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PIR - Q3 2014 Pier 1 Imports, Inc. Earnings Conference Call

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OVERVIEW:

PIR reported 3Q14 total sales of \$465m and net income of \$27m or \$0.26 per share. Expects FY14 total sales growth on comparable 52-week basis to be in high-single digit range and EPS on comparable 52-week basis to be \$1.21-1.27. Expects 4Q14 total sales growth on comparable 13-week basis to be in high-single digit range.



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CORPORATE PARTICIPANTS

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John Marrin *Jefferies & Company - Analyst*

Brian Nagel *Oppenheimer - Analyst*

Brad Thomas *KeyBanc - Analyst*

PRESENTATION

Operator

Welcome to the Q3 fiscal 2014 earnings call. At the request of Pier 1 Imports, today's conference call is being recorded.

(Operator Instructions)

I would now like to introduce Bryan Hanley, Director of Investor Relations for Pier 1 Imports.

Bryan Hanley - Pier 1 Imports Inc - Director, IR

Thank you, and good morning, everyone. Prior to market open today, we issued a press release, which included the detailed financial results for the third quarter ended November 30, 2013. In just a few moments, we'll hear comments from Alex and Cary about the financial results, as well as the Company's positioning for holiday and full-year outlook, followed by a question and answer period.

Before we begin, I need to remind you that certain comments made during this call may contain forward-looking statements within the meaning of section 27 A of the securities act of 1933, and section 21 E of the securities act of 1934, and can be identified by the use of words such as may, will, anticipate, 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 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. Forward-looking statements made today are as of the date of this call and we do not undertake any obligation to update our forward-looking statements.



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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 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 would like to turn the call over to Alex Smith, our President and Chief Executive Officer.

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

Thank you, Bryan. Good morning, everyone, and thanks for joining us today. Also on the call with us is Cary Turner, our Senior Executive Vice President and Chief Financial Officer. As always, Cary will provide a detailed review of our financial results a little later in the call.

We are pleased to have returned the business to strong levels of operating performance in the third quarter, generating improvements across many of our key financial metrics. We achieved robust sales growth of nearly 10% and produced a comp store sales gain of 6.9%. We maximized merchandise margin dollars, controlled expenses, and delivered \$53 million of EBITDA.

We saw broad-based strength across virtually all of our product categories in the period. Sell-through in our harvest merchandise was excellent and all indications are that our holiday assortments will bring it home for us once again in the fourth quarter.

Of particular note, we are seeing continued strength in our furniture business, which was boosted significantly by both our fall indoor furniture bulk and the relaunch and rebranding of Express Request. I'm also pleased to let you know that we've seen some improvements in table top, a classification you know we were concerned about.

Our 1 Pier 1 omni-channel strategy continues to gain momentum. E-commerce outpaced the previous quarter yet again, reaching 4.2% of total sales in the period.

We hit a high water mark with cyber Monday. Total demand that day, which obviously takes a few days to flow through to sales, was 13%. This gave us a sales number of 8% of total sales later that week. E-commerce sales are also running stronger in December, up 4.7% of total sales. Weekly visitors are 1.7 million and climbing. We couldn't be more thrilled about the opportunity that a strong and growing e-commerce presence affords us.

Traffic and conversion continue to move up in tandem. Our customer base is expanding both in size and quality, and we have the ability to increasingly offer our customers a broader assortment of merchandise beyond what's in-store. This year's online-only assortment is approximately 600 SKUs. We plan to more than triple that number through the same time next year.

We are pleased with the robust operating performance of both our website and fulfillment center. The increased volumes have been managed very effectively, with little to no service deterioration during the busy trading days around the holidays.

We continue to introduce enhancements to the site during the quarter. While our major upgrades and enhancements in the second quarter focused on the customer experience, the change that we made in Q3 focused primarily on the back office.

The evolution of pier1.com and our supporting systems are part of our ongoing 1 Pier 1 omni-channel strategy and you can fully expect that we will continue to refine and improve the user experience, as well as the back office interfaces in the coming quarters.

But it's not just about adding new functionality. As we build out our e-commerce team and fine tune operations, our ability to exploit the functionality we have already built is increasing rapidly. Our investments have to pay back.

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I'm delighted that our 1 Pier 1 omni-channel strategy is being embraced by our stores. Although it is early days, we are seeing the growth in the e-com purchases made by customers when they are in a Pier 1 Imports store. We expect that activity to increase meaningfully next year, when e-commerce purchases will be incorporated into the sales targets at the store level.

Indeed, as customers make more of their purchases using pier1.com and take possession of their purchases in a variety of ways: in store, by parcel, home delivery service, or a combination thereof; we expect eCommerce and store sales to become increasingly interconnected.

The traditional role of the store expands to also become a showcase and advice center for our online assortments, a convenient location to pick up an online order, or to return an online purchase.

Let's talk about marketing. We changed our strategy for Q3, which helped drive strong traffic to both our Pier 1 Imports stores and pier1.com. We employed a more overtly promotional approach that included a stronger call to action and expanded direct mail program, and substantial increases in our TV presence. Indeed, the third quarter marked our return to network television. Our traffic and conversion levels tell us that our revised approach worked.

We're very pleased with the quality of our creative and messaging this year, from our iconic find what speaks to you ads, to our Cheer 1 imports tag line. Outside of traditional media, this was the first quarter in which we were able to work with our new e-mail software. Through our continually expanding database, we are able to test specific levels to drive conversion.

Personalization, as we all know, has become key to customer engagements, and our new e-mail software enables us to identify and target our marketing message more specifically than ever before. We believe that a more powerful, customized call to action, will not only help us to drive traffic and conversion, but equally important, help us to gain more valuable long-term customers.

We are focused on delivering a powerful and balanced value proposition to our customers, responding thoughtfully to today's trading environment in order to maximize merchandise margin dollars and grow market share, and I would believe we did that successfully in the third quarter. We have so many things in our favor. We have talented merchants, unique assortments, an exceptional planning and allocation team, a new robust POS system, highly energetic and passionate store associates, and a growing omni-channel capability, just to name a few.

We will continue to capture incremental market share in the coming years, as we have done in the last five. If it takes a slightly more promotional stance in the current environment, our business model can support it.

Speaking of growth in market share, let's return to our express request program, which far outperformed our expectations. The business has been growing rapidly, with third quarter sales up more than 60% versus a year ago. As many of you know, this program allows us to offer the customer much deeper assortments beyond what she sees on display in-store. In short, we're expanding our SKU count and giving her more choices without the need for incremental floor space, one more way that will help us achieve our \$225 per square foot productivity goal.

Express request now accounts for roughly 15% of total sales, and we see room for plenty of additional growth. We intend to continue to expand our Ex R assortments in fiscal 2015, and this is over and above our online-only SKU growth.

Our new POS system is also proving beneficial to express request, with new systems in place to improve inventory availability accuracy, ensuring prompt delivery to the customer store and the positive in-store order experience. Express request has already been a home-run for us, and we're excited about the potential we've yet to tap into.

As we expected, our newly installed POS system is significantly enhancing the customer shopping experience and serving as a highly effective selling tool for our associates. This was particularly beneficial over the Black Friday weekend, when we were able to position our most senior associates on the selling floor. Sales for both Black Friday and the fall holiday weekend were the highest in the Company's history.



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Our field teams and store associates throughout the Company did an exceptional job in the third quarter, which is evidenced by our strong conversion rates. Quarter after quarter, our store team is proving that we can drive substantial growth through our real estate strategy. Recall that our focus regarding real estate is on driving productivity within the confines of our existing square footage. It's about the quality, not the quantity.

We will continue to maximize market share through remodels and tactical relocations, as opposed to exponential new store growth. To this end, up to 10 new stores opened in the period, six were relocations within the current market. An early gauge of business at our relocations shows all performing ahead of plan.

In the fourth quarter, three of our planned openings are relocations. Going forward, you can expect to see a continued emphasis on this strategy, as we drive towards our \$225 sales per square foot target for fiscal 2015.

Well, I know you'll all be anxious to hear more about holiday sales. And we are very pleased with our holiday assortments and our in-store execution. The organization has done a great job. The season got off to a strong start over Thanksgiving weekend, our biggest ever, and the momentum has continued in those markets that have not been weather-impacted.

Unfortunately, we did experience a fair amount of disruption in the first and second weeks of December. Now, into the third week, we thought we were getting back to normal, but as recently as Tuesday, our northeast stores closed early, as yet another storm moved through. However, customers are loving our stores and we are achieving the highest conversion rates in the Company's history.

As you'll hear from Cary in just a few moments, the level of disruption was significant and regrettably, it necessitated revision to our fourth quarter guidance. But I want to emphasize that the revision to guidance is purely a response to the lost sales due to the various weather events we have had to contend with. It has nothing to do with the underlying trends in our business, which we can see from the non-disrupted areas, are strong.

Delivering value to our shareholders is a critical importance to our management team and Board of Directors. We recently implemented a new share repurchase program and raised our dividend by 20%. Equally important, we're committed to delivering strong financial results. We have addressed the imbalance we had between delivering results today and building for tomorrow, which affected our second quarter performance. We feel good about where we are.

We're certainly not operating in the best of environments, but we are energetically managing our business, executing every day, leveraging our competitive advantages, and pursuing the many growth opportunities we have. Our plans for fiscal 2015 are well underway and we expect a strong year, as we have huge confidence in our ability to execute our 1 Pier 1 omni-channel strategy and continue to build market share.

We have exceptional product that our customers love. It's better than ever. We are beginning to offer her a broader arrange of assortments and new merchandise categories to support our e-commerce and express request businesses. She already has multiple ways to shop and we will be providing more and more delivery options, as we execute our 1 Pier 1 omni-channel strategy.

Our portfolio of stores is benefiting from our targeted investments and becoming increasingly productive. Our marketing programs are fun, on brand, and powerful. We have a strong and growing rewards cardholder base. The business is supported by best-in-class systems and we have facilitated a lot of treasure hunts, enabling us to build meaningful brand equity and a loyal customer base, which we are actively growing.

We are very happy that our store associates were able to enjoy their Thanksgiving day and I would like to take a moment to thank all our associates for their effort, their dedication, and commitment to our customers and our much-loved company. As we ran the home stretch into our 2013 holiday season, you have done a superb job and we look forward to bringing the joy of the Pier 1 Imports experience to more and more customers in 2014.

I would like to thank everyone for joining us this morning. I want to wish all of you a safe and happy holiday season. We'll open the call for your questions after Carey's review of the financials. Cary?



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

Thank you, Alex and good morning, everyone. From a high level perspective, we generated significant top line growth, achieved a 6.9% comp store sales gain, leveraged expenses, and delivered increases in EBITDA, operating income, and earnings per share. This year's third quarter comp store sales increase came on top of last year's 7.9% gain, while total sales were up 9.6%, to \$465 million.

The 270 basis point delta between total sales and comp store sales growth is primarily attributable to the sales from our direct-to-customer business, as well as sales from our new and intermediate stores. As Alex highlighted, our e-commerce business, including both direct-to-customer, and pickup in store, accounted for over 4% of total sales in the quarter.

On a trailing 12-month basis at the end of the quarter, sales per retail square foot reached \$205. That's up from \$194 at the end of last year's third quarter. Sales on the Pier 1 rewards card at the end of the third quarter remained robust and accounted for 29.1% of US sales on a trailing 12-month basis, compared to 28% at the end of the second quarter, and 25.7% at the end of last year. We have seen the number of cardholders grow more than 25% over the past year. In addition to strong economics, we continue to garner significant strategic benefits from the program.

Moving down the income statement, third quarter gross profit increased 8.6% to \$202 million, compared to \$186 million a year ago. As a percentage of sales, gross profit declined 50 basis points to 43.4% versus 43.9% last year. This reflects our strategic decision to adopt a somewhat higher promotional cadence versus last year in order to drive sales, maximize merchandise margin dollars, and grow market share. To Alex's point earlier, although we were a little more aggressive with promotions in the third quarter, our model continues to generate significant increases in margin dollars.

Store occupancy costs were \$72 million compared to \$69 million last year, and as a percent of sales, leveraged 70 basis points to 15.6% from 16.3% last year.

Third quarter merchandise margin came in at 59%, or 120 basis points lower than last year. Approximately 60 basis points of the decline was due to slightly higher levels of promotional activity I just mentioned, while the other 60 basis points is attributable to the direct-to-customer business in the quarter. This is slightly higher than we expected, because of the additional direct-to-customer sales. For the fourth quarter, we expect the merchandise margin rate to decline similar to what we saw in Q3, as we continue to position ourselves to gain market share.

Turning to expenses, we are continuing to exercise strict control of the cost structure to ensure that we have the flexibility to invest in our growth plans. Third quarter SG&A leveraged 70 basis points, coming in at 149 million, or 32.1% of sales, despite continued investments in head count to support our 1 Pier 1 strategy.

Variable expenses were \$108 million, or 23.2% of sales compared to \$101 million, or 23.9% of sales last year. The 70 basis point improvement was primarily related to the leveraging of store payroll and also marketing expense. For the quarter, marketing expense dollars were up \$2 million versus the same period last year, and at 7% of sales, was in line with our expectations. We continue to expect that our full-year marketing spend will be on plan, at approximately 5% of sales.

Fixed expenses during the quarter were \$41 million, or 8.8% of sales compared to \$38 million, or 8.9% of sales last year. The dollar increase is primarily attributable to the investments in additional head count to scale our e-commerce business and expand our organizational capabilities in support of 1 Pier 1.

Looking at expenses for the fourth quarter, we believe that seasonally higher sales volume, coupled with the anniversary of our increased investments to drive growth, will allow us to achieve expense leverage as a percent of sales, similar to what was realized in the third quarter.

We generated third quarter EBITDA of \$53 million. That's up 13.3% compared to \$47 million last year. Operating income for the third quarter increased 11% to \$43 million, while operating margin improved by 20 basis points to 9.3% of sales.

Net income in the third quarter came in at \$27 million, or \$0.26 per share. That compares to adjusted non-GAAP net income of \$27 million, or \$0.25 per share last year. You'll recall that during the third quarter of last year, the Company's adjusted earnings per share included a \$0.03 benefit.



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As we noted in the financial disclosure, advisory section of our press release, the utilization of an effective tax rate of 35.6% provided a \$0.01 benefit. An additional \$0.01 came from the incremental expenses associated with Hurricane Sandy and another \$0.01 from lost sales related to that event. Taking into account these adjustments, the Company's net income on a GAAP basis for the third quarter of last year, was \$24 million, or \$0.22 per share.

Turning to the balance sheet, inventory at the end of the third quarter totaled \$429 million, up 3% over last year. That's in line with our expectations, and is due in part to the added control over inventories we have achieved from investments from our planning and allocation systems. We're continuing to strategically manage the business in order to enter spring in a good position. At the end of the fourth quarter, inventories are planned to be up about 5% to 8% over last year.

The Company remains in strong financial condition and ended the quarter with \$128 million of cash and cash equivalents, and no cash borrowings under our \$350 million credit facility. As Alex highlighted, we remain committed to returning cash to our shareholders, which is reflected in our share repurchases and cash dividend payments.

Year-to-date, through the third quarter, the Company has paid \$16 million in cash dividend, and utilized \$114 million to repurchase more than 5 million shares. This resulted in the completion of our \$100 million share repurchase program that commenced in December 2012, and we announced a new \$200 million share repurchase program in October of this year. Of the \$54 million spent on repurchases in the third quarter, \$14 million was deployed under the new program, resulting in the repurchase of 650,000 shares of common stock.

Since the end of the third quarter, we have repurchased an additional 325,000 shares for \$7 million. Approximately \$107 million remains available for repurchase under the new program. In the third quarter press release issued this morning, the Company also announced that our Board of Directors has declared a \$0.06 per share quarterly cash dividend, reflecting a 20% increase from the previous quarterly cash dividend of \$0.05 per share.

Capital expenditures year to date through the third quarter totaled \$61 million. Of that amount, \$32 million was deployed towards stores, including the opening of 24 new and 5 remodeled Pier 1 Imports stores, new merchandising fixtures and lighting, other lease hold improvements and equipment. The remaining \$29 million was utilized for technology and infrastructure initiatives, including the Company's new point of sale system and e-commerce. We remain on track to spend approximately \$75 million related to capital this year, with roughly half allocated to stores and the other half allocated to technology and infrastructure.

During the third quarter, we opened 10 stores and closed 2, ending the period with 1,074 Pier 1 Imports stores. That includes 993 locations in the US and 81 in Canada, for a total of 8.5 million retail square feet. During the fourth quarter of fiscal 2013, we plan to open approximately four stores and close five.

We expect to end the year with approximately 1,073 stores, reflecting 28 gross store openings, and 17 closings, for a net of 11 new locations. We continue to be pleased with the level of improvement we're seeing throughout the portfolio, in both comp store sales growth and overall productivity.

Now I'll turn to our fourth quarter and full-year outlook. Our financial guidance for the fourth quarter on a comparable 13-week basis is as follows: total sales growth in the high single-digit range; comp store sales growth in the mid-single-digit range; and earnings per share in the range of \$0.60 to \$0.66, representing year-over-year growth of 9% to 20%.

Recall that last year's fiscal fourth quarter contained 14 weeks. We previously disclosed that the 14th week contributed an estimated \$29 million to net sales and approximately \$0.03 to earnings per share.

Our financial guidance for fiscal 2014 on a comparable 52-week basis is as follows: total sales growth in the high single-digit range; comp store sales growth in the mid-single-digit range; EBITDA growth in the range of 9% to 13%; depreciation and amortization expense of approximately \$38 million; an annual effective income tax rate of approximately 38%; earnings per share in the range of \$1.21 to \$1.27, representing year-over-year growth of 3% to 9%; and capital expenditures of approximately \$75 million.



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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

The first question comes from Matt Nemer with Wells Fargo Securities.

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

Hi. Good morning, everyone.

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

Good morning, Matt.

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

So I just have -- the first question is on the increased promotional stance. Obviously, you're using that as a tool to drive sales and gross margin dollars, but is there anything that you saw in the quarter from a competitive standpoint that caused you to make that change, or is it primarily just kind of managing the gross margin dollars?

And then as customers -- I mean, obviously, that's not unique in the home furnishings industry, but other players have had a pretty hard time weaning off of the 20% off total basket type offers. How do you -- is that something that you think will stick with us, or do you expect to be able to wean off of these promotions over time?

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

Thanks, Matt. Well, if you think back, I think it was two quarters ago, maybe it was three, and we were talking about our sort of record merchandise margins at the time. And the question was asked, how will you respond if the climate tends to get more competitive, and what we said to you is we're going to protect our business.

So what we have seen throughout this year is an increasing level of discounting by the home furnishing guys, and frankly, we're not prepared to lose market share. Our ambition is always to take market share. So we decided as we were moving through that quarter that we want to forget that we would be far more aggressive in Q3 and into Q4 and that's exactly what we did.

Now, in terms of weaning ourselves off it, I think that's really all to do with what's happening in the environment and, we'll play that by ear. But your point is correct. Once you've started these things, it's hard to stop.

The final thing I would say on this is what we, what Carey and I both said in the call, is our business model is such that even if we do sustain this level of promotional activity, which I'm not saying we will, but if we do, our business model can handle it pretty well and we can still generate a lot more sales and margin dollars.



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

The only other thing I would add there, if you recall, our business model has been running for the last three, four years at about 50% regular price and 50% either clearance or promotional activity. That number of regular price has come down a little, but not significantly.

Matt Nemer - Wells Fargo Securities, LLC - Analyst

Okay. That's helpful. Can you give us an update on the online offering -- how many SKUs are online only and maybe a little bit of an outlook for how that could grow in 2014.

Alex Smith - Pier 1 Imports Inc - President, CEO

I think the number I just gave was 600 and some. For the moment, obviously our normal Pier 1 store assortments online plus -- we'll just call it a handful -- 600 plus online only SKUs. We have got a huge amount of additional SKUs in the works. By which I mean there is merchandise on the water as we speak, there's merchandise being produced in factories as we speak.

So as we move into spring of next year and get past Chinese New Year, that number is going to increase very significantly. I'm just looking at Michael at the moment, who is nodding vehemently, and we think that number will triple by this time next year is very achievable. By the way, I'd just tell you anecdotally that we're seeing some very nice responses to some of our online-only SKUs, particularly some of the textiles, which I think we mentioned last time.

Matt Nemer - Wells Fargo Securities, LLC - Analyst

Great, and then just lastly, Carey, can you help talk to the non-comp sales? It seems like with the strength in the e-commerce growth, that the growth rate would have been higher there.

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

Well, it's just the e-commerce and the new stores.

Alex Smith - Pier 1 Imports Inc - President, CEO

Yes, there's nothing -- I don't know whether you've done some extrapolated math. Our non-comp stores performed just as well as our comp stores and our new stores.

Matt Nemer - Wells Fargo Securities, LLC - Analyst

Okay. All right. That's helpful. Thanks, guys. Good luck through the rest of the holidays.

Alex Smith - Pier 1 Imports Inc - President, CEO

Well, bless you. Thank you.

Operator

Your next question comes from David Burman with Burman Capital.



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David Burman - *Burman Capital - Analyst*

Hi, guys. Nice results.

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

Hi, David.

David Burman - *Burman Capital - Analyst*

Hi. Two questions. One balance sheet, one operational. The operational would be if you could talk about the internet, which I think I asked you a few years ago, time flies, your internet sales were less than 1% of your total business. Now I think they are 4%. I was wondering where you think that can go, embellish upon that a little bit more and what are you seeing in terms of, the response compared to what you thought you would see?

And then the second question is really just housekeeping, looking at the balance sheet. I noticed you don't break out accounts payable and accrued expenses, prepay, and I see that the accounts payable number has gone up 42% which looks kind of odd.

I imagine it's not accounts payable, you know, because inventories are only up 3%, which is sort of the related question. Inventories seem to be very well controlled, more so than I've seen in a long time. So if you could just speak to those three quick points. Thank you very much.

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

Well, I'll let Cary talk about the balance sheet question. By the way, I want to pick you up on that question about inventory is well controlled. Ours are always well controlled. I think you're probably referring to other people. Do you want to take that?

David Burman - *Burman Capital - Analyst*

Well, no, no. Not they are not always well controlled, they are. But your inventories are growing up 3% and your sales are up 10%, unless I'm doing the math wrong, and that's the best relationship you've had in a long time.

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

Yes, that is correct.

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

So with the accounts payable, the accounts payable line does include other things besides merchandise payables. If you look at merchandise payables only, we're up about 10%.

David Burman - *Burman Capital - Analyst*

Okay. So up 10% and inventories up 3%, that means that it's obviously, it all came in quite recently, then, the last few weeks?

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

Yes.

David Burman - *Burman Capital - Analyst*

Okay, and the level of inventory, again?

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

As I said, you know, we're at 3%. I think by the end of the fourth quarter, we may be up 5% or so.

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

I think the point about our inventory, David, is obviously we think about it a lot. We've been investing over the last few years a lot in systems, of course, in terms of our allocation replenishment systems, but also in investing in people and our planning and allocation functions. I think we are really getting the results of all of that investment now, which allows us to grow sales and not go crazy with inventory.

As far as e-commerce is concerned, think that 18 months ago we had zero sales on e-commerce, so we're really only 18 months into this. When we launched our e-com business, we said that our initial goal was to get to 10% of revenues by 2017 and we're certainly well on track to do that.

Our sales this year will exceed our projections. We're really pleased with the way it's developing and I think it's going to be a big, big growth driver for us over the foreseeable future.

David Burman - *Burman Capital - Analyst*

Right, right. So what, as a percent of sales, what do you think it could be?

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

I don't know. When we get to 10, we'll chat about it then. I want to get to 10 first and then we'll see where we go from there.

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

But there's nothing out there that doesn't suggest we can't get closer to 20 over time.

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

Oh, Cary.

David Burman - *Burman Capital - Analyst*

All right, guys. Thanks a lot. Keep it up.



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

Thank you.

Operator

Your next question comes from Budd Bugatch with Raymond James.

Budd Bugatch - *Raymond James - Analyst*

Good morning, Cary. Good morning, Alex.

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

Hey, Budd. How are you doing?

Budd Bugatch - *Raymond James - Analyst*

Good, thanks. Happy holidays to everyone there, and my wishes for a great holiday season continually.

Just a couple questions for me. We've seen gross margins or merchandise margins I think come down by 120 basis points or so in the quarter. I think you said 60 of that was the e-commerce side and 60 was from the in-stores.

I'm curious about your thoughts about the merchandise margin -- where it should land and where it should be sustained, and when we might get there.

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

Right. Are you talking about the combined margin, Budd?

Budd Bugatch - *Raymond James - Analyst*

Well, yes, sir. Any which way you care to give it to us. We know that mathematically--

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

I think I would rather give it to you, sort of dissect it out. I think as far as the store is concerned, you know we ran at those extremely high margins for quite a long time, and now as things have got a little more aggressive out there, we've elected to focus on the dollars by higher sales and the lower rates. I don't think you're going to see that continuing to deteriorate.

We're very mindful about how we manage it. So I think we're going to settle around this level for the next little while and then hopefully if the economy continues to get stronger, we'll be able to sort of pull back on some of the discounting a little bit and start to see it pick up a bit.

As far as the online is concerned, we're still really in a baby business situation there. We're still experimenting with all the things you see us doing online, with our discounting and our free shipping offers and our category-specific events.



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I'm trying to figure out online, as we figured out in-store, how to generate the most dollars. So I don't think we're at the end game there in terms of the number.

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

I believe, Budd, as we continue to put more volume through that channel, we should become more efficient with how we pick and how we package, et cetera. So there should be some improvements. Over time, throughout the quarters, I think we'll continue to give that detail to let you help model outlying years.

Budd Bugatch - Raymond James - Analyst

Okay. Do you care to give us any idea what costs are now?

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

Not yet.

Budd Bugatch - Raymond James - Analyst

Okay. Second question is, you've invested more in the corporate overhead, and I understand that. You say, I think you say have you more to go. Can you quantify where that is now and maybe what the deltas are, again, and when might that level out?

Alex Smith - Pier 1 Imports Inc - President, CEO

Well, a lot of the lion's share of the corporate overhead is, of course, people. We have been pretty aggressive about building out this organization to support the larger business and the more complex business on the one hand.

On the other hand, Budd, we're trying to also be fiscally prudent about this and not let our expenses get too far ahead of our business. I think what you can see is us striving always to try and leverage that overhead a little bit. So we will continue to invest in people, particularly.

We've certainly no plans to stop that, but we're trying to make sure that we don't get ahead of ourselves. Can you put it any better, Cary?

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

I would just add that what we would like to see is that corporate payroll does not go up as much as sales on a year over year basis.

Budd Bugatch - Raymond James - Analyst

I see, okay. Let me just make sure I understand that. You have been fiscally responsible, Alex, no question about it. During the rougher period, you were more fiscally responsible so I'm just trying to understand, do we see this--

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

Remember, Budd, all of this is to drive additional sales.



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

I think this is a question of you can't make an omelette without breaking eggs. At some point, you have to have the people to get the work done. It's a judgment call that we make every day and every month about do we need this person, do we not need this person, is it this quarter, is it next quarter?

But you're right, that was a different company and a different area. Now we're all about growth and expansion and we're certainly going to invest in our people.

Budd Bugatch - *Raymond James - Analyst*

I agree with that. I understand. I just was trying to understand the level in trying to put a framework on how to think about that, not just for the fourth quarter, but beyond.

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

I think I gave you enough so you can model next year and the year after.

Budd Bugatch - *Raymond James - Analyst*

All right. And finally for me, the tax rate for the fourth quarter is 38%. Is that the normalized tax rate now going forward for the foreseeable future? Is that a good way to think about it.

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

Yes.

Budd Bugatch - *Raymond James - Analyst*

All right. Thank you all, again. Congratulations on a solid quarter, and good luck for the rest of the season.

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

Okay. Happy holidays.

Operator

Your next question comes from David McGee with SunTrust.

David McGee - *SunTrust - Analyst*

Yes, hi. Good morning and congrats on the sales momentum here.

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

Thanks, David. Hi. How are you?

David McGee - *SunTrust - Analyst*

Hi, good. Two questions. Are you able to tailor your promotions by region and are you seeing a difference in what's needed throughout the country in terms of producing that sort of sales momentum?

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

Well, that's a great question, and the answer is no today, but it is absolutely on our to-do list. That's something we do want to get to in the future. But it's not number one on our development list.

David McGee - *SunTrust - Analyst*

With regard to the same-store sales number, the 7% number, is there a lot of variability across the country in what produced that, or are you seeing that consistent now?

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

No. In Q3, it was, it was pretty consistent. What we've seen obviously as we talked about in December so far, we've seen quite a large amount of variability. But no, that's really one of the great things, is that we're seeing success in all markets, both in the big metropolitan markets and in our smaller single-store markets, way out in Hawaii and up in Alaska. It's pretty good across the board.

David McGee - *SunTrust - Analyst*

Have you all quantified the contribution coming from remodeled or relocated stores? I know you get a nice impact from that return on investment. Is that meaningful towards that 7% comp number at this point?

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

Cary, do you want to take that one?

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

Well, the new stores are not included in the comp. Just remember that. So any store that we've built this year and last year.

What I would say is that our remodeled stores clearly have done very well and on average, probably doing about 20% more than before the remodel.

David McGee - *SunTrust - Analyst*

Okay. And how many have been remodeled roughly in the past year, Cary?

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

Well, remember, the remodel, we don't do a lot each year, just because of the investment necessary and the disruption. I would say we've probably touched with improved fixtures and lighting, et cetera, probably a little bit more than 50% now.

David McGee - SunTrust - Analyst

Okay.

Alex Smith - Pier 1 Imports Inc - President, CEO

I think we just need to clarify that, because we get stuck in the term. For us, the pure remodel store is when we close it down completely, gut it back to the walls, and rebuild it. We don't do very many of those.

What we do do a large number of is the refurbishments. The refurbishments are where they get new fixtures and new lighting and so on and so forth. That's a smaller investment.

We've done a lot of those. As Cary says, we've probably touched half the chain in terms of numbers. But in terms of volume, of course, you start with the big stores, we've--

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

Probably 75%.

Alex Smith - Pier 1 Imports Inc - President, CEO

Yes.

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

And just remember, every store has some element of new fixtures in there.

David McGee - SunTrust - Analyst

Great, thank you and best of luck for the balance of the month.

Alex Smith - Pier 1 Imports Inc - President, CEO

Thank you very much. We need it.

Operator

Your next question comes from Cristina Fernandez with Telsey Advisory Group.



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Cristina Fernandez - *Telsey Advisory Group - Analyst*

Hi, good morning. I wanted to touch on inventory. It ended the quarter very lean, but I wanted to know, with December being disrupted, how is the inventory trending between the seasonal assortment and the year-round assortment?

Related to that, as far as clearance merchandise, how is that trending? What is your current thinking between the balance of having enough clearance to drive that value consumer versus not having too much in the stores?

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

Let me talk about the clearance inventory first. I think you've heard us speak on previous calls. Our inventory levels are running now at sort of historical lows. Frankly, they are not fluctuating very much, because we have such great processes for taking our mark-downs and clearing through the slow merchandise.

You know we have said in the past that it is -- you do lose some sales when your inventory, your clearance inventory goes down. I think we've compensated for that effectively with our promotional pricing strategies. So we certainly are not going to artificially pump up the amounts of clearance.

As far as the seasonal merchandise is concerned, we are very comfortable with the sell-throughs that we are seeing on our holiday assortments. You heard me say in the prepared remarks that we think our holiday will bring it home for us again, and I think it is. The response has been pretty good across the board.

So we will put that product on clearance the day after Christmas and it will go very, very quickly. So we don't see any jeopardy there. What was the last piece of the question?

Cristina Fernandez - *Telsey Advisory Group - Analyst*

I think you answered the question. Yes, then I have one more. You talked about personalization and being able to send more targeted e-mails. Could you provide some examples of what you can do different now that you weren't able to do a few months ago?

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

We're on a completely new platform for sending e-mails now. On our old platform, the way you interrogated the database to send targeted e-mails was incredibly cumbersome and time-consuming. It just was not practical to be segmenting out the database of our customers a lot.

Now we have the new system. It is an easier exercise for the marketing team to profile the e-mails. So it's really just a more sophisticated platform that we are working on.

Cristina Fernandez - *Telsey Advisory Group - Analyst*

Okay. Thank you and good luck here in the fourth quarter.

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

Thank you very much.



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Operator

The next question comes from Gary Balter with Credit Suisse.

Simeon Gutman - Credit Suisse - Analyst

Hi, it's Simeon Gutman. I wanted to follow up on the gross margin and the sales piece again. I think sales were great. The margin maybe came in a little light.

Is there a way that -- how do you know if, or can you know if you're optimizing that mix, meaning if you were to manage the business to let's say 5 or 6 comp, but the gross margins were closer to flat and you got the same gross profit dollar growth, would that have been acceptable?

Alex Smith - Pier 1 Imports Inc - President, CEO

That's an interesting question. Well, if we had been forecasting a 5% to 6% comp at the historical margin rates, would we have taken that?

Well, I can't answer that question because that's not what we were looking at. We were looking at a situation if we didn't spike up our promotional activity, that we thought the sales would be lower than that.

So we spent a lot of time modeling out if we do this, the sales will be this and the margin will be that. I want to emphasize that we were keen to make sure that we took incremental market share in the quarter. We have such amazing products and a wonderful brand and we want to share the love.

Simeon Gutman - Credit Suisse - Analyst

The promotional cadence that you are on, is that something that was consistent, or do you flex it back and forth, depending on how the quarter is shaping up?

Alex Smith - Pier 1 Imports Inc - President, CEO

Well we have a plan and we execute the plan, and then we look at the results and then like you would expect us to do, we sort of tweak it to reflect the conditions. So it's an ongoing process.

Simeon Gutman - Credit Suisse - Analyst

Okay, and then in terms of the drivers of comp, I think the conversion was mentioned (inaudible) was mentioned, in an area that you are not impacted by weather, was the traffic positive in those markets?

Alex Smith - Pier 1 Imports Inc - President, CEO

Yes.

Simeon Gutman - Credit Suisse - Analyst

Okay, and then my last one is on the guidance. The upside to the range, is it purely sales? I guess it may not be, given that the gross margin seems to have a little bit of flex. But I guess sales gross margin, are they the primary levers to doing something closer to the higher end of that range?

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

Yes.

Simeon Gutman - *Credit Suisse - Analyst*

Okay. Thanks. Good luck for the rest of the holiday and the year.

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

Thanks a lot. Bye for now.

Operator

The next question comes from Adam Sindler with Deutsche Bank.

Adam Sindler - *Deutsche Bank - Analyst*

Good morning, guys. Very good quarter.

First question on housekeeping. In the first and second quarters, you provided that to-go was about a third of your total e-commerce business. Do you have that number available for the third quarter?

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

It was higher. I'm looking at Laura here. Do you have that, Laura?

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

It was about a third. We are continuing--

Adam Sindler - *Deutsche Bank - Analyst*

Wonderful. You had also commented, I believe, that just because of the way mix flows, that historically, or not historically, that you would have thought the second quarter would have been the high water mark on e-commerce as a percent of sales. Obviously this quarter came in a bit higher than last.

What are you thinking for the fourth quarter? Should it be something around this or do you just have extraordinary success in this quarter?

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

Well, we're absolutely thrilled the way it's going this quarter. My guess is we're relative rookies at best. I don't want to say what it's going to be for the quarter and we'll just, you know, take it as it comes I think.

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

It's not going to be much different than what we've seen between the three and four.

Alex Smith - Pier 1 Imports Inc - President, CEO

We've got some great activity planned for Jan and Feb so we'll tell you in fourth quarter.

Adam Sindler - Deutsche Bank - Analyst

And then just back to the call, two things you had talked about earlier, the back office enhancements you made during the quarter, and then the new POS system that was the selling tool. If you could give me a little bit more color on each of those? What were some of the enhancements you made and how exactly is the new POS a selling tool, as well as a just back office tool?

Alex Smith - Pier 1 Imports Inc - President, CEO

Well, I really don't want to get into the sort of all the back office systems. The reason I made that point is because everybody sees the front end of what we do, which is the website. But hanging underneath that are literally dozens of systems, all sort of interrelated and helping us go through the process of fulfillment and forecasting and replenishment and delivery and so on and so forth.

It was important that we were sound operationally, as important, sorry, that we were sound operationally, as that we had an attractive selling vehicle at the front end. That's really why I made those points, so that the investor know we're paying attention to all of it. In terms of the POS--

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

As Alex said in his prepared remarks, the simplicity of the POS to run it allows us to have more tenured associates on the sales floor working with the customer instead of being behind the cash rack.

Adam Sindler - Deutsche Bank - Analyst

Got it. Perfect. And then just lastly, real quickly, maybe this is more high level, but as we look at the promotional impact in the quarter, is it any potential that relative to the last third quarter, where it's more decorative accessories, that adds online growth which is more weighted towards things like furniture, that we could start to see some more let's say, promotional pressure in the third quarter, just as that grows as a percentage of the mix relative to things like decorative accessories. Is that possible? Just that more of your mix is subjected to potential promotional activity than it was in the past.

Alex Smith - Pier 1 Imports Inc - President, CEO

No, I don't think I would look at it like that at all. I think our mix actually online is not as different from in-store as you might, as you might imagine.

Adam Sindler - Deutsche Bank - Analyst

Okay.

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

First of all. But I don't see that the online business is going to give us any more promotional pressure.

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

We continue to see our mix with furniture staying around that 40% or so and 60% everything else. We don't see that changing.

Adam Sindler - *Deutsche Bank - Analyst*

Okay. Very good. Thank you.

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

Okay. You're welcome.

Operator

The next question comes from John Marrin with Jefferies.

John Marrin - *Jefferies & Company - Analyst*

Hi. Thanks, guys. Very nice bounce-back and congrats on a good quarter.

Most of my questions have been answered. I was hoping that you might expand a little bit on the comment, Alex, that you made earlier about the quality of the customer base improving. Are we talking about the result of a concerted effort to capture more market share in the higher income households, whether it's through targeted e-mail or mailers? Or maybe is the higher end customer responding to your value proposition? Maybe just a little more color there.

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

Yes, I think there is a number of elements to that. First of all, we are increasing the number numerically, so that's clearly important. We're getting more folks in the database. But then we're -- within that database, we are beginning to -- we are now looking sort of more specifically about who are the online-only customers, who are the store-only customers, and who are the cross-shoppers.

Clearly for us, what we want to build is an increasing number of cross shoppers who -- really that's the whole point of 1 Pier 1, that our customer shops how she wants, when she wants. So we're seeing a pickup in that.

And then we're obviously looking at frequency. Frequency is a big part of our success, so we're starting to see some improvements in the number of times people shop. Now, all of that applies to our general base. I know Carey would like to say something about the Pier 1 rewards card.

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

Yes, as we've told you, that customer who signs up for a rewards card and uses it over time is probably double as important as our regular customer, not with the card. The fact that we grew that customer base over 25% year over year is really exciting for us, because we continue to see more and more opportunity for that to grow.



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John Marrin - *Jefferies & Company - Analyst*

Okay. Thanks, guys. Congrats.

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

Okay. Many thanks.

Operator

Your next question comes from Brian Nagel with Oppenheimer.

Brian Nagel - *Oppenheimer - Analyst*

Hi, good morning.

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

Hi, Brian.

Brian Nagel - *Oppenheimer - Analyst*

Congratulations on a nice jump back in your sales. So a couple questions.

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

Thank you.

Brian Nagel - *Oppenheimer - Analyst*

I know there's been a lot of people already addressed the gross margins. I just wanted to ask one more question on that. Was there something -- as you look at the implementation in the quarter to use more promotion to drive sales, was there something unique in Q3, or should we expect this type of effort, if you will, to continue into subsequent quarters?

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

I think that does depend. I think it depends on what's happening in the environment generally. We're certainly going to respond to that, but I think what you can expect is that we are going to be reasonably aggressive about this whole question of market share.

I really want to go back to the point that I made a couple of times, which is we are so pleased and proud of our products and our in-store experience and our online experience. We really just want to make sure that we can really leverage those enormous assets as effectively as we can in terms of taking market share. So you're going to see us probably be more focused on keeping our sales number moving forward and within sensible reason, we'll do what it takes to keep those sales numbers moving.



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

And to drive the margin dollars.

Alex Smith - Pier 1 Imports Inc - President, CEO

Margin dollars, always margin dollars, yes.

Brian Nagel - Oppenheimer - Analyst

Got it. Okay. Then the second question, on the buyback. You announced a few months ago a new \$200 million buyback, which replaced the exhausted \$100 million buyback.

The question I have is, should we interpret this larger buyback, the larger size of the buyback as indication that you're going to be more aggressively buying back stock, or is it just a longer duration type buyback plan?

Alex Smith - Pier 1 Imports Inc - President, CEO

Do you want me to take it? Well, I think it's both. I think firstly, we are wanting to convey the confidence that management and the board has in our long-term ability to return cash to shareholders. I think that's the first part of it.

The second part of it is we will do what we've always done, which is be fairly opportunistic about how we go in and out of the market to buy stock so that we can take advantage of the dips in the market. What else would you add to that, Cary?

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

I would just say, yes, it is probably a little bit further looking, but we'll keep you informed. As I've said in the past, that the board's and our management's thoughts on this continues to evolve.

Alex Smith - Pier 1 Imports Inc - President, CEO

Yes, I think that's a good point.

Brian Nagel - Oppenheimer - Analyst

Thank you. Congrats again. Happy holidays.

Alex Smith - Pier 1 Imports Inc - President, CEO

Merry Christmas. Thank you.

Operator

Next question comes from Brad Thomas with KeyBanc.

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Brad Thomas - *KeyBanc - Analyst*

Good morning, and thanks for taking my question.

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

Hi, Brad.

Brad Thomas - *KeyBanc - Analyst*

Want to just follow up on e-commerce and talk a little bit about the profitability of the segment. You've alluded to it in a number of ways, but I was hoping you could comment on how that's tracked to the anniversary of its launch and what the latest thinking is going forward.

There's clearly opportunities for leverage and scale, but by the same token, it's one of the more exciting top line opportunities for you as you add more categories. At this stage, it's lower profitability for you, but for many of your competitors, it's higher profitability than their retail margins are.

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

Let me start with the retail profitability. I think the first thing I need to say about that is our stores are enormously profitable. If you think about it as we don't have a primary mall strategy, we're predominantly in strip centers. Our stores generate huge amounts of dollars.

I think it's a hard act to follow in terms of a new business, to be as profitable as our stores. Having said that, clearly as we get bigger with our e-com business, we're going to get more efficient in terms of our fulfillment and our ability to scale that. So we expect the profitability to increase over time.

But it is going to be a matrix. We are, in a sense, not going to worry whether customers shop online or whether they stop in-store or whether they do a bit of each. For example, you know, I mentioned in the call that we've had some great initial reads where customers are in-store shopping and we maybe have -- and they may want to add to their sales through something that's not stocked in that particular store, so the store is facilitating them to do the online purchase there and then. And so I don't know -- is that an online sale or a store sale?

That's the sort of debate that we get into. So I'm giving you a very long-winded answer, which I think is to say we really don't mind where the sale comes from. We will make sure that we drive the gross profit line incrementally with a blended mix of sales.

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

I would say that from a financial point of view, in terms of the bottom line, you're very pleased with the incremental income that the e-commerce business is generating.

Brad Thomas - *KeyBanc - Analyst*

That's great. Cary, if I could just squeeze in a quick housekeeping item. You guys obviously have done a lot on the share repurchase front. Do you have, by chance, the quarter end share count for us?

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

We're just looking through bits of paper.



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

You know what, Brad? I'll call you back with that number.

Brad Thomas - KeyBanc - Analyst

No worries.

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

And for everybody else, it will be in the 10-Q. It's around -- yes, just under 104.

Brad Thomas - KeyBanc - Analyst

Okay.

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

104 million shares.

Brad Thomas - KeyBanc - Analyst

Thanks very much. Hope you guys have great holidays.

Alex Smith - Pier 1 Imports Inc - President, CEO

Thank you very much. Well, thank you, everybody for being on the call today, and thank you for your questions. Once again, happy holidays, Merry Christmas. We will be releasing sales in January. Thank you.

Operator

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

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