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PIR - Q1 2015 Pier 1 Imports, Inc. Earnings Conference Call

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OVERVIEW:

PIR reported 1Q15 total sales of $419m and net income of $15.1m, or $0.16 per share. Expects FY15 EPS to be $1.14-1.22.

CORPORATE PARTICIPANTS

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

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

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

CONFERENCE CALL PARTICIPANTS

Matt Nemer *Wells Fargo Securities, LLC - Analyst*

David Vargas *Raymond James & Associates - Analyst*

Alan Rifkin *Barclays Capital - Analyst*

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Joan Storms *Wedbush Securities - Analyst*

Brian Nagel *Oppenheimer & Co. - Analyst*

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Pier 1 Imports first-quarter fiscal 2015 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-and 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 of IR*

Thank you, and good morning, everyone. Prior to the market open today we issued a press release which included the detailed financial results for the first quarter ended May 31, 2014. In just a few moments we will hear comments from Alex and Cary about the financial results as well as the Company's 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 projections or statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. And can be identified by the use of words such as may, will, anticipates, believes, expects, estimates, intends, plans, projects and other similar words and phrases.

Our actual results and future financial condition may differ materially from those expressed in any such forward-looking projections or 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 projections or statements made today are as of the date of this call and we do not undertake any obligation to update our forward-looking projections or 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 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, Pier 1 Imports' President and Chief Executive Officer.

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

Thanks, Bryan, and good morning, everyone. Joining me on the call today of course is Cary Turner, our Senior Executive Vice President and Chief Financial Officer. And with us in the room are members of my senior leadership team.

Last fiscal year was transformational for us as I said on our last earnings call. This year the transformation is gaining speed as we accelerate the execution of our 1 Pier 1 omni-channel strategy.

For the first quarter of fiscal 2015 we generated strong traffic to the Pier 1 Imports brand and achieved a Company-comparable sales gain of 6.3% against a backdrop of a challenging retail climate. We are delighted with the dramatic increase in e-commerce and how the advantages of 1 Pier 1 strategy have been embraced by our customers both new and returning.

First-quarter online sales accounted for 9% of our total business well ahead of where we were trending in the back half of last year. E-commerce sales increased 260% from the first quarter last year and almost 50% sequentially from the fourth quarter.

When we planned fiscal 2015 we did not expect our customers to engage our brands through pier1.com with quite this much enthusiasm. We are of course responding to this enthusiasm by modifying our plans accordingly.

Based on the momentum we are experiencing we are revising our e-commerce growth expectations for fiscal 2015 and 2016. We now anticipate that we will achieve e-commerce sales of over $200 million this year, a number that will see us hit our original target a year early.

We now see for fiscal 2016 e-commerce sales exceeding $400 million. Although our online sales for the quarter were outstanding overall the quarter did not unfold as we planned. Store sales and profitability were disappointing, impacted by soft traffic and a higher level of promotional activity than we anticipated.

Whether or not this softness in-store traffic is representative of a permanent sea change in customer behavior or a temporary phenomenon is hard to tell at this stage. However, for the time being we are planning our business going forward assuming store sales are more actively driven by increases in conversion and ticket both of which are strong.

For the quarter our gross profit dollars came in flat to last year, reflecting the additional promotional activity that I just mentioned. In the near term we expect the pressure on the gross profit rate to continue and we are adjusting this year's expectations accordingly.

We are very frustrated that we did not show year-over-year growth on the bottom line, particularly as our execution was significantly improved over last year. However, there are many positive takeaways from the quarter, not least of which is the strong performance in e-commerce which I have mentioned several times already.

Sales from our direct-to-customer business are already as profitable as our stores. This is extremely promising as we have yet to reap the advantages of scale.

With the acceleration of the business in the first quarter we can see how over time profitability of e-commerce will continue to improve and eventually move ahead of the stores. Our conversion rates were up in-store; those customers who visited our stores loved what they found. And conversion rate was also up significantly online.

What is really exciting to us is how our stores have embraced our online business and are playing a vital role in the marketing of the 1 Pier 1 concept. So for perspective 25% of our first-quarter e-commerce transactions were generated in our stores. The decision to credit our stores with e-commerce sales is quickly proving to have been a valuable one.

And with the upcoming addition of tablets to complement our existing PCs in-store we have the potential to drive that percentage even higher. Another compelling statistic about our customers, approximately one-third of those who order from home choose to pick up in-store presenting us with yet another opportunity to drive incremental sales.

1 Pier 1 is playing out even better than we had planned. And customers are embracing our omni-channel presence with tremendous enthusiasm.

We're continuing to make significant investments in improving our customer database. Our multichannel customer continues to grow up 25% from the fourth quarter. And with the acceleration of e-commerce there is we know great potential to drive incremental brand traffic by segmenting and customizing our marketing messages based on our customers' shopping behavior.

We are making great strides in this area and this is a key priority for us the remainder of this year. Our comprehensive marketing programs are inspiring our customers and driving both new and existing consumers to the brand. We're building a strong digital marketing team with new senior hires to ensure we are positioned well in the digital space going forward.

Our promotional TV spots in the quarter, which tagged on to our highly successful Find What Speaks To You message saw great response. We are prepping for summer clearance message that is much improved relative to last year and begins next Friday.

We are continuing to build out our merchandise assortment increasing the number of SKUs offered both online-only and through the continued expansion of our highly successful Express Request program. As we move through the summer the expansion will begin to accelerate as we build into the peak fall and holiday selling seasons. We're very pleased with the contributions that our online-only SKUs are already making to the total sales volume.

In August we will be launching in-store swatch stations that will enable us to showcase the multiple fabrics and finishes available through both Express Request and our e-commerce site in a more effective way than we do today. The rollout will roughly coincide with our fall indoor furniture book which drops in the first half of September and should enable us to drive incremental sales in the second half.

We are particularly pleased with the response to our new in-home delivery service. This was rolled out nationwide earlier this year and has quickly gathered momentum. Noteworthy is that the average ticket on in-home delivery purchases has continued to exceed $1,000 since its launch in March.

As we move farther along the omni-channel continuum we will be mindful of how we direct our resources and capital spending. As we mentioned on our yearend call among our priorities is a second e-commerce fulfillment center to accommodate future growth.

The buildout of our new facility in Columbus, Ohio is underway and slated to open later this summer. This will give us ample time to be ready -- to be online and fully functioning well in advance of our peak holiday selling season.

Additionally, we are pulling forward a number of projects pertaining to customer experience on pier1.com. These include updates for search and navigation including recommendations.

Also, importantly, we have prioritized site upgrades in support of mobile optimization. This will ensure that our customer can shop Pier 1 Imports when she wants, where she wants and however she chooses.

Our highly productive portfolio of stores remains a centerpiece of the brand. Going forward our real estate strategy will evolve in tandem with the expansion of e-commerce as we work towards building a best-in-class omni-channel model.

The flexibility afforded by our store size and lease tenure ensures that we will able to optimize the portfolio's contribution as we progress under 1 Pier 1. Creating value for our shareholders is always top of mind. Our strong cash flow and ample liquidity afford us the ability to drive shareholder value through investments that will drive future growth, most notably our 1 Pier 1 strategy, but also dividends and share repurchases.

Notwithstanding short-term results we feel excited about our market position and the significant opportunity to drive growth through our omni-channel strategy. And we could not have a more dedicated and enthusiastic organization to help us achieve our goals.

Thanks for your attention that this morning. Now I will ask Cary to review our first-quarter financial results and discuss our outlook for fiscal 2015. Cary?

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

Thank you, Alex, and good morning, everyone. While we are very pleased by the continued expansion of sales being driven through pier1.com the level of promotions required to drive store traffic impacted our bottom-line results.

For the first quarter total sales rose 6.1% to $419 million while Company-comparable sales increased 6.3% reflecting increases in total brand traffic, conversion and average ticket. Business improved throughout as the quarter progressed.

As you heard from Alex, we are seeing the powerful combination of factors influence our business right now. E-commerce is growing rapidly, the percentage of pier1.com sales initiated at the store is growing and the number of online orders being picked up in-store is on the rise.

For perspective, comparable-store sales increased in the 4%-ish range. It is clear to us at this stage the comparable-store sales are quickly becoming less and less meaningful in terms of the total picture. As we continue to progress under 1 Pier 1 Company-comparable sales is the metric we will be using to measure the strength of the business.

On a trailing 12-month basis at the end of the quarter sales per retail square foot were $205, up from $202 at the end of fiscal 2014. At the end of the first quarter sales on the Pier 1 Rewards Card accounted for 31.5% of US store sales on a trailing 12-month basis compared to 30.4% at the end of last year. This program continues to be an increasingly important part of our business and remains a key driver of growth.

Moving down the income statement, first-quarter gross profit was $168 million which was relatively flat to last year. As a percentage of sales, gross profit declined 240 basis points to 40%. 150 basis points of the decline is attributable to a promotional cadence that was higher than planned with the balance resulting from the shift in our channel mix.

We were pleased to leverage store occupancy cost by 30 basis points which came in at $73.5 million or 17.6% of sales compared to $70.6 million or 17.9% last year. For the second quarter we expect gross profit as a percentage of sales to deleverage on the order of about 100 basis points compared to the second quarter of last year. This is reflective of the acceleration of e-commerce as well as the promotional and clearance activity during the quarter.

While we do expect to leverage occupancy it will not be enough to offset the year-over-year impact at the merchandise margin level. Looking at expenses we continue to exercise prudence in managing our overall cost structure. SG&A for the first quarter leveraged 40 basis points coming in at $131 million or 31.4% of sales; that compares to $125 million or 31.8% of sales for the same period last year.

Variable expenses were $90 million or 21.6% of sales compared to $86.9 million or 22% of sales last year. The 40 basis point improvement was primarily related to the leveraging of store payroll.

For the quarter marketing expenses were in line with our expectations at 5.3% of sales, up 10 basis points from the first quarter of last year. We are planning marketing dollars in the second quarter to be comparable to the first quarter of this year. The year-over-year incremental spend is principally in support of digital marketing efforts and mailers.

We continue to expect that the full-year marketing spend will be approximately 5% of sales. Fixed expenses during the quarter were $41 million compared to $39 million last year.

As a percentage of sales fixed expenses were flat to last year at 9.8%. The dollar increase is primarily attributable to planned growth and headcount to scale e-commerce and expand our organizational capabilities.

Looking at expenses for the balance of the year, as Alex mentioned, we plan to continue to prudently invest in support of the growth of 1 Pier 1. To that end in the second quarter we are planning for total SG&A to be approximately $6 million to $7 million higher than the first quarter of this year.

The increase is primarily attributable to the investment of hiring for 1 Pier 1 and start-up costs related to that new Columbus fulfillment center. We believe that higher sales volumes in the third and fourth quarters will allow us to achieve slightly better expense leverage and achieve greater earnings power in the back Of the year.

First-quarter EBITDA was $36.4 million compared to $42.3 million last year. Depreciation increased to $10.4 million, up from a $8.9 million a year ago. For the full year we expect depreciation and amortization to be approximately $47 million.

Operating income was $25.8 million versus $33.2 million in the same period last year. For the first quarter interest expense totaled $2 million compared to $750,000 last year. The increase is primarily attributable to the Company's new seven-year $200 million senior secured term loan, which closed at the end of April.

Taxes for the first quarter were $9 million representing a rate of 37.5%. Net income for the first quarter was $15.1 million or $0.16 per share which compares to $20.3 million or $0.19 per share last year.

Moving to the balance sheet, inventory at the end of the first quarter was in line with our expectations and totaled $417 million, up 9% versus a year ago. Having one inventory is allowing us to be more efficient. Inventories at the end of the second quarter are planned to be up in the mid-teens reflecting our expanded SKU count in support of Express Request and the e-commerce growth as well as the receipt of merchandise a little bit earlier this year.

The Company paid approximately $5.5 million in cash dividends during the quarter and utilized $107 million to repurchase 5.7 million shares of common stock. Since the end of the quarter we have repurchased an additional 390,000 shares at a cost of $6.8 million.

Under the April 2014 $200 million share repurchase program, $182 million remains available for future repurchases. Currently there are approximately 93.5 million shares of common stock outstanding.

Capital expenditures in the first quarter totaled $15.3 million. Of that amount $7.4 million was utilized for technology and infrastructure initiatives including e-commerce and the buildout of our new fulfillment center in Columbus. The remaining $7.9 million was deployed towards the opening of new Pier 1 Imports stores, new merchandise fixtures and lightings for existing stores and other leasehold improvements and equipment.

Capital expenditures for the year will be approximately $80 million. During the first quarter we opened 9 stores and closed 14. A number of these were relocations.

We ended the period with 1,067 Pier 1 Imports stores including 986 locations in the US and 81 in Canada for a total of 8.4 million retail square feet. Our real estate strategy continues to be focused on quality versus quantity. Our location and store economics provide us with a great deal of flexibility affording us the ability to maximize the portfolio as e-commerce continues to grow.

And finally as we noted in our press release earlier today, we are revising our full-year earnings per share guidance slightly downward. Our financial guidance for the fiscal 2015 is now as follows -- comparable Company sales growth, which includes e-commerce, in the high single-digit range; SG&A expense relatively flat as a percentage of sales compared to fiscal 2014; EBITDA growth in the range of 9% to 14% compared to previous guidance or growth of 11% to 17%; earnings per share in the range of $1.14 to $1.22 utilizing the fully diluted share count of 95 million shares representing year-over-year growth of 13% to 21% compared to previous guidance of $1.16 to $1.24.

Additionally for modeling purposes you should continue to assume interest expense of approximately $11 million and an effective annual tax rate of 39%. As you think about the cadence of earnings this year there are some other factors to consider.

First, as I mentioned earlier, we expect to see second-quarter gross profit deleverage as a percentage of sales compared to the second quarter of last year. Second, we will be up against easier comparisons in the third and fourth quarter as we begin to lap the disruptive weather and more aggressive promotional cadence of last year.

Third, we believe the initiatives we're putting in place earlier in the year will help drive sales, particularly during our peak holiday season. And lastly, we anticipate that e-commerce will continue to accelerate with the most significant opportunity coming in the all-important fourth quarter.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Matt Nemer, Wells Fargo Securities.

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

First I wanted to dig a little deeper on the gross margin pressure. And I'm wondering if that is primarily driven by the blend of full price versus clearance or if there's anything happening in terms of category mix or margins within categories?

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

Matt, so in terms of the pressure it is not so much the markdown pressure, I mean we continue to run a very clean inventory as I know you know. So it is really the promotional markdowns, the temporary sale markdowns that we take in our monthly promotional cadence.

So that is really where the pressure comes from. Do you want to add to that, Cary?

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

I would say she is definitely being driven towards a deal, the amount of sales that are promotional are higher than what we are seeing with our inventory. And it is just how she is shopping right now.

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

In terms of the category mix we are sort of pretty agnostic about the mix of categories, our initial mark-ons are pretty similar across the whole assortment.

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

Okay, and then as a follow-up to that, do you think that it is primarily a customer issue where she is looking for a deal or is there something more competitive out there that is also impacting you?

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

Well I think that is one and the same thing, actually. I mean I think you've seen it from everybody else's results as they have flowed in in the quarter. I mean there is no doubt about it that the customer wants to save on the initial pricing.

And as you know with Pier 1 we tried for a long time to stay out of following the rest of the market but that proved really, really hard to do if you are going to maintain your market share. So now we are in there with the rest of the pack promoting away.

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

Okay and then just lastly. The buyback program is that a 10b5 program that you had sort of pre-arranged prior to the quarter or are you kind of making those decisions real time?

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

We do some and some. We have bought a lot of stock back under the 10b5, but sometimes we just go in and out of the market depending on what is happening to the price.

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

When the windows are open.

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

When the windows are open.

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

Okay, thanks so much.

Operator

Budd Bugatch, Raymond James.

David Vargas - *Raymond James & Associates - Analyst*

Good morning, gentlemen, this is David Vargas on for Budd, how are you?

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

Good morning, David, we are just great. Thank you.

David Vargas - *Raymond James & Associates - Analyst*

A couple of questions. Last quarter you gave comp store guidance for the full-year 2015 of mid single digits.

I was just wondering if that still stands? I know you are trying to move to a Company-comparable -- Company-comp guidance.

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

Well as you heard me say, you know if we look at the first quarter the comp store gain was a 4-ish number. But it is really getting the fact that 25% of the online business is coming from the stores and 30% of the online business is being picked up in the store we are just going to focus on the comparable Company comp.

David Vargas - *Raymond James & Associates - Analyst*

Okay, all right. And going off of that, would you be able to give an idea of where you expect total revenue growth maybe for the year to be and for next quarter? I don't know if you had mentioned that already.

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

We didn't mention for the quarter, but if you take a look I would use the Company comp number and adjust it just ever so slightly for the new stores.

David Vargas - *Raymond James & Associates - Analyst*

Okay. And I didn't see it in the press release but was there any -- do have an estimate or give some idea of what other income might have been for the quarter, royalties, et cetera?

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

It is de minimis.

David Vargas - *Raymond James & Associates - Analyst*

Okay, all right, I will get back in the queue. Thank you very much.

Operator

Alan Rifkin, Barclays.

Alan Rifkin - *Barclays Capital - Analyst*

Alex, do you think the level of promotions, Alex, is more a reflection of the channel shift or do you think it is more a reflection of the environment that we are in?

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

No, I mean absolutely it is a reflection of the environment, Alan. I mean we just I mean we said it in all the prepared remarks. And as Cary just alluded to what we are seeing even within our promotional pricing we are seeing that -- how can I explain this.

We put a fairly fixed amount of our inventory on promotion every month. And what we're seeing now is that is over indexing much more than we are accustomed to in terms of percent to our sales. I think that is the best way I can put it.

Alan Rifkin - *Barclays Capital - Analyst*

Okay. If you look at your long-term guidance you're essentially by our estimates doubling the e-commerce contribution from about 10% of the fiscal 2016 revenues, which implied $200 million to now $400 million, which by our estimate implies about 20% of revenues. Why would that significant increase in contribution from e-commerce not result in a higher EBIT margin goal for fiscal 2016?

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

Well, we for fiscal 2016 we haven't actually said anything about fiscal 2016. I mean you are right about the percentage, I mean that is pretty much the way the math works. But we have said nothing about the profitability yet in 2016.

Alan Rifkin - *Barclays Capital - Analyst*

Unless I'm mistaken did you not say that your EBIT margins would be 11 to 11.5 by fiscal 2016?

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

Yes, and right now we are continuing to keep that guidance.

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

That I say -- okay, I'm sorry.

Alan Rifkin - *Barclays Capital - Analyst*

Okay, but if I may --.

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

Remember the bigger thing is, is yes we're getting the incremental sales but we also have the incremental headcount that we need to manage this business.

Alan Rifkin - *Barclays Capital - Analyst*

Right, but, Cary, should we be thinking about as e-commerce continues to grow and certainly it is exceeding your expectations, does there come a point in time where that will be more accretive to EBIT margins than that same dollar generated on the brick-and-mortar side?

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

I see where you are going. Yes, absolutely. And we said that in the -- yes in the prepared remarks.

So we are pretty confident that as we scale it out and it is the way it is going to flow through is the online business will be more profitable than the stores business.

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

But I don't see that for next year.

Alan Rifkin - *Barclays Capital - Analyst*

Okay. Thank you very much.

Operator

Adam Sindler, Deutsche Bank.

Adam Sindler - *Deutsche Bank - Analyst*

I was hoping you could help us walk through the brand comp math. Alex, can you just confirm that you did say in your prepared remarks the growth rate was 270% year on year?

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

260%.

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

260%.

Adam Sindler - *Deutsche Bank - Analyst*

260%, okay. So if about 9% of your business grows at 200 -- so when you are looking at your the internal calculation do you use just total percent of sales, average percent of sales?

Because I'm having a very hard time getting from a 6 brand comp with only 33% coming from in-store to how the sort of store, which is the brick and mortar plus the pickup in-store, is anywhere even close to 4. By my calculations retail was down almost as much as it was last quarter.

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

No, I think maybe the best thing to do, if you call Cary afterwards he will kind of walk you through line by line and do the math. I think that is probably the best way to tackle that.

Adam Sindler - *Deutsche Bank - Analyst*

Okay. Just one more broadly then. I know you guys talked about last quarter moving to a more of a 20% off anything in the store on the promotional sort of initiatives you have this year.

Have you moved to that in the first quarter? And what was the response that you saw to that?

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

Well, that is a very good question. We did do some more generic percentages off, as you know. I would say our sort of view on that was mixed; some categories works really well, some categories work less well.

I think what we came back to is we're still going to do a little bit of that. But we find that our SKU-specific pricing is more effective for us because we can direct the customer spending a little more accurately. So we did it but I don't think you are going to see us doing it wholesale for the rest of the year.

Adam Sindler - *Deutsche Bank - Analyst*

Okay, and then just sticking with that for a moment. As we look to the second quarter we remember that last year it was definitely much more promotional on the I guess outdoor patio furniture, the seasonal business than you guys had expected. As we look to this year just from a sort of sitting in my chair looking outside the window type of thing, weather seems to be a little worse this year than last, a little bit cooler, a little bit rainier.

How was your outlook for the promotional environment on clearance for outdoor patio furniture in the second quarter I guess relative to last year?

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

Well, I mean you are right about the weather at the beginning of the season. And if you sort of think about the whole season we told you at the end of Q4 that the warm weather stores had done extremely well on outdoor, which they did.

As we moved into Q1 it was a really slow start for all of the reasons that you can imagine. But it really picked up momentum as we got towards Memorial Day and we really had a terrific time on outdoor from I guess really the week before Memorial Day and it is still doing very nicely.

We are being more aggressive than last year in terms of how we clear out the SKUs that we are not going forward with. So that we are good and clean for when harvest and Halloween ships.

Adam Sindler - *Deutsche Bank - Analyst*

Okay. And then just as you are growing 9% of total sales well ahead of expectations and I very well familiar with the sort of thought process around building teams as they get to a certain percent of sales.

Are you seeing that happen a bit quicker than you expected? Are certain categories growing faster and is this why we need the incremental headcount in e-commerce? In a [buying, framing allocation?]

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

Well so much of e-commerce is based on number of SKUs. And as we have taught you that we are building the SKU base very rapidly. And every SKU that we have creates a lot of work in terms of photography and art direction and creating the product and so on so forth.

There is a lot of transactional work that needs to be done. But more than that I think when you heard us talk about the database, I mean we understand that some of our competitors are much further down the road than we are in terms of the sophistication with which they can manage and manipulate their customer database.

So we are really playing catch-up on that but we are playing catch-up pretty aggressively. And that is another piece of the investment.

Adam Sindler - *Deutsche Bank - Analyst*

Okay, thank you so much. I appreciate it.

Operator

Cristina Fernandez, Telsey Advisory Group.

Cristina Fernandez - *Telsey Advisory Group - Analyst*

I wanted to go back with a question on e-commerce profitability. If you are assuming e-commerce is margin neutral next year even with the doubling in sales, I mean what makes you comfortable that you can get to that 11, 11.5 operating margin target with the pressure you are seeing on the gross profit this year?

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

Well, you have the gross profit but when you continue down the income statement you don't have the store payroll, et cetera. And also remember with our e-commerce business we are running the business as one so we have a matrix organization so we don't have a solid organization built into the expenses as well. So -- we -- as we look at if you want to call it contribution from either channel we are agnostic as to how she is shopping.

Cristina Fernandez - *Telsey Advisory Group - Analyst*

Right, but then that means that for next year if I am looking at the EBIT line by just (technical difficulty) that most of the improvement is going to come from the store level to get to that target? Or is it both?

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

No, it will come from both in the leveraging of the total sale.

Cristina Fernandez - *Telsey Advisory Group - Analyst*

Okay. And then secondly, with e-commerce penetration accelerating so rapidly, I mean what -- I mean at what point do you, would you reevaluate your store strategy and think about the need to operate over 1,000 stores?

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

Cristina, that is a very good question and of course we evaluate that strategy on an ongoing basis. But again as we said in the prepared remarks we are very fortunate with the flexibility that we have with our real estate both in terms of the store size and the way we're able to move in and out of leases on a fairly short term basis.

So you can be sure that as we look at the strength of our online business in parallel with that we are thinking how many stores we need to go with it. But don't forget the stores are just a very powerful vehicle for online.

We have already reached a remarkably high number in terms of how much of our online sales is generated through the stores. And you know about the pickup in stores.

We see the stores really as not just revenue generated in terms of brick-and-mortar POS sales. But also as an important part of our 1 Pier 1 strategy.

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

And as I said in the prepared remarks we are looking at quality not quantity. So I think the best thing to think about is you won't see us having a fill-in store or just to have another store in a market. We are really looking at each individual market and seeing exactly how many and where those stores should be to gain market share.

Cristina Fernandez - *Telsey Advisory Group - Analyst*

Thank you and good luck with the rest of the year.

Operator

Joan Storms, Wedbush Securities.

Joan Storms - *Wedbush Securities - Analyst*

I wanted to ask again about sort of, and I'm sorry to beat a dead horse but on the gross margin. And you took down the guidance by $0.02, I'm sure your plan might have been a little bit below where the street was on average for the first quarter.

But how -- like, to account for that shortfall do you think -- I guess the question is, you talked about the gross margin being under pressured near term, but you feel like now you will be able to offset that more with the accelerated sales and the easier comparison in the back half. I know you were trying to go over the cadence of that, Cary.

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

Yes, as I said in the first quarter the promotional cadence hurt the margin by about 150 basis points. I think when we look at the second quarter gross profit will be down probably 100 basis points, some because the additional promotions in clearance but probably even more so that the channel mix changed.

And then as we go into the back half it probably should be a little less. But we will update everybody as we go through.

Joan Storms - *Wedbush Securities - Analyst*

Okay. And then just remind us in the second quarter last year you did not have enough marketing year towards the promotion -- the end of summer sale when everyone else is promoting as well you guys did not market that. So you missed out on some store traffic and then so how are you prepared to deal with that this year?

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

Well, we try not to make the same mistake twice. So we've got a much more aggressive plan this year, Joan, around summer clearance. It is already kicking into gear now.

The sale posters are up in the windows, we have some very powerful promotional TV spots, especially around July 4. So you can expect to see us much more aggressive in our marketing of the summer clearance period.

Joan Storms - *Wedbush Securities - Analyst*

Okay. And then the fall inventory starts to come in right around the same time towards the end of that?

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

Yes, yes it starts to flow in sort of August-ish.

Joan Storms - *Wedbush Securities - Analyst*

Okay, thank you very much.

Operator

Brian Nagel, Oppenheimer.

Brian Nagel - *Oppenheimer & Co. - Analyst*

A bigger picture question on promotion, the promotional activity that you discussed in the press release and the prepared comments. But I'm having a tough time making sense because as I think about Pier 1 and the overall environment you have had this phenomenal recovery story over the past several years.

At least in my mind, to a large extent Pier 1 operated above the promotions. You were using promotions of your store clearance activity to drive traffic but very, very selectively. And as I think about that consumer right now and you may have better idea of this than I do but it seems to me the consumer should be in a better shape now than the consumer was maybe one, three years ago.

So I guess the question I have is what is actually driving this promotional activity that now has waned upon Pier 1? And as you think about who is leading this is Pier 1 more of a leader or a follower in the activity?

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

I think there is some interesting discussion points in there, and I think we could talk about it for hours. I mean I think to sum it up I think we, and I don't mean Pier 1, I think the industry generally is somewhat a victim of its own activity in that we have trained the customer to expect a degree of off-pricing and because everybody does it everybody does it.

And then she expects it and it just it becomes a habit. I think that is a piece of that.

In terms of whether we are the follower or the initiator, no, we are absolutely the follower. Again you put it very well, we tried to -- we tried and succeeded relatively well to hang back from this for a long time.

But you will recall when we released our Q3 earnings last year we talked about this a lot. The conclusion we came to, Brian, is that we just couldn't be -- we couldn't afford to be giving away market share. And so we started really our more aggressive stance on promotional activity in Q3 last year and it has continued, Q3, Q4 and into Q1.

Truthfully I wish it wasn't -- it wasn't this and I wish we could -- and we will try to over time to pull back on it. I don't want to sound too negative about it but we are where we are in terms of the competitive environment. And our job is to -- we think preserve our market share.

Brian Nagel - *Oppenheimer & Co. - Analyst*

So at the risk of overthinking this, it is had the dynamic right now, it seems to me as I think about when Pier 1 started to see the pressures of comp -- pressures of promotional competition. It is coincided with the launch or the growth of the e-commerce effort.

So are those two -- I guess the question I am working towards is, does going online in a more aggressive way make you more susceptible to industry-wide promotions?

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

I don't think so, I really don't. Because the online, the pure online merchants, the omni-channel merchants, the pure brick-and-mortar ones I mean frankly all behaving pretty much the same way. So I don't think there is any cause and effect there.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Cool, thank you.

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

All right. Well that is the last question.

Thanks, everybody, for joining us today and we look forward to talking to you at the end of Q2. Thank you.

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

Thank you.

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

Thank you, Melissa.

Operator

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