses?

And then the second question I have on that is, so us as analysts, how should we look at — what should we be looking at as signals of success with this POS system as you're really trying to drive the business?

**Cary Turner** - *Pier 1 Imports, Inc. - Senior EVP, CFO*

Well, Brian, you have got to remember that the old POS system was 22 years old. Yes, it worked, but it was very clunky, cumbersome, et cetera. And now we will have a system that is touchscreen. And most importantly, it acts as another PC in the store so that you will be able to buy something online while you are in the store that may not be there in the store.



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**Brian Nagel** - *Oppenheimer & Co. - Analyst*

Got it. So from an efficiency standpoint, then, that just helped the labor model within your store, as well?

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

No, no, no, no. It's really about — with the new system, we can just build in much, much more functionality in terms of the POS system per se. And most importantly, we can link the POS system to the data we are getting from our online business.

So it means that when a customer is in store, ultimately — and this is not next week — she will be able to do combined transactions, for example. So a transaction could include merchandise that was available in store. It could be an online item, and it could be an express request item. And that could all be done as one transaction, which was going to be fantastic for the customer.

From a marketing point of view, we'll also have the ability to see what the customer bought when we have our records both in-store and online. So it will just help the stores in terms of the advising customers what else they might like to buy.

So the list goes on and on. And we are at relatively early stages of spec'ing out. But basically it can do whatever we need it to do, I guess is the best way I can put it.

**Brian Nagel** - *Oppenheimer & Co. - Analyst*

Well, thank you.

**Operator**

Denise Chai, Bank of America.

**Curtis Nagle** - *BofA Merrill Lynch - Analyst*

This is Curtis Nagle filling in for Denise. Just a quick question on AUR. Was wondering how that trended in the quarter — how it compared to the prior two?

**Cary Turner** - *Pier 1 Imports, Inc. - Senior EVP, CFO*

AUR was up slightly, and that benefited the average ticket.

**Curtis Nagle** - *BofA Merrill Lynch - Analyst*

Was that a function, again, of contribution from online, bigger items, that sort of thing?

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

No, not really. It's always — like you say, it's always a combination. It's partly the reduction in markdowns that we talked about. It's partly a function of mix in terms of which department is performing most strongly. And there's always a little bit of price inflation in there, as well. So it's all those things.



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**Cary Turner** - *Pier 1 Imports, Inc. - Senior EVP, CFO*

And remember, the e-Commerce business is not part of the comp.

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**Curtis Nagle** - *BofA Merrill Lynch - Analyst*

Right. Okay.

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**Cary Turner** - *Pier 1 Imports, Inc. - Senior EVP, CFO*

— After ticket and traffic.

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**Curtis Nagle** - *BofA Merrill Lynch - Analyst*

All right. I appreciate the commentary. Thanks a lot.

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

Okay, thanks.

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**Operator**

Cristina Fernandez, Telsey Advisors.

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**Cristina Fernandez** - *Telsey Advisory Group (TAG) - Analyst*

I wanted to see if you can give a little more color on the tests you are making online as far as free shipping. What are you finding to be most effective in driving conversion?

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

Well, we said in our prepared remarks we are doing a number of tests. I certainly wouldn't want to go into detail with you about which ones were most effective and which ones were least effective. But I guess you will figure that out over time, because you will see which promotions we kind of land on. But I really don't want to go into too much detail at this stage.

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**Cristina Fernandez** - *Telsey Advisory Group (TAG) - Analyst*

Okay, thanks. And could you comment on how performance is going so far in the second quarter?

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

No. We're just a couple —

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**Cary Turner** - *Pier 1 Imports, Inc. - Senior EVP, CFO*

Just started.

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

Just a couple of weeks into the first month.

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**Cristina Fernandez** - *Telsey Advisory Group (TAG) - Analyst*

Okay, thank you.

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**Operator**

John Marrin, Jefferies.

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**John Marrin** - *Jefferies & Company - Analyst*

Welcome aboard, Brian; and thanks to Kelley for all of her help. I know everybody here is going to miss her.

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**Bryan Hanley** - *Pier 1 Imports, Inc. - Director of Investor Relations*

She is not going anywhere.

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**John Marrin** - *Jefferies & Company - Analyst*

Well, you get to see her, but we will miss her. So I'm just looking for a little more color around sales. I know you said that the Spring seasonal assortment did very well. And I'm interpreting that to mean that the comps finished very strong in the quarter around Mother's Day and Memorial Day. So am I guessing correctly when I say that the cadence of the comps for the quarter strengthened it towards the end there?

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

Not really, no. Actually, it was pretty consistent. It was pretty consistent throughout the three months, actually.

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**John Marrin** - *Jefferies & Company - Analyst*

Okay, that's interesting.

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

All the [basis on that.]

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**John Marrin** - *Jefferies & Company - Analyst*

So I was also hoping to get some more commentary around conversion, and maybe how the conversion is looking in stores where you have the new POS system rolled out already.

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

Well, as we said in the prepared remarks, I think our stores have done a really outstanding job in taking advantage of the traffic we get. And our conversion rates — we made huge increases in our conversion rates over the last few years, and you're not going to see them going up at the rate they've gone up.

But they still continue to inch up. And the good news is the conversion rates are really consistent. So we are executing, really, day in and day out, which is fantastic.

**Cary Turner** - *Pier 1 Imports, Inc. - Senior EVP, CFO*

Especially when you think about the disruption that was potentially there with the rollout of point of sale and everything else that's going on in the stores. So we are very pleased.

**John Marrin** - *Jefferies & Company - Analyst*

Got you, okay. That makes sense. And I guess I was a little surprised to hear that you're not still getting unit increases. AUR is up slightly, but are you still seeing units up on a year-over-year basis?

**Cary Turner** - *Pier 1 Imports, Inc. - Senior EVP, CFO*

Oh, yes. It was a little bit AUR and a little bit number of items in the basket.

**John Marrin** - *Jefferies & Company - Analyst*

Okay, cool. And one final question on SG&A. Obviously, a great job on variable. I was just curious how much of that could be a benefit of e-Commerce growth versus store execution?

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

No, I think the e-Commerce is really not big enough to impact —

**Cary Turner** - *Pier 1 Imports, Inc. - Senior EVP, CFO*

To impact the total sales yet.

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

It will, and you'll see that in the coming quarters and years, but not so much at the moment.



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**John Marrin** - *Jefferies & Company - Analyst*

Okay. All right, great. Thanks, guys.

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

All right. Well, thanks for joining us today, everybody. And we'll be back with you in a few months. Bye-bye.

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**Operator**

Thank you for participating in today's conference call. You may now disconnect.

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