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PIR - Q2 2017 Pier 1 Imports Inc Earnings Call

EVENT DATE/TIME: SEPTEMBER 28, 2016 / 9:00PM GMT

OVERVIEW:

PIR reported 2Q17 net sales of $406m, net loss of $4m or $0.05 per share. Expects FY17 net sales to be down approx. 4-6% and GAAP EPS to be $0.16-0.24. Expects 3Q17 net sales to be down approx. 2-4% and GAAP EPS to be $0.03-0.09. Expects 4Q17 net sales to be down approx. 3-5% and GAAP EPS to be $0.22-0.30.

CORPORATE PARTICIPANTS

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

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Jeff Boyer *Pier 1 Imports, Inc. - EVP & CFO*

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen. Welcome to the Pier 1 Imports FY17 second-quarter earnings call. At the request of Pier 1 Imports, today's conference is being recorded.

(Operator Instructions)

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 afternoon, everyone. Today after market close, we issued an earnings press release, which included the detailed financial results for the FY17 second quarter. In just a few moments, we will hear comments from Alex and Jeff about the results, our strategies and outlook. This will be followed by a question-and-answer period.

Before we begin, I need to remind you that any statements made today regarding our business may be deemed to include forward-looking statements that are based on current estimates or expectations of future events or future results and are made pursuant to and within the meaning of the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are subject to both known and unknown risks and uncertainties that could cause actual results to differ materially from such statements. Any forward-looking statements made today or as of the date of this call and Pier 1 does not assume any obligation to update or revise any such forward-looking statements.

The Company will also discuss non-GAAP financial measures on this conference call. Pursuant to the requirements of Regulation G and Item 10-E of Regulation SK, the Company has provided a reconciliation of the non-GAAP financial measures to the most directly comparable GAAP financial measures in our earnings press release that was issued this afternoon, which is available on our website at Pier1.com. Now, I'd like to turn the call over to Alex Smith, Pier 1 Imports' President and Chief Executive Officer. Alex?

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

Thanks, Bryan, and good afternoon, everyone. Also joining me on the call today is Jeff Boyer, Executive Vice President and Chief Financial Officer. Also with Jeff and me are most of my senior leadership team. I have Mike Carter, who you all know; Darla Ramirez, who runs our Finance Department; Stacey Renfro, who runs our IT; Jeff Webb, who runs FP&A; and down at the end of my table I've got my three merchants. I've got Cathy David with Shannon Berner and Ron Negron, and then just at the other side of the table from me, we have Mark Haley, who runs stores; and Laura Coffey, who you all know. I have a great leadership team, and you know, we're doing what we always do, working hard, helping each other, supporting each other for the betterment of our well-loved Company.

Now, given all of the goings on of late, one might think that our teams are distracted. They are not. Quite the contrary. They know that we're entering our most important time of the year. We have holiday transitions starting in stores next week, and then it's go, go, go until January. We've seen some nice green on the sales dashboard recently, and we would all like to see more, and we are determined to stay focused on execution, controlling what we can control, and delivering a strong holiday season for all our shareholders.

We told you earlier this year that we expected a tale of two halves. The improved sales trend that started in August and continued into September is encouraging because in the second quarter, our top-line performance was below plan with the most significant pressure seen during the month of July. We're not really sure what happened in July. The internal factors were no different from June or August but there were some significant events affecting the news cycle. Anyway, we saw sales pick up in August, comps were minus 1%, and in September, comps are trending positive low-single digits with merchandise margin also ahead of last year.

Our merchandise margin rates came back strongly in quarter two, helped by the execution of a balanced promotional plan, improved efficiency in our distribution centers, and healthy inventory levels. With the new test and learn capabilities that we have with APT, we are able to establish in a statistically robust way which promotional activities generate the most merchandise margin dollars. With our new learnings, we've made many adjustments to our marketing calendar as we move through the year. We gained some benefit from this new tool in Q2 and we expect to see more benefits to margin in Q3 and Q4. Generally speaking, I would describe our promotional cadence as simpler with fewer overlapping activities. I'd also tell you that we have a very good sense as to how our customer will respond given particular choices.

Touching on some other inputs into our merchandise margin, I couldn't be more pleased with the job that Michael Benkel and his teams have done to reduce the cost of moving freight from Asia as well as reducing the costs of domestic distribution. With the help of third-party consultants, we have developed a robust five-year plan for our distribution network. We believe that the plan will reduce expenses by eliminating up to four buildings from our six DC campuses and adding eCommerce capabilities to more DCs. Additionally, we will deploy more automation for store and eCommerce operations. Over the next five years, we expect to lower our DC handling rates and also reduce fulfillment center costs as a percentage of direct to customer sales. Michael told me this morning that the holiday pick has gone extremely well, so well done to the allocation and DC teams.

Laura Coffey and her team have continued to manage inventory effectively. We are determined to get back to or exceed our long-term trailing 12-month inventory turn, but in a careful way that does not have a negative impact on sales. And, as we said in today's release, overall inventory is down by approximately 10%.

Our teams did a good job on cost containments in quarter two, and as you can see in the guidance we're providing today, we're having success in driving margin expansion and reducing expenses in nearly all areas. We intend to stay very focused on both, and Jeff will give you some more detail on this shortly. We feel very good about how the business is positioned for fall and holiday. Let's talk about our initiatives and how they are beginning to take hold as we enter the primary selling season.

First, merchandising. Our new floor sets reflect a greater emphasis on item and category statements rather than vignettes and themes. And when you visit our stores this fall and holiday, you'll see an area dedicated to art glass, another dedicated to wreaths, another is all about our wonderful critters, and so forth. The stores feel more streamlined, and our associates love the cohesive presentation and our customers are finding it easier to shop and see clearly our beautiful exclusive Pier 1 Imports products.

We're also pleased with the reset of our fragrance departments with new fragrances and packaging which convey a more compelling message to the customer and bolsters our strong market position in this category. This fragrance transition has taken almost a year but it is worth the wait. The evolved presentations in our store will also be evidenced in our holiday set, and as we move into January, there will be further changes especially to our furniture presentation. Another benefit of the new floor set is they are easier to set and maintain giving us more opportunity to leverage payroll.

Turning more specifically to eCommerce. We're driving sales through ongoing enhancements to Pier1.com, increasing our online only SKUs, and adding new categories and features to the website. We have our new gift registry, which is met with a terrific response. This is something our customers have been requesting for some time now, and we're pleased to be able to leverage our omni-channel model further to further engage them and enhance the shopping experience. We went live on August 3, and we're already seeing a good level of sign-ups and sales flowing from the registry. 65% of the customers signing up are new to our database. Next month, we'll start to include registry in our digital marketing and from January onwards, it will be called out in our retail mailers.

As you all know, the Pier 1 rewards credit card is very important to us, and I'm going to talk about loyalty more broadly in a moment, but I wanted to mention here that we've made important improvements to the online application process and have now launched deferred interest. Also, we relaunched the credit card this month with redesigned plastic and collateral.

Now, let's turn to marketing where we have several other areas of focus, digital and print initiatives, television, and customer loyalty. From a high-level perspective, our messaging is on brand and we believe our media strategies will continue to drive strong customer retention results and help attract more casual shoppers to our stores and new customers to the Pier 1 Imports brand. First, I'll cover prints and digital. We directed greater resources to direct mail in the second half with planned circulation up sequentially from the first half. Our digital strategy will support and build on our new creative campaign which reenergizes our very successful Find What Speaks To You tag line.

Next is television. As I said before, this is an important and strategic investment which we believe can help bring new customers to the brand and reengage those who haven't shopped it in awhile, especially during fall and holiday. Recall that we ran outdoor TV ads this past spring. We were off air in the summer, returning with our promotional spot over the Labor Day timeframe. At the beginning of this month, we started airing three new fall spots. The ad speaks to the uniqueness of Pier 1 Imports products in a light hearted and engaging way.

We're seeing this fall what we saw this spring, significant growth in our direct to site traffic when we're on air. In fact, traffic spikes precisely when the spots show. The impact on store traffic is harder to quantify. Our early sense is that our television ads are resonating well, and we'll continue to watch these trends carefully and measure awareness and consideration through our monthly brand tracker research.

Last, but certainly not least, is our newly expanded loyalty program. This is something the entire organization is really excited about. The last time we spoke to you, we were piloting our new loyalty platform called My Pier 1 Rewards. This program encompasses our existing credit card program of our cobalt and platinum members along with a new multi-tender loyalty tier that we call Pearl. The strong response to this tier has allowed us to surpass our membership goals early on. This new three-tier platform provides us with the opportunity to add significantly to our already powerful database of known customers.

In connection with the recent launch, we held our first national in store event for My Pier 1 Reward members, Harvest Happy Hour. Customer participation and new enrollments exceeded our expectations and we will be building on this momentum with our Holiday Finds and Designs event on November 6. These events are a great way to showcase our product and use our fabulous associates to demonstrate to customers how they can bring Pier 1 Imports merchandise to life in their own homes.

Next on the horizon for our rewards program is the launch of customer level texting, an enhanced online enrollment process, a rollout in Canada, and a new tier for designers. In August, nearly 70% of our US sales were made by a customer enrolled in loyalty, bringing the total of our matched sales to nearly 90%. We're starting to carefully test as we said we would, easing back general promotions and using more dollars to enrich the desirability of our loyalty programs. We have a great plan in place for the balance of the year.

So when we think about how to grow sales going forward, we have many ideas. Some relate to enhancements and improvements to the assortment. Some to improved marketing effectiveness, and others to additional long-line functionality. Let me touch on just a few.

You may have noticed over the last several months, different free shipping offers on our site. We have tested many permutations of shipping thresholds and surcharges, and the goal of this strategy is to remove a significant barrier to online conversion and put us on a level playing field for the online only retailers. Free shipping also creates a competitive advantage for our stores and differentiates Pier 1 Imports by allowing our customers to shop where and when she wants with no financial penalty. Now clearly, free shipping is a promotional cost which we have largely offset thus far by reducing other promotional activity. So far, we are very encouraged by the results and believe that we are driving increased sales and margin dollars.

The next big piece of functionality we are planning to build into our eCommerce capabilities is drop ship. Initially, the aim is to fill in the assortment gaps that we have today and test new categories with much less risk using vendor owned inventory. We will start modestly and then ramp up the SKU count once we are confident in the processes. We believe that drop ship has the potential to add meaningfully to our eCom sales.

A few other ideas that I think will interest you, in October we're testing Google Express in a couple of markets, Dallas and Boston. Google Express is a turnkey marketplace leveraging the store inventory, and it will work in a similar way to pick up in store and give a new customer base direct access to the Pier 1 Imports assortment. Also in October, we go live with back in store alerts and a multitude of improvements to enhance search on the site. And in January, we roll out a number of important improvements to the product detail pages.

As we've talked before for some time now, in an omni-channel world, we are focused on contribution from operations understanding that rent, store payroll, and fulfillment costs are our biggest expenses. We're beginning to see signs of stabilization and contribution from operations and expect this to inflect in the second half of the year. Everything we've learned as we reinvented our business model reinforces our view about the importance of this metric. The separation of eCommerce and store sales is arbitrary.

Remember, when you add together our sales that are placed from the store and those that are picked up in store, it accounts for approximately 90% of net sales. Direct to customer orders purchased outside of the store and delivered to home account for approximately 10% of sales, and our research tells us that half of our direct to home customers pre-shop in a Pier 1 Imports store before making a purchase. Put another way, 95% of our sales are influenced by a store. That's a big number, which brings me to our initiatives around real estate.

There has been much discussion among investors and retailers about what the right-sized portfolio looks like in today's omni-channel world. As you've just heard, our stores play a central role in almost every aspect of a Pier 1 Imports sale. We believe our current store optimization program, when completed, will provide us with an appropriate number of locations for the foreseeable future.

Closing stores is not a panacea. We lose store sales, we lose online sales, and we deleverage our costs more rapidly. The importance of stores must not be underestimated. And we all know that store traffic has become an industry wide challenge and it's certainly impacted our sales. Eventually, however, we believe equilibrium will be reached between store and site traffic.

In the meantime, the fact remains that our customers love Pier 1 Imports stores. They love the sensory experience that stores provide. They use them as showrooms. They use them as a means of placing online orders and making POS purchases. They serve as a convenient place to pick up their online orders. They are also a convenient place to return merchandise. We fully expect the significant store base will be part of our future. Our task is to optimize our fleet, continue to reduce occupancy costs by closing peripheral stores, renegotiating leases, and closely managing payroll, all of which have been key priorities for the past 18 months.

Pier 1 Imports has been through many successful iterations in our 50-plus-year history. Since I've been here, we've nailed it as a brick and mortar retailer and I am confident that we're going to nail it as an omni-channel retailer. Now, I'll turn the call to Jeff to review the financials but first, I want to thank all our associates for their unrelenting commitment to all things Pier 1 Imports. Your hard work and dedication is as always greatly appreciated. Jeff?

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

Thank you, Alex, and good afternoon, everyone. While our top-line results underperformed our expectations in the second quarter, we did achieve year-on-year expansion of our merchandise margin rate. Improvements that translated to higher merchandise margin and gross profit levels per revenue dollar. Net sales decreased 6.7% to $406 million while Company comp sales decreased 4.3% primarily reflecting soft store traffic. As Alex mentioned, July was the most challenging month of the quarter. We are encouraged that, sequentially, sales trends improved in August and have demonstrated further improvement in September. ECommerce sales penetration reached approximately 20% in the second quarter. That represents growth of about 10% versus a year ago and reflects a similar growth to what we experienced in this year's first quarter.

Moving on to merchandise margin. Second-quarter merchandise margin dollars declined to $230 million from $240 million a year ago. Merchandise margin rate expanded 150 basis points to 56.6% versus 55.1% in the second quarter of FY16. This was in line with our guidance and reflects a more carefully balanced promotional cadence as well as improved efficiency in our DCs. As we expected, the recognition effects of last year's issues in the DCs continue to tail off in our second quarter and should continue to provide a favorable comparison in the back half of this year. Additionally, we're seeing DC handling and freight costs come down. We expect to benefit from further improvements for the balance of the year. Importantly, our teams are very focused on controlling promotional discounts and improving clearance markdown levels in order to capture margin rate improvements in both the third and fourth quarters.

Second-quarter delivery and fulfillment net costs increased both in dollars and as a percent of sales. In the second quarter, we saw close to 70% of our eCommerce sales fulfilled to the customer through either parcel or in home delivery. Store occupancy costs in the second quarter declined to $74 million compared to $76 million last year. As a percent of net sales, they were up 90 basis points year over year. We continue to expect our real estate program and cost initiatives will help us reduce FY17 occupancy costs below our FY16 levels. Second-quarter gross profit was $145 million or 35.7% of net sales compared to $155 million or 35.5% of net sales a year ago.

Expense control continues to be an area of high focus for us. We have been working on our expense reduction program for four quarters now. This initiative represents our ongoing effort to lower the costs associated with the brick and mortar model in a new omni-channel world. We've done a good job of reducing store occupancy and related costs. We've also stripped inefficient tasks out of the stores, which is reflected in the year-over-year declines in our compensation for operations metric.

Another area of focus with respect to cost savings is efficiency here at the home office. With this most recent quarter, we've now achieved a 9% reduction in corporate payroll and related costs versus last year. We've also begun to sublease extra space we have in our headquarters building. Our cost reduction efforts are very helpful in the near term, and we continue to see opportunities to further streamline our costs going forward.

Looking at second-quarter SG&A expenses, we captured efficiencies across the organization achieving savings of approximately $2 million in compensation for operations year over year. We also closely managed operational and recurring corporate overhead. However, those savings were offset by our planned increase in marketing spend along with certain incremental expenses that are affecting us this year but we expect will be transitional. These include legal and consulting fees, lower bonus accrual reversals, and sale leaseback accounting considerations.

In total, SG&A dollars grew slightly over a -- year over year coming in at $136 million. As a percentage of net sales, SG&A increased by 280 basis points to 33.5%. Second-quarter operating loss was $4 million while EBITDA was positive at $9.5 million. Net loss for the quarter came in at $4 million or a loss of $0.05 per share.

Turning now to the balance sheet. The Company ended the quarter with $38 million of cash and cash equivalents and $20 million of working capital borrowings under our revolving credit facility. This borrowing level compares to the $60 million of working capital borrowings outstanding at the same time last year. We are forecasting that our peak working capital borrowing for FY17 will be below that of FY16.

Second-quarter inventory totaled $481 million representing a decline of approximately 10% versus a year ago. We are focused on managing inventory closely and continue to expect FY17 year-end inventories to be below FY16 levels. We are maintaining a strategic view of our capital allocation plans to ensure we are appropriately positioned for the current operating environment. We continue to reinvest appropriately in the business to drive growth. That said, we have streamlined a number of initiatives which is allowing us to lower our full-year capital expenditures guidance to approximately $45 million.

This reduction is primarily coming from stores and supply chains -- supply chain programs. We have moderated our share repurchase activity to a more modest program in the near term that is currently intended to offset the dilutive effects of stock compensation awards. And lastly, our dividend, which we view as an important component of returning value to our shareholders, remains intact. We will continue to evaluate these strategies together with other opportunities and manage to the appropriate level of liquidity to support the business. As we look at the remainder of the year, we are encouraged by our current sales and merchandise margin trends and believe we have strong initiatives to support our business; however, we believe a conservative posture is appropriate at this time.

Let's turn to full-year guidance. For FY17, we expect the following. Company comparable sales down 2% to 4%. A net sales decline of approximately 4% to 6%. Our merchandise margin guidance remains unchanged in the range of 56% to 57%.

General -- selling, general, and administrative expenses in the range of $580 million to $585 million, which includes approximately $10 million of estimated costs related to Alex's departure. Depreciation of approximately $56 million. GAAP earnings per share in the range of $0.16 to $0.24, and diluted shares of approximately 81 million. In adjusted earnings per share, which excludes the estimated cost related to our CEO transition in the range of $0.24 to $0.32, and again, on diluted shares of approximately 81 million. For modeling purposes, we continue to expect that net interest expense will be in the range of $12 million.

For the third quarter of FY17, we are providing the following guidance. Company comparable sales in the range of down 1% to 3%, net sales down approximately 2% to 4%, merchandise margin in the range of 57% to 58%, SG&A expense of $155 million to $160 million, including approximately $33 million of marketing spend and approximately $8 million in costs related to our CEO transition. GAAP earnings per share in the range of $0.03 to $0.09, and adjusted earnings per share in the range of $0.09 to $0.15, excluding the costs related to Alex's departure.

For the fourth quarter, we're providing the following guidance. Company comparable sales in the range of down 1% to 3%, net sales down approximately 3% to 5%, merchandise margin in the range of 55% to 56%, SG&A expense of approximately $145 million to $150 million, including approximately $2.5 million in costs related to our CEO transition. GAAP earnings per share in the range of $0.22 to $0.30, and adjusted earnings per share in the range of $0.24 to $0.32 when the costs related to Alex's departure are excluded.

With that, I'll ask Chantelle to open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Your first question comes from Seth Sigman with Credit Suisse.

Seth Sigman - *Credit Suisse - Analyst*

Good afternoon.

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

Hi, Seth.

Seth Sigman - *Credit Suisse - Analyst*

So if you look at comps in the performance over the last few quarters, the performance at retail, I don't think its changed a whole lot but I guess we've seen lower online growth. So I guess the question is, what are you seeing there, like what do you attribute that slowdown to over the last couple quarters?

And I think there was a view at one point to maybe pull back on investing following a big investment period. Do you feel like that's limiting some of the growth right now, and is there a risk that maybe you need to reaccelerate that spending at some point?

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

Good question, Seth. So in Q2, we did see -- we didn't see the sort of growth in online that we've seen sort of through the previous couple of years. Since the turn of the quarter and we've changed some things in terms of our digital marketing and our email cadence, and of course, the shipping that I alluded to.

We have seen the trajectory on eCom sales accelerate quite meaningfully since that point. As far as -- and these things are all a function of traffic and conversion, as you know.

As far as investment is concerned, no, we are continuing to invest. There's no holding back, and I think I outlined today some very important investments in eCommerce both in terms of the front end, in terms of how we sell and what we sell, and in terms of the back end in terms of improvements to our fulfillment center. So we are highly, highly committed to growing the total omni-channel business.

Seth Sigman - *Credit Suisse - Analyst*

Okay. Thanks for that. And then, Alex, you mentioned a number of free shipping tests and other offers that you're running. I guess the question is, do you still generate revenue from shipping and furniture delivery? And I know you're able to offset that by pulling back from other promotions.

How confident are you in the ability to continue doing that? Is there more room to cut before shipping becomes a net negative to margins? Thank you.

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

Do you want to just talk through the mechanics of that, Jeff?

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

Yes, Seth, good to talk to you. We are managing the cost structure for our shipping programs on this and what we're offering. From a home delivery standpoint, really the revenue equation hasn't changed. Largely our shipping offers are more for parcel on it, and what we are doing is changing the cadence of our promotional offers in order to balance those out. So net-net, if you lock at contribution from operations, you aren't going to see degradation because of our stronger shipping offers we have out there.

Seth Sigman - *Credit Suisse - Analyst*

Okay, thank you.

Operator

Your next question comes from Budd Bugatch with Raymond James.

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

Yes, thank you for taking my questions as well.

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

Hi, Budd.

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

Hi, Alex. Jeff, can you maybe give us a little more color on the change in merchandise margin, what the sources were, maybe how it tracked over the quarter? And talk a little bit about how you are parsing your thinking about it for third and fourth quarter as well?

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

Probably don't give you the detail, Budd, within the quarter but I would tell you that it's well balanced between what we're seeing from a merchandise standpoint versus supply chain. Those are the two big elements that go through our merchandise margin on it.

In the second quarter, probably a little bit more strength that we had from the pure promotional markdown side; that was nicely favorable to our 150 basis points. As we look at the back half of the year, we're going to continue to see we think good improvement in performance in our merchandise margin growth overall, but we also have favorabilities against some unfavorable comparisons, some tough comparisons from last year. So actually we'll do better on the supply chain in Q3 and Q4 so you'll see some expansion if you compare to last year, some nice expansion of merchandise margins in Q3 and Q4, again through both the merchandise portion of it as well as on the supply chain.

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

And the clearance, the drag that has been there from inventory clearance and what was embedded in inventory, has that pretty well worked its way through system now?

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

I would say, yes. Our clearance markdowns were less in Q2. In Q1, we still had a challenge in Q1 but less clearance markdowns in Q2. As we look out into Q3 and Q4, we continue to see improvement in the level of clearance markdowns as well.

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

I think you had told us all that all the centers were operating or the distribution centers were operating well with the exception of one, and I wondered if there's been progress on the one that might not have been operating as well as you would like.

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

That has, Budd. I would say now that all our facilities are operating well and exceeding their budgets. They are, of course, not back to their historical levels of efficiency yet and that's really what we were talking about when we talked about the five-year plan for the distribution centers, but we are really pleased with the progress those guys have made.

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

Okay, and last for me. Advertising is an area where I have -- I'm glad to see you back on television and working on that. Can you give us a feel of the success of that and how you're spending the dollars, maybe parsing the dollars between digital and more conventional advertising?

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

Well, we don't sort of break out the components exactly, but we have, frankly, if you take the three main buckets of print and digital and TV, we have upped the level investments in all three of those buckets this year, so the point is they're all important. They are all important, and they all do a different job, and so that's the reason why we made the decision to let our ad spend as a percentage of sales move up well past our historical norms. But what we're trying to figure out now, and we'll talk to you more about this, is whether those higher levels of advertising spend really are now part of our new business model. Would you say that, Jeff?

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

Yes, I would say we've definitely invested heavily in television this year as well as digital is up. On the print side, the only main reduction in print was some refinement and getting out of magazines. [I'm on it], magazine wasn't viewed as a strong a vehicle for acquisition as television and digital, Budd.

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

And the balance between the three buckets, any help on that?

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

No, I don't think we're going to give you that much, Budd.

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

Okay. Well, I tried. Thank you very much, and good luck on the third and fourth quarter.

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

Thank you, Seth.

Operator

Your next question comes from the line of Brian Nagel with Oppenheimer.

David Bellinger - *Oppenheimer & Co. - Analyst*

Hi. This is David Bellinger on for Brian.

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

Hi, David.

David Bellinger - *Oppenheimer & Co. - Analyst*

I just had a couple questions. First, just with the challenges and the business over the past year or so and the reduced guidance today. How should we think about the sustainability of your dividend and just the overall outlook for cash flows?

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

We mentioned in the script that we evaluate that on an ongoing basis. The most important thing for us to consider is funding the business. We have got strong operational cash flows to invest in CapEx.

Really next on the list is really maintaining a dividend program, and really what reflects largely is the share repurchase. So we continue to evaluate and review that. Just recently, you saw the Board announced another dividend payable shortly, and we'll continue to review that as we go throughout the year.

David Bellinger - *Oppenheimer & Co. - Analyst*

Okay.

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

Our cash position is -- our net cash position is stronger this year than last year, and it's always helped as we continue to reduce inventories.

David Bellinger - *Oppenheimer & Co. - Analyst*

Then just a follow-up on the marketing spend. So that step-up that we're going to see in Q3 and Q4, is that mainly from more television advertising ahead of the holiday season? And based on your guidance, why is that higher marketing spend not necessarily lead to a better sales outlook in the back half of the year?

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

Well, I think that's a good question, particularly as we weren't on TV last year. I'd answer that in two ways. I'd say that the competitive -- our competitive set is advertising very heavily on TV, has done all the way through this year, and we're assuming they will do in the back half, so in a sense we think we have to be on TV almost to maintain the status quo, if you like. But the second thing I think given our recent poor track record of forecasting sales, we want to be very cautious until we can demonstrate to you guys that we can hit the numbers.

David Bellinger - *Oppenheimer & Co. - Analyst*

Perfect. Thanks for taking my questions.

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

You're very welcome.

Operator

Your next question comes from the line of David Mann with Johnson Rice.

David Mann - *Johnson Rice - Analyst*

Yes, thank you, good afternoon.

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

Hi, David.

David Mann - *Johnson Rice - Analyst*

Hello. Question about the improving performance you're seeing this quarter. What do you think is mainly driving that? Are you seeing higher traffic? Is eCommerce as robust? The new fall set maybe just --?

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

Well, all of the above. I think when things go against you, it's very rarely one thing. It's always an accumulation of a lot of things. It's just the way it works, and what we are seeing now is the impact we think of a lot of things going right, which sort of all add up to better sales performance.

Certainly, we're seeing good traffic increases to the site. We are seeing less bad store traffic, if that's the right phrase. Improving store traffic, so that clearly helps.

We're very happy with the quality of our merchandise after this fall. We think the merchants have done a terrific job. We think our marketing is hitting the mark, and so on and so forth.

It's an accumulation, the store presentation that I alluded to. It's really all the things that we work on day in and day out and sometimes hopefully it all comes together.

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

I'd add to that, like you said in your script comments, Alex, the promotional programs are a bit more focused. Probably in the past we had a bit more layers out there of promotions than having a stronger more focused promotion seems to be helping drive traffic, resonate with her, and yet still give us better margins.

David Mann - *Johnson Rice - Analyst*

And the implied math for how you're looking at October would seem to suggest a meaningful drop off from the current trend. Is that all just the conservatism and the competitive environment or -- (multiple speakers).

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

We said the first thing they are going to do is do the backward math, and thank you for doing that.

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

You win the prize. And you're absolutely right that it would imply a drop off from where we're at given that we're in a positive territory, right now but it is reflective of just being cautious and conservative until we get a bit more trend and runway behind us.

David Mann - *Johnson Rice - Analyst*

And one more housekeeping on that. We seem to remember last year that the business trend in this quarter tended to drop off as you went through the quarter. Is that correct, that October was weakest last year?

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

I'm not sure we gave color on that.

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

I don't recall. We usually don't give a lot of color on that, David. I don't think I have that.

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

You may be right. We don't have last year's remarks with us.

David Mann - *Johnson Rice - Analyst*

Okay.

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

We'll check what we said.

David Mann - *Johnson Rice - Analyst*

One other question if I can, just on the supply chain. We appreciate the detail there. How should we think about the timeline for implementation on that and potentially the CapEx related with that? Should we expect CapEx to jump back up next year? Thank you.

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

I think those are good questions, and I think we'll give you more granularity on that in December.

David Mann - *Johnson Rice - Analyst*

Okay. Thank you, good luck.

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

Thank you.

Operator

Your next question comes from the line of Dan Binder with Jefferies.

Dan Binder - *Jefferies & Company - Analyst*

Thanks. It's Dan Binder. My question was regarding the weakness that you saw in July and the subsequent recovery. Was it mainly traffic or were there particular categories that you saw were weak and then strengthened as you went into August and September? And if you could also comment on ticket, what we saw in the quarter.

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

Yes, I mean I think it's fair to say that it was mainly traffic driven. Having said that, the category mix changes depending on the traffic, so when the traffic is depressed it tends to hurt some of the impulse departments more than it hurts the furniture departments.

So when we start to get a healthy traffic, we start to get a sort of healthier mix between furniture and non-furniture departments. So I think we've seen some of that happening.

In terms of ticket, we have seen an uptick in the ticket. That's partly a consequence of where we are with clearance and partly a consequence of she's liking the product.

Dan Binder - *Jefferies & Company - Analyst*

And then if you could -- I just want to talk about marketing a little bit more. Obviously, the marketing spend up year over year but the comps have been softer, and it's not as much a criticism as it is a question of how do you think about the effectiveness of that marketing. And as you mentioned earlier, this may become a permanent part of the business. So I'm just curious, as you do the post mortem on the first half, what did you see in the marketing that may have been disappointing that didn't support the stronger comp trends that you probably hoped for?

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

Okay, Dan. Well, don't forget but if you think of marketing in those three buckets, print, digital, and TV, everything we do in digital is measurable to the minute degree, so we know exactly what return we are getting for spend on everything to do with digital, and we can move dollars around between email and search and display depending on the -- how efficacious they are all seeing at the time. So we just have to make sure with digital that we don't try and make it too efficient because we have to make sure that we get a balance between reach and efficiency.

Print is pretty similar. I mean, we know pretty exactly what the response is to our print books. We know which customers are spending in which of the categories and which of the versions of the book are working better than others, so we can adjust what we're doing very precisely, so three or four months out in terms of print.

TV is the one where it's harder to instantaneously make a judgment, although as I think I said last call and on this call again, we can see directly the impact on TV on the direct to site traffic. And then every month, we do what we call a brand tracker and we ask a series of questions about to customers about whether they've seen the TV ads, what their response to the ads are, and whether it changed the likelihood of them visiting a store or visiting the website. So we do get the info on TV advertising but there's a lag. It comes four to six weeks later.

Dan Binder - *Jefferies & Company - Analyst*

Okay, and then one last one if I could. With regard to the share repurchase, you talked about moderating that to an offset to just offset dilution. Can you just give us a sense of what that dilution looks like in the back half so we can model that appropriately?

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

Dilution in general, and I'd say in more general terms, you don't have it forecasted necessarily by quarter and half the year, but it generally runs 1 point or 2 points of dilution, 1% or 2% of dilution you have in terms of stock grants and restricted stock, so it's usually not a significant number but we'll continue to offset that. Now we have purchased a fair amount of shares in the first half of the year so that doesn't necessarily mean we'll still be in the market in the second half. It's more of an annual number we take a look at to offset dilution versus quarterly.

Dan Binder - *Jefferies & Company - Analyst*

Okay, great, thanks.

Operator

Your next question comes from the line of Simeon Gutman with Morgan Stanley.

Simeon Gutman - *Morgan Stanley - Analyst*

Thanks, hi, it's Simeon. So my first, just a clarifying question. I think it was a point you mentioned during the call and Jeff answered a question earlier.

I think you said gross profit dollars on items that you tested with free shipping actually increased. I'm just trying to figure out the dynamic, I guess. Are you raising the price of an item? You're being less promotional, but you're baking free shipping into the order. Is that effectively the mechanic?

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

It's actually volume is probably the biggest driver. Volume response, a bit less promotion to less margin give up on that piece of it, and then the free shipping element, so those are the three main dynamics going on. Really not a pricing change on it. It's really a promotional change reducing the promotional piece to fund the free shipping but really getting a nice lift in volume.

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

And we did this with test and control groups, so we know the numbers are real, so that's what we are alluding to is the uptick we would get versus the controls and that was incremental sales, incremental margin dollars.

Simeon Gutman - *Morgan Stanley - Analyst*

Right. I guess can you share with us, I'm sure you won't share the specific uptick, but maybe the conversion, I don't know of some type of increase, was it by order of the conversion increase by 50% versus where it was prior to when you had an item that was free shipped?

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

I'm not sure we would want to give those numbers, but you're absolutely right. It's a conversion story. The conversion goes up.

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

Definitely online conversion, we see the benefit there and in stores we see actually traffic and conversion both are affected to get to the volume numbers, Simeon.

Simeon Gutman - *Morgan Stanley - Analyst*

Right, okay. And then secondly, Alex, you mentioned about this equilibrium that eventually gets reached I think in the store perspective which I think makes a lot of sense. I don't know how long your modeling goes out, but curious if you can talk about timeframe or does that happen at a certain margin. Granted, it will always happen if the store traffic stabilizes and then you can operate a cost structure around that, but in an environment where there is uncertainty about that level of store traffic, how do you know when or where or what margin level that occurs?

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

Well, the truth is we don't. And that of course has been the entire dilemma for us and nearly every other retailer in the United States over the last three years is none of us is entirely sure where it settles. I think what we do know is from all the research that there is, we are getting moving towards a sort of ceiling where the percentage of home furnishings that are bought online starts to -- as a percentage of the total starts to slow down very considerably because there's many, many customers, not just our customers but our competitors' customers who like to visit stores for all the reasons that we talked about. So all the things I said about stores, anybody else could say about that store as well.

So the answer is, I don't know, and that's one of the dilemmas but we're watching it very carefully. We are certainly not ready in any shape, way, or form to declare victory but we are pleased to see that the slowdowns in store traffic, the decreases in store traffic have ameliorated over the last nine weeks.

Jeff, can you say anymore to that?

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

I'd say, Simeon, that it is as Alex said, it's probably the most challenging question retailers have right now is what is that equilibrium level on it, and we are still modeling as we think about the rest of this year and into next year that they will still continue to have a shift to online from stores, and exactly when that changes, we're not sure. But we are probably moderating our view a little bit as we're looking at the last few weeks that it's not going to be as significant as it has been the last couple of years.

Simeon Gutman - *Morgan Stanley - Analyst*

Right, okay. And I guess, are there any other levers, I mean we talked about occupancy. I'm sure you've made changes to the labor model. Are there other things as it relates to optimizing that store level expense that I don't know, new innovative way to think about it?

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

I wouldn't say there's a new innovative way. It's looking at all the cost elements we have in the store, and it does start with rent and occupancy costs. I will tell you that as we go through rent negotiations with our landlords, they understand the retail pressures and we're getting good responses to them from our renegotiations.

I'll tell you the stores are doing a fantastic job of figuring out how to operate the stores more efficiently and take tasks out, so reducing labor hours is probably the second leading one. But I wouldn't say there's a secret formula or a special solution other than the tried and true of continuing to work hard on all the different cost elements.

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

I would concur with what Jeff has said, and I think the stores have done a great job and this is just a relentless process of continuing to look at everything we do in stores and saying, can we do it simpler? Can we do it for less hours? Are the tasks that we can take out? Do we need to do that? The little example I gave of if we have a simplified floor set, then it doesn't take so long to swap from one season to another, and then you may think that's a small thing but we spend hundreds of thousands of hours on, thousands of hours on changing floor sets, so if we can make some savings in there, then that's real dollars, so it's just relentless detailed work.

Simeon Gutman - *Morgan Stanley - Analyst*

Okay, thanks.

Operator

Your next question comes from the line of Michael Lasser with UBS.

Michael Lasser - *UBS - Analyst*

Good evening. Thanks for taking my questions. So as you look back on the last eight or nine weeks, how much of the improvement would you attribute to the change in the promotional strategy versus the registry kicking in, financing offers, the loyalty program, et cetera?

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

I mean, I think that's a good question. I think we touched on that in answer to a previous question which is it's never -- it's not one thing. It's all of the above, and I think all those things that you have just listed have all helped plus all the other things that we talked about in our prepared remarks.

So again, like taking costs out, there's no silver bullet. In terms of driving sales, there's no silver bullet. You just have to layer on many, many things which are additive and when you put it all together, you end up with a number that you're happy with.

Michael Lasser - *UBS - Analyst*

Maybe another way to ask it is, how much of a contribution have you had just from the registry kicking in or maybe what do you expect that to be as a percentage of your sales over time?

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

Oh, I see. Well at this stage, we're certainly not going to break out those individual components but measurable and nice.

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

It's early and we are appreciating the traffic and the sales to it. But it's not a major contributor at this point.

Michael Lasser - *UBS - Analyst*

And then my follow-up question is on the poison pill. What was the thought process behind that? Thank you.

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

Well, the Board and we are always monitoring our situation regarding stock activity and given some recent stock activity, we determined it was appropriate to put those protection plan in place. The real goal is to make sure that all our shareholders can participate and benefit in the appreciation we expect for the Company so we took that action -- the Company took that action to put that in place.

Michael Lasser - *UBS - Analyst*

Thank you very much.

Operator

Your next question comes from the line of Adam Sindler with Deutsche Bank.

Adam Sindler - *Deutsche Bank - Analyst*

Yes, thank you.

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

Hi, Adam.

Adam Sindler - *Deutsche Bank - Analyst*

Wanted to touch quickly on the free shipping that you discussed in the prepared remarks. I think you said something about the fact of doing that to compete specifically with the online only competitors. Are you going to be moving the free shipping on furniture as well similar to Wayfair or only on non-furniture items?

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

Well, don't forget that our smaller furniture items actually do go through the UPS system, so already a significant number of our furniture SKUs are included in that. What are not included, you're entirely correct, are the very large heavy pieces which we ship through MXD and we have no plans currently to make that a free service.

Adam Sindler - *Deutsche Bank - Analyst*

Okay, thank you. That was definitely helpful. As I have just maybe a little bit more of a broader picture question here. As we look at the world today, I think clearly one of the -- and you talk about the iconic brand of Pier 1 and adopting the whatever measures last night to help protect your shareholders as you spoke about to realize that value. It just seems that a lot of that was driven by the fact that for a very long time, Pier 1 was just head and shoulders above anyone else or even really no one else existed that did what you did.

You offered very high quality, unbranded merchandise that's style conscious at a very good value and but now though, you have home goods. You have Wayfair on the other side. What do you think Pier 1 can do from a merchandising standpoint to try and differentiate yourselves a little bit or get back to that leadership position in this specific part of home furnishings?

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

Well, I think that's an intriguing question, and I think I would start by saying I think our merchandise is still exclusive and it is still highly differentiated on an item-by-item basis compared to any of our competition. And I think the other big difference that we -- the other thing that we have which others don't have is our ability to put together highly edited and thought through collections which make sense to customers. I mean those are our points of difference.

We are not aiming to have the biggest assortment in the universe. That's not our go-to-market proposition, and we are happy for others to do it. We are not driven by being the lowest price in town, and that's not part of who we are as well.

We are exactly what you said, and I think you'd described Pier 1 beautifully. You can come and write some copy for us. That was a fantastic sort of exposition of our brand positioning.

I don't think any of that's changed. I think what has changed is the way people talk about it, and I think you've heard me say this before on calls. As some of the brick and mortar deep discount retailers have expanded their physical footprints very aggressively, they've also expanded their marketing, particularly their TV marketing very aggressively, and the online only retailers also spend a lot of money on marketing everywhere and particularly on TV.

So what we believe is, we're just as valid and relevant as we've ever been. It's just we really didn't do a good enough job about communicating our message to our customers, and we were being drowned out a little bit. And that's the reason that we are now, I think I used the phrase last time, we needed to shout a little louder, and so now we are shouting a little louder and we think that's going to help considerably.

Adam Sindler - *Deutsche Bank - Analyst*

That was great. I really appreciate that. Thank you so much.

Operator

Your next question comes from the line of Seth Basham with Wedbush Securities.

Seth Basham - *Wedbush Securities - Analyst*

Thanks a lot, and good evening.

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

Hi, Seth.

Seth Basham - *Wedbush Securities - Analyst*

I'm doing well. My question relates to some of the commentary around your online initiatives, specifically your comments about potentially exploring the addition of additional categories that you might sell and categories that might be supplied by vendors directly. Can you assume more information on what types of categories you're thinking about and how big an expansion you might consider?

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

Well, no, is the answer to that. Not because I don't want to share with you but I would really rather wait until these plans are a little firmer baked and we could share with you specifics. What I can say at this stage is what we aren't going to do is put product on our website which is in direct competition to our own unique assortments, which we've just been talking about in the last question.

So we will be looking at things that are complementary to our existing offer or ones or products that we just don't think we have the expertise -- that we want to build the expertise to buy. But I think it's a nice question, and as soon as we've got a little more firmness to our plans then we'll certainly share them with you.

Seth Basham - *Wedbush Securities - Analyst*

Got it, okay. And then my second question as it relates to the online traffic trends. Over the holiday periods in recent years, we've seen explosion in online sales taking more share from retail store sales. Do you expect that trend to start to ameliorate here this year based on the trends you've seen over the last nine weeks or not?

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

Well, do you want to take that one, Jeff?

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

I would say what we're seeing is we're seeing nice online growth, stronger growth now in the early part of this quarter relative to what we saw in the second quarter, so that's great. But we're seeing equally strong growth in the stores on it, or as Alex would say, less traffic weakness on it.

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

I couldn't think of the right word.

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

(laughter) But, and so right now, the business is pretty well balanced on it and that was through Labor Day weekend and as we get into September, it's always a mad dash when we get into Thanksgiving and Christmas, we tend to do really well as you get really close to Christmas, and our pick up products and our in store product does really, really well. So it will be interesting to see how the business evolves but it is a trend that we continue to see online shifting to online. This will be an interesting season to see how it plays out.

Seth Basham - *Wedbush Securities - Analyst*

I look forward to it. Thanks.

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

You're welcome.

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

Thanks, Seth.

Operator

Your next question comes from the line of Steven Forbes with Guggenheim Securities.

Steven Forbes - *Guggenheim Securities - Analyst*

Good afternoon.

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

Hi.

Steven Forbes - *Guggenheim Securities - Analyst*

Regarding the store optimization program, can you expand on how your success thus far in renegotiating leases has impacted your store relocation and store refurbishment efforts, maybe even including the store of the future project? Is that project still in test mode? And if so, what learnings have you gotten from it?

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

On the store of the future, we actually have a lot of elements that we have completed on store of the future, and we have it in a few different stores. I would tell you most of it is about merchandising presentation, and how the stores look. It probably will not involve a big remodel program but it will be incorporated as we go into new stores and into relocated stores.

In terms of our store optimization initiative, we continue to look at our store patterns, our store growth, and looking forward at the economics of the stores. If those stores aren't contributing from a bottom line standpoint or it's likely they won't in the near future, we utilize that either to go back to our landlords and say we're going to pull out of this location and get better rent negotiations or in fact just pull out.

So we're in a good position with a number of leases we have coming up, and our ability to talk to our landlords about the opportunities we have, and as I've said in my comments before is they've been very willing to work with us. We're a great brand within a power center or a strip center, and they enjoy having us. We're a female based brand that's not apparel, and so it's a nice draw for them and so we find them to be very accommodating and willing to work with us on our rent negotiations, and if we have to we'll close a store if it's not going to be profitable in the foreseeable future.

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

Don't forget, though, some of this is about rent reduction but a lot of it is about rent avoidance going forward. So it's when we are negotiating the costs of our options. So let's say we had a 10% rate hike in the lease and we get that back to flat or below what the existing was, so you don't necessarily see big near-term reductions in the rents.

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

You build as you go.

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

Yes.

Steven Forbes - *Guggenheim Securities - Analyst*

And then as a follow-up, if you can, is it possible to break down the second-quarter performance in the September comp performance between your loyal known customer base and your unknown customer base? Really just trying to understand what customer category was responsible for the shortfall relative to plan in the second quarter and then subsequently what customer category drove the reacceleration thus far in September?

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

You know, we have those numbers, of course. I don't have them with me today, but if you want to call us, we can certainly go through that with you, tomorrow or Friday.

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

One thing about July and the second quarter, second quarter in particular, that's a pretty heavy outdoor category for us, and as a category versus a consumer standpoint, that was one of our challenges was outdoor. The beauty as we get into the fall is outdoor as a percent of our business gets to be a much smaller overall percent, and it were much more seasonally correct as we get into the fall so we're seeing benefits of that percent of outdoor going away and getting to be much smaller. So I can tell you that from a category standpoint but can't tell you from a customer piece of it.

Steven Forbes - *Guggenheim Securities - Analyst*

Thank you.

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

You're welcome.

Operator

Your last question comes from Alan Rifkin with FTIG (sic -- "BTIG").

Alan Rifkin - *BTIG - Analyst*

Thank you. It's Alan Rifkin with BTIG. As a follow-up to the last question, as you consider rationalizing the store base, what does the portfolio look like perhaps in a year or two, and how many of your stores today are not earning their cost of capital?

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

In terms of the store base and what it looks like, it was probably earlier last year, midyear, we had identified that over a four-year period, we probably closed about 100 stores. Last year, we closed about 33. This year, we're in the range of 15 to 20 so call it 17, pick the midpoint on it. We'll be about halfway through that program through this year.

As you look to the future with the number of leases coming up, we look like we're on track for that roughly 100 store closure. So about half way through that four-year time period, we're about halfway through the number of stores and we think that will -- we'll be right on track for that.

In terms of cost of capital on it, Alan, I don't have those numbers right in front of me. I will tell you that from the standpoint of being cash contributors, really we look at it really right now as a cash contributor and then in overall to the bottom line.

In those stores that are not cash contributors are probably between 5% and 8% of our stores and that's from more recent phenomenon we've seen. So really kind of a limited amount that we work through. A number of those stores are within that 100 store closure that we're working through and those will be the ones that will be closing as we go forward.

Alan Rifkin - *BTIG - Analyst*

Okay, thank you. And as a follow-up, as you contemplate the balance between preservation of merchandise margins and gaining share, obviously it appears that you're willing based on your revenue guidance and what you've produced thus far, you're willing to sacrifice market share in an effort to preserve your margins. Is there any contemplation on your part of maybe becoming more promotional which will obviously degrade the merchandise margins but yet boost your top line to a greater extent?

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

I'm not sure that's a fair statement of what we're thinking. I mean, no. Our intention is to grow top line and get back to a position where we were growing market share as we did very successfully for six years. What I think what we've said to you today is we want to be very cautious about our sales forecasting based on our recent history, which let's be fair, is not exactly stellar, so --.

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

Alan, I can see how you could draw that conclusion because we have fairly conservative sales guidance out there and we feel pretty good about our margin performance or committing to a margin number, and that would appear to be what our intent and our strategy is, but to Alex's point, it's not. It's actually just a function of the conservatism on the top line right now.

Alan Rifkin - *BTIG - Analyst*

Okay, and one more, if I may, and I think you may have already -- (technical difficulty). But the drop off in the third quarter, is that related to tougher compares or is it something in the economic environment that you see as an incremental headwind? And then before I sign off, Alex, I just want to wish you the best of luck in your next endeavor and it's been nice working with you all these years. I'd be remiss for not saying it.

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

Well that's very nice of you, but I've got one more of these to do so I take your good wishes and look forward to your giving -- you can give them to me again in December.

Alan Rifkin - *BTIG - Analyst*

Okay.

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

Alan, you said the drop off, and what drop off are you referring to?

Alan Rifkin - *BTIG - Analyst*

In comps. You said business has accelerated. Right now, you've been positive but based on your guidance, you're calling for comps to be as weak as [3%] which would imply certainly a drop off in the latter part of the quarter. Is that due to tougher compares or is this something else that you're seeing on the horizon?

Jeff Boyer - *Pier 1 Imports, Inc. - EVP & CFO*

That's our conservatism again. We feel good about our current performance and encouraged about the sales trends, but we're not going to take our numbers up so you do get the backwards math calculation that says the October to November on average have to be down about 4% comp on it. But that's just because of we're trying to be conservative on the sales call.

Alan Rifkin - *BTIG - Analyst*

Okay. Thank you very much. I appreciate it.

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

Okay. Thank you, and thank you everybody for your questions and interest today. As I just said, we will be back in December. Thank you very much.

Operator

This concludes today's conference call. You may now disconnect.

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