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PIR - Q2 2014 Pier 1 Imports, Inc. Earnings Conference Call

EVENT DATE/TIME: SEPTEMBER 19, 2013 / 3:00PM GMT

OVERVIEW:

PIR reported 2Q14 total sales of $396m and net income of $17.8m or $0.17 per share. On a comparable 52-week basis, expects FY14 total sales growth to be in the high-single digit range and EPS to be $1.23-1.29.

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

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PRESENTATION

Operator

Good morning ladies and gentlemen, and welcome to Pier 1 Imports Second Quarter Fiscal 2014 Earnings Call. At the request of Pier 1 Imports, today's conference call is being recorded. All lines will be in a listen only mode until the question answer period, at which time instructions will follow. I would now like to introduce Bryan Hanley, Director of Investor Relations for Pier 1 Imports.

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

Thank you, and good morning everyone. Prior to market open today, we issued a Press Release, which included the detailed financial results for the second quarter ended August 31, 2013. In just a few moments, we will hear comments from Alex and Cary about our financial results, as well as the Company's growth initiatives and full-year outlook, 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. They can be identified by the use of words such as may, will, expect, anticipate, believe, and other similar words and phrases. Our actual results and future financial condition may differ materially from those expressed in any such forward-looking statements as a result of many factors that may be outside of our control. Please refer to our SEC filings, including our annual report on Form 10-K, for a complete discussion of the major risks and uncertainties that may affect our business. The forward-looking statements made today are as of the date of this call, and we do not undertake any obligation to update our forward-looking statements.

The Company will also discuss non-GAAP financial measures on this conference call. Pursuant to the requirements of Regulation G and Item 10E of Regulation SK, the Company has provided reconciliations of the non-GAAP financial measures to the most directly comparable GAAP financial measures in our earnings Press Release that was issued earlier this morning. If you do not have a copy of today's Press Release, you may obtain one, along with copies of prior press releases and all SEC filings, by linking through to the Investor Relations page of our website, Pier1.com.

Now, I'd like to turn the call over to Alex Smith, our President and Chief Executive Officer. Alex?

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

Thank you, Bryan. Good morning everyone, and thanks joining us today. Also on the call with us is Cary Turner, our Senior Executive Vice President and Chief Financial Officer. I have two key messages for you this morning. First, we are very disappointed with the performance of our Pier 1 Import stores for the quarter, which clearly fell short of everyone's expectations. Second, we are highly confident that we can return to solid levels of performance in the second half of the year.

Now, I'll talk about the factors that impacted our store results, the benefits we're seeing from our 1 Pier 1 strategy, and the reasons we expect to deliver improved store performance in the second half of the year. Although total sales increased 7.6%, helped by a better than anticipated contribution from eCommerce, comp store sales were lower than we planned at 3.5%. Much of the sales weakness in stores was due to soft traffic in July. The store teams, however, did a good job, and continued to deliver the planned conversion rates and average ticket.

Most of our product categories performed well, with the exception of tabletop, which was down year-over-year. We believe that the traffic to our stores was negatively impacted by our marketing message, which did not have an appropriate emphasis on seasonal clearance and promotional pricing. Additionally, our second-quarter TV buy, which drives traffic, was down on last year. And with the benefit of hindsight, our ad spend per sales ratio, whilst comparable with last year, was probably a little too light in the current environment. We decided in early August that it was imperative that soft, late-summer business in our stores should not impact the Fall. So, we took additional markdowns over and above what we would usually do, which reduced our store level merchandise margins in the period. We should also have done a better job of both flowing new product to the stores and reflecting the newness in the floor sets.

We know that we could and should have produced better performance from our Pier 1 Imports stores. And believe are less than flawless decision-making occurred because we did not strike the right balance between short-term execution and long-term planning. This is something our Management team has prided itself on for the past 15 quarters, and I am not happy that our run has been broken. I can tell you with absolute certainty that we are now more appropriately focused on day-to-day operations, and are very much looking forward to resuming our proven track record of growth.

Focusing on our omni-channel strategy, which we call 1 Pier 1, we continued to make important advancements in this area during the quarter. First and foremost, we completed the rollout of our new point-of-sale system as expected. The new POS system is one of the linchpins of our 1 Pier 1 strategy, as we work towards the full integration of our two individual businesses. Secondly, July marked the first anniversary of our eCommerce launch, and we are extremely pleased with the performance of this business and its current trajectory. Again this quarter, we saw positive increases in the online business as a percentage of total Company sales, with August reaching a high watermark of 5%. And while 5% is emboldening, we still hold firm to the believe that our crawl, walk, run approach to scaling the business is serving us well, ensuring high quality execution.

Traffic to our site continues to trend upwards, now averaging 1.4 million visitors per week. This is a level of traffic equal to or greater than some of our specialty store competitors. Conversion rates are also strengthening. They are certainly not as great as our competitors, but herein lies a great opportunity as we build out new features and functionality on Pier1.com. To that end, during the quarter, we unveiled an improved landing page and introduced a redesigned checkout process, enhancing customer interaction with the brand. We also released upgrades that enabled us to accept coupons and discounts through the site for the first time since the launch. As such, in the latter part of the quarter, we were able to begin to test incentive offers outside of promotional shipping. We continue to analyze that we continually analyze results of these various offers to better define what level of promotion is appropriate for our business model, and carefully factor the costs into our overall promotional plans.

Our eCommerce business is certainly bringing new customers. The number of online only customers has increased 80% since the beginning of the first quarter. And while the absolute number is still small, the trend is very encouraging. We're also seeing the developments of those super valuable multi-channel customers, who spend more per transaction and purchase more frequently. We have only converted a small percentage of our store customers to multi-channel, another huge opportunity for us.

The combination of increased traffic to Pier1.com, our rewards card holder base, and our new POS system are significantly bolstering our customer list and providing us with more and more valuable data on shopping patterns and preferences. In fact, over the last 12 months, our database has grown by over 30%. And interestingly, our customers are now telling us that e-mail and direct mail are equal in terms of their preferred communication vehicle. Only 12 months ago, e-mail was significantly behind print. In the second quarter, we moved to a new e-mail platform, which will allow us to target and test our e-mail strategies with a much greater sophistication than before, but the size and quality of our database continues to improve. Our ability to utilize the efficient capabilities of this system will allow more time for strategy, which will translate to more personalized custom e-mails and greater response to our messaging.

Moving to our store portfolio, during the quarter, we opened eight new stores including one in Canada. We also completed three store remodels, including two in the Boston area, and a third in California. Throughout the quarter, particularly in the month of July, our store teams, as I said earlier, did a great job driving conversion in average ticket in the face of soft traffic. We fully expect that our store portfolio will continue to be a key component of our growth strategy, an important driver of our long-term profitability.

Turning now to the second half, our stores have transitioned to Fall. Harvest and Halloween merchandise is fully set, and the customer response has been positive. However, we want to be cautious and conservative given this last quarter, and hence, we are reducing guidance for the full year at this point. However, I would also like to remind you that although Q2 was not good, we generate approximately 70% of our pretax income in the second half of each year.

Looking at our marketing programs for Fall and holiday, we feel the quality of our creative and messaging is terrific. Additionally, we believe our media plans have the right balance between acquisition and retention between online and stores. During the second half, we're increasing our TV presence by 30% with our quirky, fun and on brand Find What Speaks to You television spots. Also during the third quarter, we will return to network TV after an absence of many years.

As you know, direct mail is also an important driver of traffic and conversion for both Pier 1 Imports both online and in-store. As we've previously discussed, we are increasing our direct mail program by approximately 25% in fiscal 2014, with more pages and increased distribution. Our new, large format outdoor book dropped in April. We've built upon the success of this book through the introduction of a new, large format indoor furniture book, which arrived in homes earlier this month.

In conjunction with the release of the large format furniture book, we re-launched and rebranded our special request program as Express Request. The new branding emphasizes both the expanded assortments and the speed at which our customers will receive their purchase. We are very enthusiastic about this program, which we view as a significant growth driver beginning in the second half of the year. Specifically, Express Request allows us to showcase fewer pieces of a particular collection in the stores, while staging a deeper assortment further up the supply chain. And making those items available by way of pickup in store, or beginning early next year, through home delivery. This in turn will enable us to draw maximum efficiency from our selling square footage as we move towards our $225 per square foot goal, and allow us to use our inventory most efficiently.

Outside of eCommerce, Express Request offers us the greatest opportunity to expand our SKU count and give our customers more choices. Already, sales from SKUs not in-store account for 4% of sales, and total sales from the program are presently around 10% of sales. Through improvements to our supply chain, including current tests of forward distribution centers in Boston and South Florida markets, we are able to guarantee to the customer that Express Request items can be received within ten days. Going forward, expect us to reduce the lead time even further. In short, Express Request is and will continue to be an extremely powerful selling tool for our stores. We also believe it is a significant competitive advantage.

As we've said in the past, Pier 1 Imports has a relatively small share of a very large and highly fragmented market. Therefore, we're less susceptible to the macro trends, and our ability to deliver strong performance is really a function of solid execution day in and day out. Our Associates throughout the organization are energized and excited about our products and plans for Fall and holiday, and they're committed to our underlying culture of flawless execution.

We missed the mark this quarter, and I'm very displeased about that and what it means for our shareholders. But we fully expect to deliver improved performance during the balance of the year. Equally important, we remain solidly on track to achieve the financial goals under our three-year growth plan, which calls for $225 in sales per retail square foot, and operating margins of 12% by the end of our fiscal year 2015. As well as online revenue contribution of at least 10% of sales by fiscal year end 2016. As always, we remain focused on returning value to our shareholders. And going forward, you can expect us to see us continue our program of cash dividends and share repurchases.

I'd like to thank everyone for listening this morning, we'll open up the call for questions after Cary's review of the financials. Cary?

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

Thank you Alex, and good morning everyone.

As Alex noted, we were not satisfied with our comp store sales and bottom line performance in the quarter. Total sales in the second quarter rose 7.6% to $396 million, while comp store sales increased 3.5% on top of the last year's 6.7% gain. The delta between total sales and comp store sales growth is primarily attributable to sales from our new and intermediate stores, as well as sales from our eCommerce business. Sales from our new and intermediate stores comprised 3.1% of total sales. Our eCommerce business, including both direct to customer and pickup in store, accounted for approximately 3.8% of total sales in the quarter. Of that amount, orders picked up in the store accounted for one-third. As you heard from Alex, sales through our eCommerce channel reached 5% in the month of August alone. Based upon the seasonality of our business, we do not expect eCommerce to continue to perform at this level on a near-term basis, but it is certainly indicative of the intermediate and longer term potential.

On a trailing 12 month basis at the end of the quarter, sales per retail square foot were $202, up from $190 at the end of last year's second quarter. Sales on the Pier 1 rewards card at the end of the second quarter accounted for 28% of the US sales on a trailing 12 month basis, compared to 27% at the end of the first quarter, and 25.7% at the end of last year. We are pleased to see this program continue to strengthen, and believe it will remain an important driver of growth going forward.

Second-quarter gross profit increased 6.4% to $161 million, compared to $152 million a year ago. As a percentage of sales, gross profit declined 40 basis points to 40.8% versus 41.2% last year. Store occupancy costs were $72 million, compared to $69 million last year, and as a percentage of sales declined by 60 basis points to 18.3%. Second-quarter merchandise margin as a percentage of sales was 59.1%, or 100 basis points lower than last year. Approximately 40 basis points of the decline was due to increased promotional activity and clearance mark downs at the store level, and the other 60 basis points is attributable to the higher mix of direct to customer business in the quarter. As we've discussed in the past, our eCommerce business creates a drag on the merchandise margin rate due to the inclusion of fulfillment and shipping costs. For the balance of the year, we anticipate store level merchandise margin to be about the same as last year, and the direct to customer business to have an approximate 50 basis point impact on total merchandise margin.

Looking at expenses, we continued 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 second quarter deleveraged 50 basis points, reflecting softer than expected sales, and coming in at $122.6 million or 31% of sales. That compares to $112 million or 30.5% of sales for the same period last year. Variable expenses were $87 million or 22.1% of sales, compared to $82 million or 22.3% of sales last year. The 20 basis point improvement was primarily related to the leveraging of store payroll. For the quarter, marketing expenses were in line with our expectations at 4.4% of sales, up 10 basis points from the second quarter of last year. That level of spending reflects the marketing initiatives Alex described, as well as investments in digital and social media. We continue to expect that full-year marketing spend will be on plan at approximately 5% of sales.

Fixed expenses during the quarter were $35 million or 8.9% of sales, compared to $30 million or 8.2% of sales last year. The dollar increase is primarily attributable to the investments in additional headcount to scale our eCommerce business and expand our organizational capabilities in support of 1 Pier 1 that we began last year. Looking at expenses for the balance of the year, we believe that the higher sales volumes in the third and fourth quarter will allow us to achieve slightly better expense leverage in the back half of the year.

Second-quarter EBITDA was $38.8 million compared to $39.8 million last year, a decrease of $1 million. Operating income was down 10% to $29 million versus $32 million last year, while operating margins declined 150 basis points to 7.3% of sales from 8.8% a year ago. Planned increases in fixed expenses and depreciation and amortization accounted for most of the decline in operating margin for the period.

Net income in the second quarter came in at $17.8 million or $0.17 per share, down $0.02 against last year's adjusted non-GAAP earnings per share of $0.19. If you'll recall during the second quarter of last year, the Company reversed $5.9 million of its reserve for uncertain income tax positions, for which the statute of limitations expired. Additionally, the Company reversed $2.8 million of accrued interest related to that uncertain tax position. As we noted in the Financial Disclosure Advisory section of our Press Release, the adjustments related to the income tax benefit and the reversal of accrued interest utilizing an effective tax rate of approximately 35.6%, provided a $0.05 per share benefit to earnings in the second quarter of fiscal 2013. Taking into account these adjustments, the Company's net income on a GAAP basis for the second quarter of last year was $26.2 million or $0.24 per share.

Turning to the balance sheet, inventory at the end of the second quarter totaled $444.7 million. That's up 5.7% versus a year ago, and in line with our expectations. Of note, at the beginning of the third quarter, clearance inventory as a percentage of total inventory was at its lowest level since Alex has been with the Company. At the end of the third and fourth quarters, inventories are planned to be up comparable to the increase in sales.

The Company remains in strong financial condition, and ended the quarter with $124.9 million of cash and cash equivalents, and no cash borrowings under our $350 million credit facility. In August, the Company paid $5.3 million in cash dividends, and during the quarter we utilized $42.6 million of cash to repurchase approximately 1.9 million shares of common stock at an average weighted cost of $22.84 per share. Since the end of the quarter, we have repurchased an additional 544,000 shares for $12.3 million. Year-to-date, the Company has repurchased 3.1 million shares of common stock at an average cost of $22.91 per share and at a total cost of approximately $71.9 million. And there's a current $100 million share repurchase plan approximately $28.1 million remaining available for repurchase. Currently, there are approximately 105.2 million shares of common stock outstanding.

Capital expenditures in the second quarter totaled $28 million. Of that amount, $12.6 million was deployed toward stores, including the opening of eight new and three remodeled Pier 1 Imports stores, new merchandise fixtures and lighting, other leasehold improvements and equipment. The remaining $15.4 million was utilized for technology and infrastructure initiatives, including eCommerce and our new point-of-sale system. We remain on track this year to spend $75 million of capital expenditures, with roughly half allocated to the stores, and the other half allocated to technology and infrastructure. As we move into the back half of the year, we anticipate that depreciation and amortization expense will trend slightly above second-quarter levels, as we continue investing additional capital into stores and technology. During the second quarter, we opened eight stores and closed seven, ending the period with 1,066 Pier 1 Imports stores. That includes 985 locations in the US, and 81 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 adjusting our guidance for full-year EPS and EBITDA growth. Our financial guidance for fiscal 2014 on a comparable 52 week basis is as follows. Total sales growth in the high single digit range. Comp store sales growth in the mid-single-digit range. EBITDA growth in the range of 12% to 16%. 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 $1.23 to $1.29, representing year-over-year growth of 5% to 10%.

We appreciate your interest and support, I will now ask Teresa to please open the call to questions at this time.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Matt Nemer with Wells Fargo Securities.

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

Morning Matt

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

Good morning everyone. Thanks for taking my questions. So first, I'm just curious I wanted to talk about the eCommerce strength and the weakness in the stores. Do you think there's any chance that we're seeing a little bit of cannibalization from the stores to the website in the quarter?

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

Well first of all, we believe that the stores and the eCommerce business really do support each other. I think we talk about the fact that 25% of customers pre-browser website before they visit. We could spend a lot of time sort of thinking about the cannibalization. But honestly, even if every online sale had gone through the stores in the quarter, it would still have been not a great sales number. So that's the first thing I would say about that, Matt. And the only other thing I'd say, the number of in-store only customers is vastly greater than either our online only customers or our multi-channel customers. We've only converted about 1.2% of store customers to multi-channel. So I really don't think that has much impact on the store sales.

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

And just to follow-up on that, during the quarter, I think I received an e-mail that offered 15% or 20% off my online order. And I'm thinking that if I were planning to go to the store that weekend I received that e-mail, it might interrupt a visit.

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

Yes. And that's -- when we talked about experimenting and testing the various promotions, those are the things we're watching for very, very carefully to make sure that we just don't move things from one part to the other. But I come back to the point I've just made, which is we've got many, many millions of store customers who just don't shop online. So they're not going to be sort of deterred by an online only offer.

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

Okay, that's helpful. And then secondly, could you just provide an update on the assortment expansion on the website? How many online only SKUs have been launched, and how are they performing?

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

Certainly. Well, this is obviously a sort of rollout process. The biggest rollout has been in our bedding area, which is really an online only assortment. We don't do bedding in the stores. We've continued to add to that assortment through the Summer. We're very pleased with the response that we're getting to our bedding selection. Two other departments of note, rugs, I'd highlight for you. We've added a lot of online only SKUs in rugs, and rugs is hugely over indexing in terms of participation online. And then the last one I'd highlight probably is curtains, where we're seeing again a disproportional participation on our online business.

So those are the highlights. Having said that, we're starting to add SKUs in our dining furniture and in our upholstery, and really concentrating on those larger ticket items in terms of assortment expansion. But this is going to continue. We have SKU projections now going out through FY '17, so we have a good sense as to how we're going to build this out.

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

And then just lastly, Cary mentioned that you ended with the lowest clearance inventory or I guess you started the quarter with the lowest clearance inventory since you joined the Company. Do you think that you have enough clearance inventory to sort of drive the thrill of the hunt in the second half? Is that something that could impact the top line?

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

Well, that's a great question, Matt. And we spent a lot of time debating about when is reducing your mark down inventory move from a good thing to a bad thing. What we do, don't forget, is we compensate the lack of clearance inventory by ramping up our save pricing. So our overall discounts have not changed significantly, but what we've done is move it from sort of one bucket to the other, from the clearance bucket to the save pricing bucket. So in any one month, we have a very substantial percentage of our in-store inventory with some sort of incentive pricing on it. So, we think the thrill of the treasure hunt is still there.

Having said that, your point is correct. There is of course a clearance only customer, and a few of those customers will be disappointed. And the last thing I'd say on this is, is because our clearance is so low, it does allow us to be somewhat more aggressive in terms of the timing when we take clearance. So, what it means is we're marking down something sooner than we would've done historically. So we think that provides a better incentive for the customer. So it was a long rambling answer, but I hope you get the gist

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

Definitely. Thanks so much, and best of luck in the second half.

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

Well, thank you

Operator

Simeon Gutman with Credit Suisse.

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

Hello Simeon

Simeon Gutman - *Credit Suisse - Analyst*

Can we talk, Alex and Cary regarding the marketing message? Because I guess one of the issues that was mentioned was marketing execution around some of the clearance and promotional items. If you go backwards in time, can you talk about how much of the marketing message or number amount of impressions whether it's TV or print are focused on clearance? And then, could you put it into some perspective of how that changed in this quarter? Where I'm trying to go at is trying to parse out how much of an impact that was on was it just weak retail traffic, or was it really a deep self-induced marketing issue?

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

How can I best answer that? Well, let me put it to you like this. If you take the month of July specifically, we did not have a very strong clearance or sale message, either in our stores or in our marketing. We were still focused on more full priced selling. And with the wonderful benefit of hindsight in the current environment, which as you alluded to, is slightly weak. That was the wrong message, and we think that impacted our store traffic. When the customers got to the stores, those who hade it across the threshold, we had really no issues. Our conversion rates were at the levels we expected, and our average ticket was at the levels we expected. So it really was a traffic issue pure and simple.

Simeon Gutman - *Credit Suisse - Analyst*

Okay. And then as a follow-up, going forward, and you think about the marketing spend, it looks like there is a pretty big sense or there is a sensitivity in your business to how much you're out there. So it does it make sense to allow that marketing spend to trickle up even a little bit higher as a percent of sales over time? How do you think about that, maybe back half and into next year?

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

A good question. This is -- to say that Q2 is a very -- it's 4.3% was it Cary? 4.3%, is that right? In Q2, that is one of our lowest. In Q3 it leaps up to 7 point something. So, we really sort of hit the airwaves and the print presses very heavily this quarter. In terms of whether our total ad spend should be over 5%, that's something we continue to look at and finesse. And you can rest assured, along with everything else we're looking at, we'll be looking at that.

Simeon Gutman - *Credit Suisse - Analyst*

Okay. And just one more sort of broad-based question which you probably get asked every quarter, just about the landscape and how it's changing. And not just from a product and a competitive standpoint, but in the way in which competitors are communicating with customers. Do you finding it -- is it becoming harder to get the share of their mind at least, do think it's harder to get them? July showed that -- is it becoming harder to pull them into the stores?

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

No, not if we did our job properly. I don't think so. We know that customers, our customer base and I talked about this many millions of the store only shoppers that we have, they respond very readily to our promotional messaging. I think we can get through to them very clearly in all the sort of ways that we do, whether it's online, or whether it's on prints, or whether it's targeted e-mail, the whole gamut. In terms of marketing generally, the e-mails [stare] if that's the phrase, is certainly very crowded. And one of the reasons we're so pleased that we've moved our e-mails onto the new platform so that we can be much smarter and much more targeted about how we're getting e-mails to the right customers.

So, I don't think it's changed substantially. I really don't. It's every quarter we say it's very promotional. Was this quarter any more promotional than this time last year? I'm not sure. I don't think so, really. I just don't think we put our best foot forward

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

And I would also add, that's why we are so excited about the 1.4 million people coming to the website every week. And, also the strength of the Pier 1 rewards card program. Those clearly are our most loyal customers, and clearly we're benefiting from them coming back into the store time after time.

Simeon Gutman - *Credit Suisse - Analyst*

Was it that group of customers that fell off, or was it the more or less loyal group of customers that may have fallen off in July?

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

Our Pier 1 rewards card did incredibly well in the quarter. No, those guys we can rely on to show up pretty much all the time.

Simeon Gutman - *Credit Suisse - Analyst*

Okay, thanks for the color. Appreciate it

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

You're welcome.

Operator

Alan Rifkin with Barclays

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

Morning Alan.

Alan Rifkin - *Barclays Capital - Analyst*

You folks had mentioned on last quarter's call that you increased the headcount, and of course that's followed in this quarter by weaker than desired revenues. I'm curious Alex, what are your thoughts on overall headcount heading into the holiday season? Will it be at levels we're seeing today? Or, will you possibly take that down a little bit?

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

Are you referring, Alan to the headcount in the stores or our home office headcount?

Alan Rifkin - *Barclays Capital - Analyst*

The headcount in the stores

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

Well the headcount in the stores, that headcount will certainly be up on last year. We've got some big numbers to do in the second half. But we have very sophisticated labor modeling programs, and so we constantly look at the number of hours, the number of heads, and we forward model it. So, what I can tell you is we'll maintain the percentage of sales that we're planning to do.

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

Alan, if you heard me on variable expenses, we were very pleased that we were able to leverage store payroll.

Alan Rifkin - *Barclays Capital - Analyst*

That was 20 points right, Cary?

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

Right. And even with the lower sales. So that is the field manages that every week

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Alan Rifkin - *Barclays Capital - Analyst*

Okay. And as we look ahead to the holiday season, any color at all on when you folks put in your final orders for the holiday season, had you already known that the sales were slowing down or were those final orders due before you saw the slowdown in revenues in this quarter?

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

Alan, we place our Christmas orders in February, March and they are all in the distribution centers. We've now received somewhere in the region of 98% of our Christmas orders. And they'll be going out to the stores very soon. Listen, we're really good at holiday and Christmas. That's -- with all the things that we have to think about and be concerned about, our holiday assortments is pretty low on the list

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Alan Rifkin - *Barclays Capital - Analyst*

Okay. And one last question, if I may. Cary I know you mentioned the drag on margins as a result of eCommerce accelerating. At what point do you think is the breakeven point on when the margins are no longer negative as a result of an acceleration on eCommerce? Does the overall number need to get those to that 10% number that you've earmarked, or it there possibly something less than that? When we start to see leverage on accelerating eCommerce revenues?

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

Well remember, a part of this drag is really geography. It's the fact that we're including the shipping cost in our merchandise margin, and we're not marking up the revenue comparable to what our mark up in the merchandise is. So, I think we'll continue to see a drag on the merchandise margin, but at some point that will level out because there aren't any occupancy costs.

Alan Rifkin - *Barclays Capital - Analyst*

Right. Okay

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

So, yes. And that's why we want everyone really to put out continue to give merchandise level margin numbers, but I really want people to understand what's happening at the gross profit line.

Alan Rifkin - *Barclays Capital - Analyst*

Okay, thank you both very much

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

You're welcome.

Operator

Adam Sindler with Deutsche Bank.

Adam Sindler - *Deutsche Bank - Analyst*

So first question I wanted to ask on the traffic to the site. Obviously, that's a very favorable, and the 5% in August even though not sustainable is certainly well ahead of expectations, especially in relative to the 10% goal several years out. You mentioned that improving conversion rates is something that you're focusing on. I was just wondering if you could dive a little bit deeper into that. And then I have one or two follow-ups after that.

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

Can I just pick you up on the not sustainable point? Because I think that just needs some clarification. The point of that that it's only that as we move into that intense holiday period sort of from Thanksgiving weekend through December. People are very, very focused then on store business. So we expect, during that period, the stores are just going to be so much stronger so that it's not sustainable. It's just the way the sort of trade flows through the seasonal calendar.

Sorry, so your question? The conversion question. Well, we started when we started this business a year ago, our conversions were how shall I put it, very low. And then as we've got better at what we're doing, we've moved them up. We've talked to you about the new navigation and the landing page, and our conversion rates have more than doubled in the last 12 months. They are still not at the level that you would see from a fully built out sophisticated online merchant. But they are moving very solidly in that direction, and that's really the message I wanted to convey.

Adam Sindler - *Deutsche Bank - Analyst*

Certainly. But what are the steps aside from new navigation and perhaps landing that are driving the improved conversion? And then I guess even with them still being lower than competitors, how do you take the next step to improve conversions from here?

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

Well, I'd say -- I beg your pardon. Well some of that is about product as we build out the assortment. Some of it is about familiarity, and knowing that we actually have an online business. One of the numbers that we track is the number of customers who come back for the second, third, fourth and so on online purchase, and we watch that number very carefully. And that number is also growing quite nicely, so I think that's part of it. Some part of it is, as we build out new functionality, don't forget we still do not do home delivery for the largest parts of our very large furniture pieces, so we have a number of SKUs that you can't yet have delivered to your home. Now we'll start rolling that out at the backend of the year, and then fully rolling out into next year. So that's going to make a huge difference. We have what we call a road map, which really set out in great detail all the functionality and the benefits that we're going to add over the next five years, and the list is very, very substantial.

Adam Sindler - *Deutsche Bank - Analyst*

Okay, perfect. And then just a follow-up if I may, so going back to the stores, I guess there's sort of a several parts of one question. Is July -- I guess when we're looking at the months, did -- you said August improved from July, especially as you start to take some mark downs. Do you think maybe you were marking down a little bit too early and you just needed to refocus the messaging on marketing? And then, I guess what gives you the confidence that as we are looking at the $225 in sales per foot that we're able to rebound from the sort of 6% comp in the first quarter the 4% here, clearly it was marketing. But that really needs a 7% type of comp, 6% type of comp over the next six quarters to get to $225. How should we think about that? Because clearly you were doing well above that level last year. The store comp has slowed a little bit. How should we think about what drives higher levels of comps over the next six or so quarters?

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

Well I think it's all the things that we always talk about. It's a function of the quality of our products. It's a function of the quality of our in-store selling associates. It's a function of the quality of our marketing to drive folks to the store. It's a function of the effectiveness of our allocation and distribution strategies. It's really all the stuff that we should pay attention to day in and day out. And we have a lot of confidence in our ability on all of those counts.

Adam Sindler - *Deutsche Bank - Analyst*

Okay. Would you be able to confirm whether or not, at least as of August, you guys exited the quarter at the mid-single-digit rate that your guiding to for the year?

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

We're just now into the first three weeks of the second quarter. I think we really don't want to sort of go there on this particular call.

Adam Sindler - *Deutsche Bank - Analyst*

Okay. All right, thank you. I appreciate it

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

You're welcome.

Operator

Budd Bugatch with Raymond James and Associates.

Budd Bugatch - *Raymond James & Associates - Analyst*

Hello. So this is Justin Santa Cruz in for Budd this morning.

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

Hello Justin.

Budd Bugatch - *Raymond James & Associates - Analyst*

I just have a question on the ad spend for the back half of the year. You mentioned that add to sales ratio would be about 5% for the full year. What percent of that do think will be kind of weighted towards the third quarter versus fourth-quarter? And kind of what percent of that spend will be put towards the national TV as you guys kind of enter that spotlight once again?

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

Well, I think you heard Alex say the third quarter is going to be a 7% -ish, number and it's less than the fourth quarter. Remember, the way are quarters run, the -- you have September, October and November in the third quarter. So it's very important to get that ramp up of the marketing. In terms of the TV spend, don't forget that we mentioned that we're going back on network TV, but we're going to continue to be on cable television as well. So we feel the buy is very efficient and effective, and we'll go from there. In terms of the amount, I'll call it 30%, 40% of the spend.

Budd Bugatch - *Raymond James & Associates - Analyst*

Okay, thank you very much.

Operator

John Marrin with Jefferies.

John Marrin - *Jefferies & Company - Analyst*

So, I'm interested to hear some more about the gross margin headwind from the direct business. You saw a 50% plus increase in volume and in eCommerce channel sequentially, but the headwind was up at 60 basis points versus 50 over the past couple quarters. And I was just -- Cary if you could just speak to the dynamics of that improvement, maybe discussing product margin and direct channel when you strip out shipping and the free shipping incentives?

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

Well, I think I explained it. It's really more geography that we have these additional costs going through margin, and we don't have it going through occupancy. So as we go forward, I think you'll see us leveraging the gross profit line. If merchandise margin at the store level stays flat, then over time you'll see a gross profit coming and being leveraged.

John Marrin - *Jefferies & Company - Analyst*

So --

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

John, if your question was is the sort of basic merchandise margin the same online as in stores, the answer is yes. If you ignored everything to do with what Cary has just described, the shipping costs and so on and forth, the basic buyers margin less mark downs and say pricing is pretty much on par. If anything, it's a tad higher. So the differences come below that line

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John Marrin - *Jefferies & Company - Analyst*

Okay, that's a great point. I think that's a pretty good improvement there. On the higher volume, you would expect more of a headwind, but that's not coming through. So but then just building on Alan's question earlier, the SG&A performance for the total Company in the quarter was pretty good as far as I see it, and I know you leveraged store payroll. But does this good performance also reflect leverage from the direct business?

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

Well yes. Because we're leveraging total sales, so absolutely, you're correct. What we have to do of course is we -- and we've talked to you about this a lot. Is it always a balance for us in terms of when we invest in particularly in people who we need a lot of talent to run this new business we're building. So we're always trying to judge very carefully how much we allow the home office headcount to rise versus how quickly the revenues are building with the online business. And that's a sort of constant -- it's a constant readjustment as we sort of look at the sales and look at the needs to get the work done.

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

And I think you'll continue to see that leverage, because we do have this matrix organization. We don't have the eCommerce business sitting in a silo organization.

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

More important. Yes.

John Marrin - *Jefferies & Company - Analyst*

Okay, okay. And then just on the PLS roll out, that's complete now. And are you seeing some conversion improvements early on here?

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

I think it's early on, John. I think if the stores get better and better -- I always say once we put in a system that stays [zero]. Once they get better at utilizing it, we will start seeing some leverage, and I'm excited to see what happens over Christmas. The fact that we got it in in August and they have a couple months to use it prior to the holiday season was very important.

John Marrin - *Jefferies & Company - Analyst*

Okay, all right. Thanks guys

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

You're welcome.

Operator

Anthony Chukumba with BB&T Capital Markets.

Anthony Chukumba - *BB&T Capital Markets - Analyst*

Good morning. Yes, so my first question sort of just a point of clarification. So you said that eCommerce accounted for 3.8% of total sales, so probably about $15 million, and you said a third of that was picked up in the store. I just want to -- so call it about $5 million picked up in the store. I just want to understand, that $5 million, is that included in your comp store sales number? The 3.5% comp store sales number, or is that completely separate now?

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

No, that's included in the comp. The direct customer is on top of that, yes.

Anthony Chukumba - *BB&T Capital Markets - Analyst*

Okay, got it. Okay.

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

So we're into wonderful [parrotry] now Alan, sorry Anthony, that we've all talked about where you have these numbers which don't add up. So we give you the total sales on eComm, which is directed customer and pickup in store. And then we give you comp store sales, which also includes the pickup in store components. It's odd.

Anthony Chukumba - *BB&T Capital Markets - Analyst*

We'll figure it out. We'll figure it out.

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

I think you will

Anthony Chukumba - *BB&T Capital Markets - Analyst*

Okay. And then just one additional question. And so you mentioned Pier 1 rewards 20% of trailing 12 month sales, and you switching [picture], you're good. The penetration rate is much faster than at least I was expecting. At this point, is it safe to say that the 30% that you guys used to do when you were doing in-house, is it safe to say you think that you can go above that?

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

Well actually, when we did it in-house our number was closer to 33%. So the answer is yes.

Anthony Chukumba - *BB&T Capital Markets - Analyst*

Okay, that's helpful. Thank you.

Operator

Cristina Fernandez with Telsey Advisory Group

Cristina Fernandez - *Telsey Advisory Group - Analyst*

Morning. I wanted to ask on the merchandising, I know the shortfall in the quarter was mostly on marketing. But in the Press Release, you also comment that you could have done a better job flowing new products to the stores and reflecting those items in the floor set. Can you elaborate on that? And also in relation to that, what are you doing differently for the fourth quarter that gives you confidence that once the consumer go into the stores they will be able to see new product all the time?

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

Well thanks for picking that up, Christina. Yes. So, what happens in the first half of the year we're very focused on our outdoor furniture, and it gets a very prominent position in the store. And over the last few years, we have extended that selling season quite considerably, and it's been hugely successful and hugely profitable. I think this year, we kind of over did that. And so what happened is we really just kept the floor looking too similar at the front for too long. We were delivering new product all the way through the season as we always do. But, what we felt to do was to appropriately merchandise it, particularly at the front of the store and put it exactly in our customers line if sight when she came into the store. So that's really what we meant by all of that. In the second half, it really isn't issue because the floor set just changes so naturally anyway. When we have Harvest and Halloween, and then we go on holiday and then we go into clearance, and then we're into our early Spring set. So we get lots and lots of movement in the second half of the year just because of the way the calendar is.

Cristina Fernandez - *Telsey Advisory Group - Analyst*

Okay, thank you.

Operator

Bryan Nagel with Oppenheimer.

Brian Nagel - *Oppenheimer & Co. - Analyst*

A bigger picture question if I could start off. In listening to Cary and Alex talk about just the issues in the quarter, it very much seems like in your view that this was a self-inflicted sales weakness, or sales miss. But as you look at the data, and maybe more from a regional perspective or store to store perspective, is there anything to suggest there could be somewhat of a macro effect here? And I bring this up to a lot of the clients we talk to, clients are very wary right now, or investors are very wary that we've seen some choppier trends in housing and recognizing you're not a pure housing play. But I guess the question is, what gives you the confidence that this is purely your own doing as opposed to something macro?

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

Well there's obviously a lot of talk and speculation about the macro and how that's playing out in traffic and sales. Here's the thing Bryan, we've always taken the view rightly or wrongly that we have a small market share in a very fragmented market. And unless things are horrific as they were five years ago, we should be able to do all we need to do to grow our business. So I don't like to sort of place the blame anywhere else then on our sales, other than our sales. But we recognize that those thoughts are out there, and yes, we've seen some regional variances throughout the quarter and with those -- those are very, very noticeable. But if we'd executed 100% flawlessly and we were really confident in everything we've done and we'd still had a 3.5% comp, I'd say to you do you know, we did a great job. It's just the macro, but I can't say that so I can't blame the macro.

Brian Nagel - *Oppenheimer & Co. - Analyst*

So the regional variances you saw in the quarter then, were those different than the in regional variances we've seen either earlier this year or back in last year?

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

No, not pronounced. As you know, we are very reliant on both coasts. So if we get a weakness in the Northeast that hurts us. If we get a weakness in California that hurts us disproportionately. But other than that, no.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Okay. But then maybe the final question, as we look towards the holiday season, any significant shift in the split between new product and the product that's been rolled over from prior years versus what we had holiday of last year?

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

I don't understand rolled over, sorry?

Brian Nagel - *Oppenheimer & Co. - Analyst*

I guess the question I'm asking as we look at the holiday mix you'll have the mix of products you'll have for the holiday thousand 2013, is the split between product that's new, new for 2013 --

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

I see. Actually, I think this year we have slightly more newness as a percentage of the total buy than we've had in previous years. But it's not very pronounced. We always bring back our customer favorites.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Well, thank you.

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

Okay. Well thanks for listening to us today, and thank you for your questions and we'll see you in a few months.

Operator

Thank you. That concludes today's conference call. You may now disconnect.
