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PIR - Q1 2016 Pier 1 Imports Inc Earnings Call

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OVERVIEW:

Co. reported 1Q16 total sales of $432m and net income of $6.9m or $0.08 per share. Expects FY16 EPS to be $0.83-0.87 and 2Q16 EPS to be $0.07-0.08.

CORPORATE PARTICIPANTS

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

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

Laura Coffey *Pier 1 Imports Inc - EVP & Interim CFO*

CONFERENCE CALL PARTICIPANTS

Budd Bugatch *Raymond James & Associates, Inc. - Analyst*

Seth Sigman *Credit Suisse - Analyst*

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to the Pier 1 Imports first quarter FY16 earnings call. At the request of Pier 1 Imports, today's conference call is being recorded. (Operator Instructions) I would like to introduce Bryan Hanley, Director of Investor Relations for Pier 1 Imports.

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

Thank you, and good afternoon, everyone. Today after market close, we issued an earnings press release which included the detailed financial results for the FY16 first quarter ended May 30. In just a few moments, we will hear comments from Alex and Laura about the results, how we're progressing under the Company's 1 Pier 1 omni-channel strategy and the Company's financial guidance for FY16.

This will be followed by a question-and-answer period. Before we begin, I need to remind you that certain comments made during this call may be deemed to include forward-looking statements that are based on management's current estimates or expectations of future events or future results. These statements are not historical in nature and can generally be identified by such words as believe, expect, estimate, anticipate, plan, may, will, intend, and similar expressions.

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

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

Refer to the Company's most recent SEC filings for any updates concerning these and other risks and uncertainties that may affect the Company's operations and performance. Undue reliance should not be placed on forward-looking statements which are only current as of the date they are made. The Company assumes no obligation to update or revise these forward-looking statements.

The Company will also discuss non-GAAP financial measures on this conference call. Pursuant to the requirements of Regulation G and Item 10(e) of Regulation S-K, the Company has provided a reconciliation of the non-GAAP financial measures to the most directly comparable GAAP financial measures in our earnings press release that was issued this afternoon, which is available on our website at www.pier1.com. Now I'd like to turn the call over to Alex Smith, Pier 1 Imports' President and Chief Executive Officer. Alex.

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

Thanks, Bryan, and good afternoon, everyone. Also joining me on the call today is Laura Coffey, Executive Vice President and Interim Chief Financial Officer. In the room with us are members of our leadership team. Over the last 12 months, I've talked extensively about our omni-channel transformation and the underlying strength of our competitive positioning.

Now it's time to focus on the new chapter that we introduced on our year end earnings call. When we spoke to you last quarter, we told you that FY16 would be the start of a multi-year period during which we will exploit the strength of our brand and our new omni-channel business model, and leverage the investments we've made in people, systems, and physical infrastructure.

It's all about improving profitability by restoring merchandise margins and [leveraging] costs while maintaining steady top line growth. Our stated goal is to move our profitability levels towards our historical highs. Our plans and strategies to do this are in place and, while we are just one quarter into the year, we are making progress with our execution.

These strategies include lowering expenses across the organization, including a reduction of our retail footprint, restoring merchandise margins by improving the efficiency of our distribution network, and ensuring that we continue to offer unique on-trend merchandise that presents a compelling value proposition, continuing to increase the profitability of our fulfilled sales, and, of course, driving sales through product and marketing enhancements.

As I said during the last call, the totality of our customer's experience as she shops how and when she wants gets better and better. So with that as a backdrop, we feel the year is off to a fairly good start. Total sales increased 3.1%, a little less than we thought, while comp store sales rose 2%, or 2.8% on a constant currency basis. We experienced healthy sales growth for much of the quarter but had some challenging weeks in April.

E-commerce, which accounted for 17% of total sales in the quarter, up from 9% a year ago, once again outperformed our expectations. We enjoyed strong growth in online traffic, conversion, and average ticket. Conversely, sales through the POS in stores were below our expectations. Online only SKUs are taking a larger share of our sales which gives us great confidence in our ability to maintain the fast growth in our online business as we build out and expand our assortments.

Merchandise margins before delivery and fulfillment costs were negatively impacted by distribution center costs, but promotional discounts were more or less what we planned. We reduced expenses below our original plan, which enabled us to deliver earnings per share of $0.08, in line with the guidance we provided at the start of the year.

Our merchandising team is executing well, and continues to do a great job developing the unique, special, and trend-right products that our customers expect from Pier 1 Imports. Our seasonal tabletop and fragrance areas were standouts in the first quarter and indoor furniture had a decent performance. We were, however, disappointed with our outdoor furniture sales in Q1. As you well know, most in the industry had their outdoor furniture on sale as early as February 1.

We keep discounts small until Memorial Day, and so the promotional impact on our margin rate was minimal in the first quarter, but I think it hurt sales. We are stepping up promotions on outdoor furniture in Q2 to ensure clean store inventory by the time we do our fall transitions. More broadly, our one big sale has now started and we're seeing strong customer response. Sales for June are tracking well in line for us to achieve our quarter 2 guidance.

Pressuring our merchandise margins, as discussed on our year end call, are the temporary costs at our distribution centers and the fact that our DCs are not performing at optimal efficiency. The DCs are going through their own omni-channel transformation and are behind the stores in this process. We expect to see improvements throughout the year helped by bringing our inventories back into line.

Turning now to contribution from operations, an important metric which we use to measure the performance of our new business model. As you can see in today's press release table, we generated only modest leverage on store occupancy costs in the first quarter. You will also note that delivery and fulfillment increased as a percentage of total sales as our direct-to-customer business increased. However, our fulfilled sales generate a higher rate of contribution from operations and than our store sales.

The margin on fulfilled sales improved in the first quarter as we leveraged the fulfillment center costs. We expect this dynamic to be ongoing as our fulfillment and in-home delivery channels continue to grow. Over the coming quarters, we expect to see contribution from operations as a percentage of total sales stabilizing, and then improving as fulfilled e-commerce sales grow, we reduce store occupancy, and we drive further efficiency through store payroll and operational expenses. In other words, we reduce store payroll and occupancy to offset the fulfillment costs.

We are in the early stages of our real estate optimization program which we introduced in April. We are pleased with the team's progress, and now expect our plans to be a little more front loaded than we told you on the last call. For FY16, we are taking up the number of expected net closures to 30, triple the number previously announced. More on this from Laura in a few minutes.

Our wonderful Pier 1 Imports stores are, of course, not going away. They remain an important part of the selling and showroom equation for our brand. In the first quarter, approximately 36% of online purchases were picked up in a store, and approximately 31% of online purchases were placed at a cashwrap PC.

The careful reduction of our real estate footprint will allow us to drive growth through our omni-channel model, reduce store occupancy and payroll costs, and improve efficiency. Additionally, as the stores we are closing have contributions below the Company average, overall profitability of the fleet will increase. We anticipate there will be additional opportunities beyond our initial 100-store assessment as we move through the process. Early discussions with our landlords on rent reductions and rent avoidance have been productive.

Moving to marketing, we are pleased with the success we've had with our marketing efforts over the last quarter. We've shifted our media mix and focused our efforts and resources on building our customer file and encouraging her to shop more frequently, and it's working as planned. We are at an all-time high in the number of visits that shoppers in our database are making annually to Pier 1 Imports, either to the stores, or to the site, up 18% from this time last year.

We are seeing meaningful improvements in both the frequency of purchases and average ticket, which tells us our focus on maximizing the spend of the customers that we know is working well. Part of this success is due to our Company's evolved brand positioning. As you may have noticed, over the last year, we've elevated the Pier 1 Imports brand imagery and storytelling through all aspects of our creative execution.

We've invested heavily in our direct mail program this year, with a planned 25% increase in both page counts and circulation. Our direct mail books are better reflecting the quality and unique nature of our merchandise, and we're pleased to say the customer is responding. Response rates to our direct mail efforts over the last quarter have increased significantly. We've also invested heavily in our digital marketing efforts, focusing on search, SCO, display, stronger partnerships with the affiliate channels, more customization and segmentation with emails, and a more exciting and engaging social media presence.

In the first quarter, we saw exceptional response rates in all these areas, which are helping to drive our e-commerce growth. What drives much of the success in both the direct and digital is our continued investment in our customer data excellence initiative. As you know, the challenge for many of us in brick-and-mortar retailing today is the decline of the casual shopper. So more and more it's about understanding individual customers and putting product in front of her that you know will resonate.

Today, our active customer database is at an all-time high with a number of online only and omni-channel customers growing the most. We expect this initiative to really pay dividends once we are able to overlay the full suite of segmentation capabilities and tied together with our newer marketing initiatives. Building the brand advocacy and loyalty that we already enjoy with our Pier 1 Imports reward card customers to a broader group of known customers is a vital building block for our success.

We're working hard to rebuild our profitability. We spent two-plus years building our 1 Pier 1 omni-channel platform and we need to exploit the benefits of our powerful new model. Our teams are energized and dedicated to driving top line growth. We're making good progress at bringing our inventories back in line and expect to be below last year by the end of third quarter.

We're working to improve the efficiency of our distribution network and fulfillment centers. Our cost containment and reduction efforts benefited the first quarter and we have identified additional opportunities that we will be executing against during the remainder of the year. And while all of this work goes on to get our back-of-house running optimally from a brand perspective, our customers continue to love what we're doing.

For several quarters now, I've been discussing the six key guideposts that we are focused on as a leadership team, brand traffic, conversion and average ticket, stores of sales and customer experience centers, merchandise margin and gross profit, fulfillment and home delivery, SG&A expense, and capital allocation. We are confident that as we make consistent progress against these guideposts over the next two years we will leverage the investment we've made, restore our lean infrastructure, and generate strong improvements and EBITDA operating income and EPS. Now I'll ask Laura to review the financials and discuss our guidance. Laura?

Laura Coffey *- Pier 1 Imports Inc - EVP & Interim CFO*

Thank you, Alex, and good afternoon, everyone. Total sales in our first quarter were up 3.1% to $432 million, while Company comps increased 2%. On a constant currency basis, our total sales were up 3.9%, and Company comps were up 2.8%. E-commerce continued to exceed our expectations in the first quarter with sales penetration reaching 17%, that's up substantially from 9% a year ago.

Now looking at merchandise margin, in total dollars, we were up slightly year-over-year in the first quarter to $248 million, yet merchandise margin decreased by 140 basis points to 57.4% of sales. As we anticipated, and previously discussed, we incurred supply chain expenses that impacted merchandise margin in the first quarter by about $3 million, or $0.02 per share.

That equates to about 70 basis points of the decline. The remaining 70 basis points of deleverage is mostly attributable to the fact that our distribution centers are not yet running at optimal efficiency. As we look at the second quarter, we anticipate margins will be impacted by three primary factors. One, as we told you at year end, there will be another $3 million, or $0.02 per share, of incremental supply chain expense.

Two, we also told you that our DCs are not running at optimal efficiency which will impact the quarter by a similar order of magnitude relative to Q1. And, three, promotional activity will be up from a year ago. Let me explain. We know that many of you are very aware of our promotional cadence.

And while it was slightly higher in the first quarter versus the same period last year, the impact on merchandise margin was actually minor. But as Alex stated, we are planning to spend incremental promotional and mark down dollars in this year's second quarter. The increase in Q2 promotional activity allows us to timely clear through outdoor merchandise during the critical summer selling season and should give us the added benefit of working through inventory in our distribution centers to prepare for the upcoming arrival of our holiday assortment.

As we reduce inventory levels in our DCs, we should begin to see efficiencies increase and expect to generate improvement in our merchandise margins beginning in the fourth quarter. On our last call, we spoke extensively about our efforts to reduce occupancy cost and how that will become an increasingly important lever as e-commerce sales penetration grows. In the first quarter, we leveraged store occupancy costs by 30 basis points, coming in at $75 million, or 17.3% of total sales.

We expect to continue to leverage occupancy cost throughout the remainder of the year. Delivery and fulfillment costs increased both in dollars and as a percentage of total sales, reflecting the strong growth of e-commerce. As we told you last quarter, we expect this trend to continue for the foreseeable future. However, we are continuing to see leverage of these costs as a percentage of our fulfilled sales.

In the first quarter, we saw nearly two-thirds of our e-commerce sales fulfilled to the customer either through parcel or in-home delivery. That's up from 60% during the same period last year. Now turning to SG&A expenses. The first quarter came in at $139 million, or 32.1% of sales. That compares to $131 million, or 31.4% of sales for the same period a year ago.

As Alex mentioned earlier, we are just beginning to see improvement in our cost reductions and we saw SG&A expenses come in below our original planned expenses for Q1. Variable expenses for the quarter, which include compensation from operations, marketing, and a portion of operational expenses, totaled $94 million, or 21.8% of sales. This compares to $90 million, or 21.6% of sales a year ago.

The increase on a dollar basis and as a percentage of sales can primarily be traced to slightly higher payroll, which is expected to moderate over the course of the year as we refine our omni-channel payroll model. Fixed expenses for the quarter increased to $45 million, or 10.3% of sales, versus $41 million, or 9.8% of sales last year. The increase is largely attributable to corporate administrative expenses, specifically the annualization of headcount additions from last year.

First quarter EBITDA totaled $26 million which compares to $36 million a year ago, while depreciation for the period increased and came in at $12.4 million. That's up from $10.4 million a year ago. Operating income totaled $14 million compared to $26 million in the first quarter of FY15 and net income was $6.9 million, or $0.08 per share.

Moving on to the balance sheet, inventory at quarter end totaled $502 million, up 20% from a year ago. You will recall that inventories were up 27% at fiscal year end. Historically, inventories at the close of our first quarter are higher than our year end levels, principally due to the seasonal build of Harvest and Halloween assortments. That said, our inventory in outdoor furniture was higher than planned at the end of Q1, and we are moving through that by way of our June clearance event.

Additionally, we are reducing inventory purchases in the back half of the year and expect to end FY16 with inventory below FY15 year end levels. Importantly, the reduction in purchasing will generate incremental free cash flow. Capital expenditures for the quarter totaled $9.4 million, with approximately half invested in new and relocated stores, and half in infrastructure and technology initiatives.

As previously announced, our full-year spending will be approximately $60 million. During the quarter, we repurchased 1.4 million shares of our common stock for a total of $17.6 million. Now let's turn to our real estate initiative. We are making good progress with our optimization program. During the quarter, we closed 10 stores and opened eight, six of which were relocations.

We have accelerated our store closure plans for this year and we now anticipate a net 30 closures compared to our higher plan for a net 10 closures. The change is attributable, in some cases, to just a few weeks in timing and in others beneficial lease discussions. We have engaged a third-party to help us monitor this progress, an industry leader who has successfully helped us renegotiate many of our leases in the past. Most of the incremental closures in FY16 will occur in the latter weeks of the fourth quarter.

This change impacts the cadence of our optimization plan as follows: In FY17, we now anticipate closing 35 to 40 locations, followed by approximately 20 locations in FY18. Looking to our financial outlook for the year, which is inclusive of our 30 net closures, as you can see, in today's press release, we are reiterating a majority of our full-year guidance while making some adjustments to our outlook for the Company comp sales, merchandise margin, and SG&A expenses.

The changes to FY16 guidance are as follows: Comp sales growth is expected to be in the range of 3% to 5%, a slight adjustment compared to the prior guidance for mid-single-digit growth. Merchandise margin, as a percent of sales, is expected to be approximately 57%. This reflects the anticipated pressure in the second quarter, as I described earlier, which includes supply chain costs, distribution center inefficiencies, and increased promotional activity.

We now expect to leverage SG&A expenses as a percent of sales in a more meaningful way, an improvement versus prior guidance for flat to slight leverage over FY15. Our cost control efforts were better than planned in the first quarter and our teams have identified further opportunities we can implement over the next three quarters.

The remainder of our guidance is unchanged and includes the following: EBITDA margin is expected to be comparable to FY15. Depreciation will be in the range of $50 million to $55 million, operating margin is expected to come in comparable to FY15. We continue to expect that EPS will be in the range of $0.83 to $0.87, and our capital expenditures are expected to be approximately $60 million. As a reminder, for modeling purpose, our net interest expense will be in the range of $12 million to $12.5 million.

In addition, we are continuing to forecast the full-year effective tax rate at approximately 39.4%. We are also providing guidance for the second quarter of FY16 with comp sales growth expected to be in the range of 4% to 5% and earnings per share in the range of $0.07 to $0.08. One quick housekeeping item before we take questions.

We are making some changes to our corporate calendar and beginning next quarter, we expect that our earnings release dates will be pushed out by a week or two. We will let you know as soon as we have firm dates, so that you can adjust your calendars accordingly. With that, now I'd like to ask Melissa to open up the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Budd Bugatch with Raymond James.

Budd Bugatch - *Raymond James & Associates, Inc. - Analyst*

Good morning -- good afternoon, Alex and Laura and Bryan.

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

Hey, Budd.

Budd Bugatch - *Raymond James & Associates, Inc. - Analyst*

A couple of questions, if I could. I just want to make sure I got the numbers of stores right. You closed 10 and you relocated -- you opened at eight but relocated six, or is that a net closure of eight stores?

Laura Coffey - *Pier 1 Imports Inc - EVP & Interim CFO*

No. It was a net closure of two.

Budd Bugatch - *Raymond James & Associates, Inc. - Analyst*

Net of two. Okay. So the store count at the end of the quarter, just make sure I have it right?

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

1,063. We just got it.

Budd Bugatch - *Raymond James & Associates, Inc. - Analyst*

All right. When you look at merchandise margin, and I know you had the $3 million of inefficiency, can you give us a feel of merchandise margin? I know the pricing is the same online and in-store, but when you look at the merchandise margin, excluding that $3 million of inefficiency, how does it compare between online and in the store?

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

Well, the pricing, you're right, is identical, but, so the only differences between the merchandise margin before fulfillment, et cetera, et cetera, the only difference between stores and online is if their mix fluctuates.

Budd Bugatch - *Raymond James & Associates, Inc. - Analyst*

Right.

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

And, honestly, it really doesn't move that much between the two channels.

Budd Bugatch - *Raymond James & Associates, Inc. - Analyst*

So it's about equivalent if you exclude that $3 million efficiency?

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

Yes, sir.

Budd Bugatch - *Raymond James & Associates, Inc. - Analyst*

That would be my working assumption. Okay. When you look at delivery and fulfillment costs, that's a new item that we haven't seen. As we go forward, how do we think about modeling that? What's the right way to think about that, Laura, if you can give us some feel for that?

Laura Coffey - *Pier 1 Imports Inc - EVP & Interim CFO*

Well, Budd, as we've said in our prepared remarks, as we continue to grow our fulfilled -- our total e-commerce business and our fulfilled business -- we will see those costs continue to increase as both a dollar and a percentage of sales. But you should expect some leverage as that volume increases.

Budd Bugatch - *Raymond James & Associates, Inc. - Analyst*

And with --

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

What you don't see and what we haven't released -- we don't release the fulfillment center costs as a percent of the fulfilled sales and we won't be disclosing that number, but what we've said to you, and we saw it a little bit in Q4, and we've seen it much more pronounced in Q1 versus Q4, is that percentage continues to decrease. So the percentage -- so fulfillment costs as a percentage of fulfilled sales continues to decrease, and that's clearly an important focus for us.

Budd Bugatch - *Raymond James & Associates, Inc. - Analyst*

Okay. Lastly for me, just talk a little bit about marketing, that expense, it looks like it was normalized, but you'll see the highest percentage of expenses in marketing again in the third quarter? Is that right the way to see that?

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

Yes, it's biggest in Q3 and then falls to a pretty small percentage in Q4.

Budd Bugatch - *Raymond James & Associates, Inc. - Analyst*

But no big change from last year as we look at that going through the year?

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

No.

Budd Bugatch - *Raymond James & Associates, Inc. - Analyst*

Okay. Thank you. Good luck on the second quarter and the balance of the year.

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

Thanks, Budd. Appreciate it.

Operator

Seth Sigman with Credit Suisse.

Seth Sigman - *Credit Suisse - Analyst*

Thanks very much. A couple questions here. You guys mentioned a couple different times the distribution inefficiencies. Can you elaborate on that, what the issue is, and some of the steps you are taking to address that? And when we should start to see the benefit from that?

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

Seth, I think this is all the things that we talked about on the Q4 call, and it's really a continuation of that story. And I think I alluded to the DCs own transformation. So two things. Well, three things have happened in the DCs.

Firstly, we have significantly increased the SKU counts in the business, both in terms of the online-only SKUs and the XR SKUs. So the DCs have to [pick] many more SKUs than they used to in the old brick-and-mortar days. So that's added a significant level of complexity to the DCs. Secondly, as you know, we -- our inventories are much too high and so the impact of that inventory is felt most intensely by the DCs because our store inventories are extraordinarily well-controlled.

So the DCs have had a double whammy of a much more complex business and very, very high levels of inventory to manage, and the combination of those two things has caused the inefficiencies. So what we are expecting -- we are expecting two things to happen. Firstly, the inventories start to moderate as we move through the year, and that on its own will help them considerably. And, secondly, they are figuring out how to run their new business and are making good progress every day at improving there efficiencies, so that's pretty much the story.

Seth Sigman - *Credit Suisse - Analyst*

Okay. And then to tie that in with merchandise margins, you guys outlined some of the drivers, some of the pressures in the second quarter. But it seems like guidance still implies some pressure continuing into the back half. Can you elaborate on what the assumption is embedded there? Thanks.

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

Right. While the -- right -- the assumption of the numbers that Laura called out to you in Q2 and the promotional impact -- the impact of the -- we saw in the fourth quarter of the big inventories and the demurrage and all the rest of it, that starts to tail off as we move through quarter 2. So that starts to go away.

But we are -- although we're assuming improvements, Seth, we're still not expecting the DCs to get back to their historical efficiency levels this fiscal year. So your assumption is correct. There is an overhang all the way through.

Seth Sigman - *Credit Suisse - Analyst*

Okay. Thank you.

Operator

Aram Rubinson with Wolfe Research.

Aram Rubinson - *Wolfe Research - Analyst*

Hi, thanks for taking the question.

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

Hi, how are you?

Aram Rubinson - *Wolfe Research - Analyst*

I am good, thank you. Couple things, when the e-commerce penetration kind of moved from 12.6%, I think, last quarter to 17%. It's a bit more of a surge in any one quarter than we've seen. Wondering kind of what you've done to drive that, and whether or not we want to reign that in at all?

And you mentioned that the omni-channel transformation is complete, did you mean that you have kind of hit a level there that you are comfortable with?

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

In terms of saying the transformation is complete, what we mean by that is we have added all the functionality to our sites that we think we need to be very credible in this space, and we think the stores have done great work in embracing the different way of shopping. So we think that part of the omni-channel transformation is complete. And now what we're focusing on, of course, as we've said, is leveraging those investments in systems, in people, and infrastructure.

The reason that e-commerce accelerated so strongly in Q1 is for all the reasons that we've been talking about. We worked very hard at building the functionality on our sites and improving our user experience. We've ramped up our spend in digital marketing, so all those things, I think, have come together. And then you layer on top of that, of course, and we must not forget this, just the changes in the way customers are shopping and their preference for shopping online, and we shouldn't underestimate that as one of the drivers, as well.

Aram Rubinson - *Wolfe Research - Analyst*

And then my final, you mentioned that the outdoor furniture maybe a little bit of an overhang with the weather and some of the competitive behaviors. Any other pockets or parts of the inventory that you think would be addressed in Q2, as well?

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

Well, as we said in the prepared remarks, we now are in the one big sale period of our calendar which will run through the summer. And during this time, we take the advantage, as we do in the winter sale, as well, to clear out that merchandise which either is just residuals or hasn't quite resonated with the customer. So if you visit the stores or visit the sites, you'll see that there's mark downs in every part of the business.

Aram Rubinson - *Wolfe Research - Analyst*

All right. Thanks for taking the question.

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

Okay. You're welcome.

Operator

Seth Basham with Wedbush Securities.

Seth Basham - *Wedbush Securities - Analyst*

Good afternoon. Thank you for taking the question. My first question is just around point-of-sale sales. It seems like in-store point-of-sale sales are down about 7% this quarter, and an accelerating decline versus recent quarters. First of all, is that about accurate? And second of all, do you plan on that level of decline going forward?

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

Well, sort of your in the sort of right ballpark directionally, but, of course, don't forget, that's not the whole story because, of course, we told you also what percentage of our e-commerce business is being booked online. So there is inevitably -- not inevitably -- there is no doubt there is an element of channel switch here as the stores are really enjoying signing up customers for online sales. So I think that is part of the decline, as well.

But, no, we see that decline is going to sort of moderate over time and we are going to reach an equilibrium where this sort of online business and the POS are a little more in harmony than they are at the moment.

Seth Basham - *Wedbush Securities - Analyst*

Got you. As you think about your profit forecast for this year, obviously, you are expecting to take out more occupancy and labor costs as you see those in-store POS sales decline. But what are you planning for terms of those POS sales? Is there a way that your planning the business?

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

Yes. We're not going to -- we've given you our overall sales number. We don't want to break it out any further than that.

Seth Basham - *Wedbush Securities - Analyst*

Got you. And then the last thing is on the promotional environment, a couple quarters ago you spoke to trying to back away from the blanket percent out the store promotions. We saw a few more of those in the most recent quarter. Are you still balancing the mix of those in with your others, or do expect to continue to move from those year-over-year?

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

Well, I want to be careful because sometimes what I say and what people hear are not the same thing. So what we said is that we wanted to decrease the number of blanket promotions. We didn't say that we wanted to do zero. And in fact, we have decreased the number of blanket promotions.

And we will continue to keep that number at a lower level, but it won't be zero. Because as we've said to you before, we find that the category promotions are much more effective. It allows us to direct customer spend a little more than with the blanket promotions. But you will see them from time to time.

Seth Basham - *Wedbush Securities - Analyst*

Got it. All right. Thank you very much and good luck.

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

Thanks.

Operator

Jessica Mace with Nomura Securities.

Jessica Mace - *Nomura Securities - Analyst*

Hi. Good afternoon.

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

Hey, Jessica. How are you?

Jessica Mace - *Nomura Securities - Analyst*

Good, thanks. My first question is on the store closure strategy, and I believe you had four closures excluding relocations in the quarter, and even though that's a small number and early on, I was wondering if you could tell us which of those stores were in single store markets and what you're seeing the trends in the online business in those areas?

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

Yes. Do you know, we haven't really -- it's too early in the program, so to tell you the results that sort of one store closing would not be meaningful, I don't think. But I think what we did say to you on the last call is what we're expecting is different patterns of sales transfer in multi-store markets versus single-store markets. We recognize that if we close a single-store market, those store sales are pretty much gone, but we hope that we will transfer a proportion of that business to online.

Different story in multi-store markets. There, we do our projections on a case-by-case basis looking at the geography and the adjacency of the other stores. And there, we expect to capture, depending on the geography, reasonable percentages of the closed store sales.

Jessica Mace - *Nomura Securities - Analyst*

Understood, thank you. My second question is to make sure I understand the change in the merchandise margin guidance. Outside of the outdoor furniture category, is there anything that you have visibility into or are expecting in the second half that's different from the pressure related to the distribution center inefficiencies that you were projecting before?

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

No, it's really the continuation of the story. We -- unfortunately those pressures from DC inefficiencies are going to be with us all the way through this year. There's nothing new that we've seen there since we spoke to you in April. The only thing new since April is this outdoor furniture story.

Jessica Mace - *Nomura Securities - Analyst*

Great. Thanks very much.

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

Okay. Thank you.

Operator

Matt Nemer with Wells Fargo Securities.

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

Afternoon, everyone.

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

Matt, hi.

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

Hi. Alex, you mentioned on the call that active customers are at an all-time high. Their frequency is up 18%, their ticket is up. So I'm just wondering if we could talk about what some of the offsets are to that strength? Is the implication that sort of non-file customers may be cash only customers in the stores are down materially? What is the offset there?

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

Well, I think you've hit the nail on the head there. It's what we described in our prepared remarks is that the casual customer, because what we're seeing is what everybody else is seeing is more and more customers are doing more and more of their pre-shopping online. And so when they come to the store, a much higher percentage of them than in the old brick-and-mortar days have a sense of purpose.

They really have a pretty clear reason why they are there. And so, yes, we are missing those people who are just coming in for a browse and making an impulse purchase whilst they are there. That's the new world that we live in.

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

Understood. And then, two quick ones, if I could. The comp strength that you mentioned at quarter end, and into the current quarter, how much of that do you think was driven by some of these broad-based promotions that you didn't deploy last year?

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

Well, a lot of promotion -- first of all, a lot of promotions in the quarter we annualize because, as you know, if you don't annualize a promotion it's very painful on the sales line. But I can't tell you exactly what percentage of our sales was driven by which events. It's all in the aggregate. We try and make sure that we've got enough promotional activity to -- over the course of a month to help drive the sales that we need.

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

Understood. And then, just lastly, in terms of the store closings, do you have a more -- since you have changed that number a little bit, do you have a more refined view on how many of those are in multi-store versus single-store markets?

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

We know exactly where they are, but, honestly, I don't have the numbers on the top of my head. We can do that as a follow-up for you probably.

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

Okay. Thanks so much. Appreciate it.

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

Okay. Thank you.

Operator

Denise Chai with Bank of America.

Denise Chai - *BofA Merrill Lynch - Analyst*

Thank you. Just wanted to ask about outdoor furniture. Could you quantify the impact of the more promotional environment in outdoor environment for both comps and also the merch margin in the first quarter?

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

Well, I think what we've said, Denise, is there was an impact on sales. And I think we've said that it was pretty much the --

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Laura Coffey - *Pier 1 Imports Inc - EVP & Interim CFO*

The shortfall that we saw in our Q1 guidance was predominantly due to the shortfall in our outdoor furniture projections. So that's basically what you'll see both in our top line and our margin dollars have gone down accordingly in Q1 as result of that sale.

Because everything else we had projected exactly hit where we thought. We knew we had DC inefficiency costs, and we also knew we had the incremental $3 million. So you'll see more of an impact to the merchandise margin in Q2 for the outdoor furniture clearance.

Denise Chai - *BofA Merrill Lynch - Analyst*

Okay. Got it. Thanks. And then when you mentioned opportunities for cost containment in the rest of the year, besides these accelerated store closures what else are you planning on?

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

Well, I don't think there is any part of the business that we're really not looking at. We are very conscious that the cost needs come in line with the business. The savings are across all our cost centers. We're leaving no stone unturned, as the saying goes.

Denise Chai - *BofA Merrill Lynch - Analyst*

Okay. And then just a quick one. Could you comment, please, on store traffic trends?

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

Yes. Well, I think, as we've indicated, we don't disclose the exact numbers, but overall traffic was very strong, and certainly, we saw very positive online traffic and that was offset by weaker traffic in the stores.

Denise Chai - *BofA Merrill Lynch - Analyst*

Thank you.

Operator

Adam Sindler with Deutsche Bank.

Adam Sindler - *Deutsche Bank - Analyst*

Yes, good afternoon. Thank you so much. Do you -- have you ever disclosed, or have you ever tried to track what percent of sales are from active customers, either in sort of now or historically?

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

Oh, of course. Yes. So, well, anyone who is in our customer database, we track those people exactly. So we have a very high match back rate, so when we look at our total sales and see what percentage of our revenues are matched back to customers we know it's a very high percent. So we know exactly what it is and the trends and the percentages and so on, so, yes.

Adam Sindler - *Deutsche Bank - Analyst*

Okay. So just if I added, when you say a very high percent, would it be north of 75%? Just try to frame it up a little bit without getting too competitive -- okay.

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

But it's getting there.

Adam Sindler - *Deutsche Bank - Analyst*

Okay. Very good. And then, in sort of the -- some of these stores that are closing in the single-store markets, you've reloaded a lot of stores over the past several years. Have those generally resulted in higher or lower rents, and is it potentially maybe some of those that are causing the decision to close?

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

No, no, no. Let's be really clear about that.

Adam Sindler - *Deutsche Bank - Analyst*

Okay.

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

The relocation program that we have done over the last year -- four or five years -- has been extraordinarily successful, and the increased profitability that we have got from those stores is great. They are, for the most part, as you can imagine, at the higher end because we've been moving from a C or a D strip center into in an A or a B strip center. So the rents go up, but the rent as a percent of sales doesn't go up because we've driven incremental revenues.

Those are not the stores we're closing. So the stores we are closing are predominantly the lower volume stores which have a lower than average, Company average revenue, and a lower than average store contribution, either in dollars or in percent. So I like to talk about the dinosaur with the long tail when you look at the bell curve of our stores. And what we're addressing is that long tail on the dinosaur.

Adam Sindler - *Deutsche Bank - Analyst*

That was perfect. Thank you so much.

Operator

Simeon Gutman with Morgan Stanley.

Joshua Siber - *Morgan Stanley - Analyst*

Hi, this is Joshua Siber on for Simeon.

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

Hey, Joshua.

Joshua Siber - *Morgan Stanley - Analyst*

Hey. You mentioned in the press release that June is running in excess of May. Could you talk about the cadence of top line compares over the next few months?

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

I'm not quite sure what you're asking there.

Joshua Siber - *Morgan Stanley - Analyst*

How June -- sorry -- go ahead.

Laura Coffey - *Pier 1 Imports Inc - EVP & Interim CFO*

We were not -- we've given you in our prepared remarks our guidance for the second quarter is going to be in the range of 4% to 5% of the top line sales.

Joshua Siber - *Morgan Stanley - Analyst*

Okay. And then, you discussed lowering store OpEx and that the reduction was better than expected in Q1. Can you talk about where you are finding that savings and your plan to rationalize expenses without impacting the customer experience or operations?

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

Well, we have a very sophisticated labor model from our stores which separates out selling activities and support activities. And so we are very focused on making sure we take as much task out of the stores as possible so that we can reduce our non-selling hours without impacting the store experience, because your point is correct.

Anybody can just reduce store labor. That's not very smart. You have to do it in a very careful way so that you're not impacting the customer experience.

Joshua Siber - *Morgan Stanley - Analyst*

Okay. Thanks. Good luck in the quarter.

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

Okay. Many thanks.

Operator

Brian Nagel with Oppenheimer.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Hi, good afternoon.

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

Hey, Brian.

Laura Coffey - *Pier 1 Imports Inc - EVP & Interim CFO*

Hi.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Thanks for taking my question. So I wanted to go back to a comment you made in your prepared remarks regarding the promotions. What I thought I heard you say is that you are able to -- you displayed in this quarter an ability to manage merchandise margins better through promotions. So did I hear that correct? And if so, just maybe help us understand the dynamic behind that?

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

What we said was that the decrease in our merchandise margin for the quarter was largely attributable to all that stuff that we've been talking about, and that the impact of promotional activity on the margin for the quarter was negligible. Did you give a number, Laura?

Laura Coffey - *Pier 1 Imports Inc - EVP & Interim CFO*

We just said it was minor.

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

It was minor.

Laura Coffey - *Pier 1 Imports Inc - EVP & Interim CFO*

Compared to the other things that we are experiencing in our margins.

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

Yes. So Q1 good. Q2 not good because we've got to clear out of the outdoor as we've described.

Brian Nagel - *Oppenheimer & Co. - Analyst*

And then, on the inventory issue, we've been discussing the inventory, coming out of the last year with excess inventory for a while now. If I am understanding you correctly here it sounds like -- if you look at the business now, you're going to be in a better position inventory-wise over the next few quarters than you initially planned, or let's say, maybe when we were discussing the fourth quarter. Is that correct?

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

I think so. I think as the time has gone on, the teams have done a great job at re-forecasting and adjusting their open-to-buys, and I think we now expect to -- is it end of Q3 we expect to be below last year, Laura?

Laura Coffey - *Pier 1 Imports Inc - EVP & Interim CFO*

Yes. For the end of Q3 we expect to be below last year's Q3 levels and we're expecting our year-end inventory to be down in the range of 5% to 10% versus the last fiscal year in numbers.

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

Yes. So I think the team are doing -- we shouldn't have been there in the first place, we understand that, but they are doing a great job at digging us out of this particular hole.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Very good. And then the final question I have, with respect to the sales softness you saw in April, and as you called out, this was not unique to Pier 1. A number of other similar type chains called it out, as well. Any idea what caused that? Was it a calendar shift, weather, or was there something else at play?

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

Lordy. I wish I knew. We sort of -- we talk about the weather, but that always seems a little lame. I honestly cannot put a finger on it and say it was just this one thing. Anecdotally, you go to places and they say, oh, the sun has just come out, it's the first of May, but I'm sure you've heard that from a lot of other people.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Okay. Well, thanks. Congratulates and you definitely have made some nice progress here, so congratulations.

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

Well, thank you very much. We'll keep it going. Okay, everybody, that's all the questions we have for today. Thank you for being with us and we will talk to you next quarter. Thank you, Melissa.

Operator

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