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PIR - Q4 2018 Pier 1 Imports Inc Earnings Call

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OVERVIEW:

PIR reported 4Q18 net sales of \$512m for 14-week period and GAAP net income of \$15.1m, or \$0.19 per share.



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CORPORATE PARTICIPANTS

Alasdair B. James *Pier 1 Imports, Inc. - CEO, President & Director*

Christine Greany

Nancy A. Walsh *Pier 1 Imports, Inc. - EVP & CFO*

CONFERENCE CALL PARTICIPANTS

Andrew James Minora *Gordon Haskett Research Advisors - Research Associate of Retail*

Atul Maheswari *UBS Investment Bank, Research Division - Associate*

Cristina Fernández *Telsey Advisory Group LLC - Director & Senior Research Analyst*

Daniel Thomas Binder *Jefferies LLC, Research Division - MD and Senior Equity Research Analyst*

Geoffrey R. Small *Citigroup Inc, Research Division - Senior Research Associate*

Katherine West

PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to the Pier 1 Imports Fourth Quarter and Full Year Fiscal 2018 Earnings Call. At the request of Pier 1 Imports, today's conference call is being recorded. (Operator Instructions)

I would now like to introduce Christine Greany of the Blueshirt Group.

Christine Greany

Thank you, and good afternoon, everyone.

Today, after market close, we issued an earnings press release, which included the detailed financial results for the fourth quarter and full year of fiscal 2018. In just a few moments, we will hear comments from Alasdair and Nancy, 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 are as of the date of this call, and the company 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 10e of Regulation S-K, the company has provided a reconciliation of the non-GAAP financial measures to the most directly comparable GAAP financial measures in our earnings press release that was issued this afternoon, which is available on our website at pier1.com.

Now I'd like to turn the call over to Alasdair James, President and Chief Executive Officer. Alasdair?



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Alasdair B. James - Pier 1 Imports, Inc. - CEO, President & Director

Thanks, Christine, and good afternoon, everyone.

Joining me on the call is Nancy Walsh, our Executive Vice President and Chief Financial Officer. Nancy joined us just a few months ago in late January, and I'm pleased to tell you we've already established a great partnership. She's adding tremendous value to the organization. Importantly, Nancy's arrival at Pier 1 coincided with the ongoing refinement and development of our 3-year strategic plan, and she was able to play an integral role in building the financial walkup, which we'll be sharing at our Analyst Day tomorrow morning to which I know many of you are attending, and I look forward to seeing you there.

Before I get into the results, let me frame what we'll be covering on today's call. I'll begin with a recap of the year and provide some context around our performance in quarter 4. Nancy will take you through a detailed review of the quarterly financials, and we'll then open the call to your questions.

As we noted in today's press release, financial guidance will be provided tomorrow morning in conjunction with our Analyst Day presentation. Guidance will include our forecast for the first quarter and full fiscal year of 2019 as well as our longer-term 3-year outlook.

Our performance in quarter 4 underscores the need for a new course to return the business to a sustainable growth trajectory. To do this, we'll be investing in tools and resources in fiscal '19 that will pressure profitability and result in a net loss for that year. We are confident these investments are necessary and expect them to drive sales growth profitability in subsequent years.

I also have tremendous confidence that we now have the right team in place to execute our plans. We have a strong combination of veteran Pier 1 executives, along with new roles and perspectives across finance, IT, sourcing and marketing.

In fact, we recently completed our search for a new marketing chief. Kelly Cook joined us recently as our new Chief Marketing Officer, bringing nearly 25 years of marketing and customer relations experience to the organization.

When we spoke to you in December, we were in the throes of the holiday season, which should, of course, be a time of year when we really shine. As you recall, early December was marked by much weaker sales than we had expected. Throughout the quarter, the competitive landscape remained challenging, while at the same time our assortments lacked the freshness and our value equation didn't compel the customer to buy. The combination of these factors resulted in comp sales to be down 7.5% in quarter 4.

Although our merchandise margin rate at 55.6% exceeded the revised financial guidance we provided in December, our promotional programs didn't drive the merchandise margin dollars or the sales uplift that we anticipated.

Our continued focus on cost control helped us achieve GAAP earnings per share of \$0.19 and adjusted earnings per share of \$0.21 in quarter 4 that was within our expected range.

On a more positive note, e-commerce sales continued to demonstrate strong year-over-year growth in the fourth quarter. In fact, in fiscal year '18, our e-commerce channel eclipsed \$450 million and now accounts for approximately 25% of our total sales. We are proud of this milestone, which represents considerable progress since the launch of e-commerce less than 6 years ago.

To that end, we view our omnichannel platform as a key asset that will enable Pier 1 to thrive in the future. Indeed, we have a great deal of confidence in our ability to strengthen our competitive positioning, reverse our recent sales declines and improve profitability.

Tomorrow, we'll be talking to you in detail about our vision of opportunities within the following key areas: our brand proposition, the pricing and the promotions, sourcing, supply chain improvements, marketing, store experience and e-commerce. And Nancy will share our financial roadmap. Among our most important objectives is to ensure that we're creating long-term value for our shareholders.

I want to thank our team members and associates who've been working incredibly hard as we begin to implement our 3-year strategic plan and to prepare Pier 1 to enter a new chapter of growth. Your efforts and contributions are greatly appreciated.



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Now I'll ask Nancy to review our fourth quarter financials. Nancy?

Nancy A. Walsh - *Pier 1 Imports, Inc. - EVP & CFO*

Thank you, Alasdair, and good afternoon, everyone.

It's great to be here at such a pivotal time for the company. I'll echo what Alasdair said about our partnership and add that one of the reasons it works so well is because I share his vision and feel equally excited about the potential for Pier 1. I'm thrilled to have the opportunity to be part of a strong executive team and use my skills and experience to add value to the execution of our 3-year strategic plan. I'm looking forward to meeting many of you in person at tomorrow's event and also look forward to working with our shareholders and analysts in the coming quarters as we share our progress.

As you heard from Alasdair, we are disappointed with our fourth quarter results, particularly our comp sales performance. On a 13-week basis, company comparable sales declined 7.5% while net sales for the 14-week period declined 3.1% to \$512 million. E-commerce performance continued its upward trend. Fourth quarter e-commerce sales grew 22% year-over-year while sales penetration increased to approximately 25% from 20% a year ago.

Fourth quarter gross profit decreased to \$190 million versus \$207 million a year ago while gross margin rate came in at 37% versus 39.2% in fiscal 2017.

Looking at the key components within gross margin. Merchandise margin dollars came in at \$285 million versus \$300 million a year ago, and our margin rate deleveraged 110 basis points to 55.6%. The year-over-year decrease in merchandise margin primarily reflects heightened promotional activity throughout the quarter.

Delivery and fulfillment net cost as a percentage of net sales deleveraged 40 basis points on a year-over-year basis, reflecting the continued growth in e-commerce sales. Store occupancy costs in the fourth quarter were up by about \$1 million to \$74 million and increased 60 basis points as a percentage of net sales.

Total SG&A dollars were essentially flat versus a year ago while SG&A rate deleveraged by 80 basis points.

Our team did a good job of controlling costs, particularly when you consider the extra week in the quarter. Going forward, expense discipline will remain a key tenet throughout the organization as we execute our 3-year strategic plan.

Fourth quarter net income on a GAAP basis was \$15.1 million or \$0.19 per share. Adjusted net income came in at \$16.6 million or \$0.21 per share and excludes \$1.5 million or \$0.02 per share related to the tax effect of regulatory costs incurred earlier in fiscal 2018 from an ongoing Consumer Product Safety Commission inquiry.

EBITDA in Q4 of fiscal 2018 was \$41.5 million versus \$58.5 million a year ago.

I'll take a moment now to update you on the expected impact of tax reform for Pier 1. Based on our fiscal calendar, the company is subject to a blended U.S. corporate income tax rate of 32.7% for the fiscal year just ended. As we noted in our earnings release today, the lower rate for fiscal '18 combined with our provisional estimate of the remeasurement of our federal deferred tax assets and liabilities, resulted in a minor net tax benefit of \$500,000 in Q4.

We expect to complete our analysis within the 1-year measurement period allowed by the SEC, and any necessary adjustment to our provisional estimates will be recorded in tax expense in fiscal year 2019. From a savings perspective, we would expect to see a benefit beginning next year in fiscal 2020.

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Turning now to the balance sheet. At fiscal year end, we had \$135 million of cash and cash equivalents, and ending inventory was \$347 million, down 13% from a year ago.

We had \$193 million outstanding under our term loan and no working capital borrowings under our \$350 million revolver.

As we noted in today's press release, the Board of Directors made the strategic decision to discontinue our quarterly cash dividend of \$0.07 per share. This is expected to contribute approximately \$22 million of incremental cash flow in fiscal 2019. The board also made the decision to discontinue share repurchases under our current program which has approximately \$27 million remaining. These 2 actions will free up incremental cash flow that we can deploy toward investments needed to execute our 3-year strategic plan.

As Alasdair noted earlier, we will be outlining our plan and providing financial guidance tomorrow within the context of our Analyst Day.

We appreciate your time this afternoon, and we'll be glad to answer your questions regarding fiscal 2018 results and assist with any housekeeping item so that we can focus on our 3-year strategic plan and financial outlook at tomorrow's event. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question will come from the line of Geoff Small with Citi.

Geoffrey R. Small - *Citigroup Inc, Research Division - Senior Research Associate*

I wanted to first ask about the promotional programs. It seems fair to say that your evolved promotional messaging over the latter part of the fourth quarter didn't produce the desired result. And I'm just curious if you can provide any color as to, number one, why that was, and number two, what you learned from the experience, and thirdly, whether you're seeing a change in the overall promotional environment thus far, in 2018?

Alasdair B. James - *Pier 1 Imports, Inc. - CEO, President & Director*

Yes, certainly, Geoff. Geoff, I think when we last spoke in the middle of December, we had obviously announced our guidance and we've cooled that down because of the promotional performance that we've seen in the first 2 weeks of December. It was our hope that we would see an improvement through the quarter. And as you've rightly called out, we unfortunately didn't see that much of an improvement. We did see a slight improvement in online as we pivoted slightly the online business, but we've communication out in the marketplace for our stores business, much of which was advertised with outside communication. We were more limited in that environment and didn't see the level of improvement that we had hoped. So I think your observations are accurate. Why do we think that is? I think it comes back to a couple of core fundamentals. Promotional activity in the market is increasing and competition is increasing. And that marries with the fact that we have a value proposition which is seen to be weaker by our customers than some of our competitors, and we need to address that. Fundamentally, the way to address that requires us to invest more strongly in the base price of products and in our core entry price point. And that's part of the communication of what we'll be talking about tomorrow is to how to bring that to life. So rather than get into the details on this call, I will then hopefully be able to share that with you tomorrow. The other thing that we've learned is that when the product is seen as slightly less fresh than you would like and doesn't resonate, it's obviously much harder to then get the customer to buy when the rest of the competition is very promotional as well. So those really were the 2 key drivers for us.



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Geoffrey R. Small - Citigroup Inc, Research Division - Senior Research Associate

Understood. That's helpful. And just wanted to ask, on the topic of marketing, it looks as though expenses were down both on an absolute basis and as a percentage of sales in the fourth quarter. I'm curious if you pulled back on spending late in the quarter given the weaker sales results you were seeing?

Alasdair B. James - Pier 1 Imports, Inc. - CEO, President & Director

We pulled back a little in the end of the quarter. But for the year, our investment in marketing was like-for-like, and so it wasn't a material amount of money.

Operator

And our next question will come from the line of Michael Lasser with UBS.

Atul Maheswari - UBS Investment Bank, Research Division - Associate

This is Atul Maheswari filling in for Michael Lasser. So if I do a quick back-of-the-envelope math, it appears that store comps declined low teens compared to, say, around a mid-single-digit decline in last quarter. So what really changed in the fourth quarter to cause such a significant step-down sequentially?

Alasdair B. James - Pier 1 Imports, Inc. - CEO, President & Director

Atul, say that again, would you please?

Atul Maheswari - UBS Investment Bank, Research Division - Associate

So if I'm doing a quick back-of-the-envelope math, it would just seem that the store comps declined low teens compared to, say, around the mid-single-digit decline levels seen in the third quarter. So what really changed this quarter that caused such a significant step-down?

Alasdair B. James - Pier 1 Imports, Inc. - CEO, President & Director

Well, I think the comps you've got is pretty accurate. The reality is we had seen a greater strength in our Canadian business historically. We saw a similar decline in our Canadian business this time. And actually, we saw less traffic coming through the stores and more purchases online. Those are the 2 key drivers of the difference.

Atul Maheswari - UBS Investment Bank, Research Division - Associate

And if I may ask a follow-up. Do you think -- are you seeing any improvement or any change in trends thus far into the first quarter?

Alasdair B. James - Pier 1 Imports, Inc. - CEO, President & Director

I mean, the trends are pretty much in line with what we've seen. We'll be talking about that in more detail tomorrow, but the trends as they are, are the trends.



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Operator

And our next question will come from the line of Dan Binder with Jefferies.

Daniel Thomas Binder - *Jefferies LLC, Research Division - MD and Senior Equity Research Analyst*

I'm guessing you'll probably address some of this tomorrow, but I was just curious, when you look at the quarter, you obviously controlled expenses well. I'm trying to understand how much of -- you obviously laid out a need for some cost in and I'm just wondering how much cost out opportunity there is and did we start to see some of that in Q4?

Nancy A. Walsh - *Pier 1 Imports, Inc. - EVP & CFO*

We did see savings in most of our SG&A across the quarter and through the year, and we will cover tomorrow some of the initiatives that we have in place to reduce costs going forward. It's a very big component of our strategic plan that we'll be talking to tomorrow.

Alasdair B. James - *Pier 1 Imports, Inc. - CEO, President & Director*

I do think, Dan, that we've done a reasonable job of controlling our costs as a business, but I'm firmly focused on the fact that to be successful longer term, we need to grow the top line. And whilst we made our earnings per share guidance, we're very conscious of the fact that the cost reductions we saw are not going to be enough in their own right to offset the declines we're experiencing as a business on our top line, and that's much of the conversation for tomorrow about how we give you guys confidence that we have a plan that's going to deliver that starting in '19.

Daniel Thomas Binder - *Jefferies LLC, Research Division - MD and Senior Equity Research Analyst*

And then just on a separate topic, can you just talk a little bit about what you're seeing in the areas of stress that a lot of other retailers have called out in terms of labor, shipping cost, things like that?

Alasdair B. James - *Pier 1 Imports, Inc. - CEO, President & Director*

So what I would say is we've done a reasonable job this year of moderating our costs of labor and being able to actually manage those. I think as we look forward into the future, there's an upward pressure to labor wages, both in terms of distribution, supply chains and also in the retail environment. And I think we'll experience some challenges that some of our competitors have called out. Obviously, that improves significantly if you grow your top line and, therefore, our hope would be that following the plan layout tomorrow, we can leverage our SG&A as we go through our plan.

Operator

And our next question will come from the line of Katherine West with Raymond James.

Katherine West

This is Katherine West in the line for Budd Bugatch. You mentioned that the merchandise isn't fresh or resonating well with the consumer, and I know that you make your purchases about 7 to 8 months before the actual season. Did you make any changes in your merchandising strategy then? And if so, can you elaborate on them?



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Alasdair B. James - *Pier 1 Imports, Inc. - CEO, President & Director*

No, we didn't. In simple terms, if I walk you through the sort of history. So I arrived in this business in May last year. In July, we actually introduced an outside consultancy to come and help us do a full strategic review. And we didn't complete that exercise until October, November time of last year. So the changes that we then started to make on an assortment basis are those that will start to flow through from the summer this year and be in stores September time. So we're going to lay that out for you tomorrow, but no, there wasn't a change to merchandise for quarter 4. And the merchandise we have in stores for Easter is for very much the same in terms of our approach that we had previously.

Katherine West

Okay. Well, can you explain further why you say it's not fresh or why it's not resonating?

Alasdair B. James - *Pier 1 Imports, Inc. - CEO, President & Director*

I mean, I think there's couple of things. We have built designs of product that we've had for several years. And as we repeated those designs year-over-year, many of our customers have already got those products and were finding similar designs or copies of those designs elsewhere at a cheaper value, and that actually sort of contributes to the value proposition issue I have referenced earlier. So that's why we have to address the fundamentals around our value prop in order to address that issue head on.

Operator

And our next question will come from the line of Chuck Grom with Gordon Haskett.

Andrew James Minora - *Gordon Haskett Research Advisors - Research Associate of Retail*

This is Andrew Minora on for Chuck. I have 2 questions for you. First, I was wondering if you could elaborate a little further on the cadence of sales throughout the quarter. I know they obviously got a little bit worse since we last spoke in December, but is there any more color you could add there?

Alasdair B. James - *Pier 1 Imports, Inc. - CEO, President & Director*

We typically don't break that out by month, Andrew, but as you can see, I'm doing this sort of back of the fact, back in -- it was worse in December and February than it was in January.

Andrew James Minora - *Gordon Haskett Research Advisors - Research Associate of Retail*

Okay. And then on inventory, down 13% in the quarter, a little bit lower than I would have expected with the sales performance. Can you talk about that in a little bit more detail, what happened behind those numbers?

Alasdair B. James - *Pier 1 Imports, Inc. - CEO, President & Director*

Could you be slightly more specific with your question, Andrew? I mean, inventory is a big topic. I want to make sure I address your concern.



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Andrew James Minora - *Gordon Haskett Research Advisors - Research Associate of Retail*

Yes, I guess, I was surprised to see inventory down so much with the comp sales down 7.5%. So wondering if there was a little bit -- if purchases were lower in the quarter or anything you can provide there.

Alasdair B. James - *Pier 1 Imports, Inc. - CEO, President & Director*

I see. So I mean, the reality is that as we sort of flagged on previous calls, we're continuing to look at our supply chain in terms of the efficiencies of our supply chain and opportunities for us to actually reduce inventory in a number of ways. We'll explain in a lot more detail on that tomorrow at the Analyst Day. I hope that you're coming. And we can lay that out completely for you. But it doesn't mean that I think there was a nervousness that our inventories would be building given our sales performance, but actually, that's not the case.

Operator

(Operator Instructions) And our next question will come from the line of Cristina Fernandez with Telsey Advisory Group.

Cristina Fernández - *Telsey Advisory Group LLC - Director & Senior Research Analyst*

We've recently noticed that you've lowered prices on outdoor furniture, which I know has been a weak category in the last 2 years. Can you talk about where the prices are now? Are they in the right place? And if so, are you seeing a better reception to that product?

Alasdair B. James - *Pier 1 Imports, Inc. - CEO, President & Director*

What I would say is it's pockets of performance across the country, Cristina. We can talk a bit more about it tomorrow in terms of the overall context to what we see with prices. But the overall situation with outdoor last year was where we struggled with outdoor. I think less about price, actually. More about positioning of Pier 1 as a business in the customers' mind. They think about us less for big-ticket items and more for the core, and we'll lay some of that out for you in a bit more detail tomorrow.

Cristina Fernández - *Telsey Advisory Group LLC - Director & Senior Research Analyst*

And just as a follow-up. Within e-commerce, the 22%, can you help us understand the key drivers? Is it buy online, pick up in-store, the sales in-store, where it gets shipped direct to consumer that's driving that growth?

Alasdair B. James - *Pier 1 Imports, Inc. - CEO, President & Director*

Yes, we can. I mean, I think again, I'm sort of -- rather than stealing from tomorrow's presentation, what I would say is we'll go through that tomorrow. We've seen growth in all areas, so -- where it comes to online. We're actually seeing growth in Pier 1 online, so you if you're sitting at home in your pajamas ordering online. We're seeing strong growth in-store, where it's being influenced by the associates in the store looking for other products. And we're seeing both pick up in-store and delivery to home growing. So it is across the board in our online business. Did I answer your question, Cristina?

Cristina Fernández - *Telsey Advisory Group LLC - Director & Senior Research Analyst*

Yes.



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Operator

And I'm showing no further questions in the queue at this time. So now, it is my pleasure to hand the conference back over to the management team for some closing comments or remarks.

Alasdair B. James - *Pier 1 Imports, Inc. - CEO, President & Director*

Well, clearly, quarter 4 results are not we would like them to be, and we look forward to seeing you tomorrow as we lay out for you our plan for the next 3 years, the implementation of which has already begun.

So we're encouraged that we've got the right plan to get our top line growing in the right way. We're excited about sharing that with you, but our quarter 4 performance underlines the necessity for the plan and the actions we need to take. So we look forward to the opportunity of doing that with you tomorrow.

Operator

Ladies and gentlemen, thank you for your participation on today's conference. This does conclude our program, and you may all disconnect. Everybody, have a wonderful day.

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