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Q2 2020 Pier 1 Imports Inc Earnings Call

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Christine Greany *The Blueshirt Group, LLC - MD*

PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to the Pier 1 Imports Second Quarter Fiscal 2020 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 *The Blueshirt Group, LLC - MD*

Thank you, and good afternoon, everyone. Today, after market close, we issued our earnings press release, which included the financial results for the second quarter of fiscal 2020.

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 and is available on our Investor Relations website at investors.pier1.com.

Now I'd like to turn the call over to Cheryl Bachelder, Interim Chief Executive Officer. Cheryl?

Cheryl A. Bachelder *Pier 1 Imports, Inc. - Interim CEO & Director*

Thank you, Christine, and good afternoon, everyone. Joining me on the call today is Bob Riesbeck, our new Executive Vice President and Chief Financial Officer. As you may have seen, subsequent to our last earnings call, Bob was appointed CFO; and at the same time, Doug Diemoz was named President. Doug and Bob bring valuable experience across retail, operations and finance that will contribute substantially to the turnaround of Pier 1's performance. They've been on the ground in Fort Worth since late July and have quickly moved into action.

We are very pleased with how our leadership has come together and feel confident we have the senior talent and capabilities in house to get the business back on track. Our teams have remained focused on our fiscal 2020 action plan and during the second quarter, we continued to make progress against the 5 key areas of the plan. As we expected, sales and margins remained under pressure as we prepared for our merchandise and marketing reset this fall. When we spoke to you in June, we told you our mission-critical objective was to exit non-go-forward merchandise through aggressive clearance actions in Q2. We did that. The clearance activity was the primary driver of our net loss this quarter, but it paved the way for fresh, on-trend assortments in our stores.

In the second half, our customer will see a revitalized Pier 1 and we believe we'll be positioned to compete more effectively. As our merchandising and marketing initiatives began to gain traction, we expect to deliver improvement in our comp sales and gross margin trend beginning in the fourth quarter. Our expectation also reflects the late Thanksgiving this year, which will cause a portion of our



holiday sales to shift from our fiscal third quarter into our fiscal fourth quarter. At the same time, the cost-cutting actions we outlined under our fiscal 2020 action plan are expected to take hold throughout the second half.

For full year 2020, we remain on track to achieve previously outlined benefits of \$100 million to \$110 million, including a reduction in SG&A expense of approximately \$90 million.

Now I'll update you on the progress we're making against each element of our fiscal 2020 action plan: revenue and margin, marketing and promo effectiveness, sourcing and supply chain, cost-cutting and store optimization.

First: revenue and margin. The success of our clearance plan allowed us to reset our stores with new fall goods to help drive traffic in sales. The level of clearance inventory in our stores has been significantly reduced and margins are recovering accordingly.

This fall and holiday, we're returning to the familiar best-selling categories our customers want from Pier 1. For example, we're highlighting important and profitable categories, such as indoor furniture and housewares, which we believe will help us begin restoring key metrics, including AUR and gross margin. New goods started flowing into stores during August and September and we're seeing some encouraging early signs in key product categories like Harvest and others that we featured in our mailers. We also had a successful Labor Day event, marked by a positive comp over the 5-day period. By the end of October, we expect our merchandising and marketing reset to be fully reflected across our stores and pier1.com.

Turning now to marketing and promotion. Among our top priorities is to optimize media, creative and promotions to drive traffic. We were successful in quickly developing a fresh and innovative campaign featuring Pier 1's new style stories for fall. In August, we showcased Style Your Mood with Calming Eucalyptus. In September, it was Energetic Ocher. And next month, we'll be featuring Elegant Indigo. The early August launch encompassed all of our key channels, including digital, social and TV, and our customers have responded positively.

Looking ahead to the holiday and next fiscal year, we have hired GSD&M, a top-tier ad agency renowned for brand transformations, to assist us with strategy and creative direction. We believe they will contribute significant value as we look to elevate holiday with a strong creative platform and position Pier 1 to begin taking back market share. Based on the productive media impact we are seeing thus far in the fall season, we are leveraging data-driven insights and optimizing our spend to really get behind the product we believe in and help us reach more customers. Most recently, we started testing some incremental spending in select markets to measure the impact on traffic.

In our third area of opportunity, sourcing and supply chain, we made important progress as well. On the sourcing front, our initiatives to strengthen our partnerships, lower our costs and differentiate our merchandise are bearing fruit. Most recently, we completed the optimization of our agent network, which is expected to result in an enhanced level of service to Pier 1 while lowering costs.

We are in close collaboration with our vendors to bring new and unique merchandising stories to our customer. Here in Fort Worth, many of us are working on our merchandise planning for fiscal 2021, and members of our senior leadership team will be traveling overseas next month to spend time with our vendor partners.

Given the fluidity of the tariff situation, we're fortunate to have a highly skilled global sourcing team to help us navigate the uncertain landscape. During the past year, we've taken tangible actions to reduce our exposure to China through cost reductions with many of our vendors and by moving some of our sourcing to other countries. We've also taken price increases to mitigate a portion of the tariff increases, but some margin impact is a certainty.

Moving to supply chain. Our cost-reduction initiatives are taking hold and are expected to begin driving savings in the second half of the year. Our teams remain focused on capturing efficiencies, increasing speed to market and better serving our customers. We're continuing to make headway around D.C. labor costs, third-party logistics and freight.

Looking now at the fourth area of our plan, cost-cutting. For fiscal 2020, we remain on track to capture approximately \$90 million of



SG&A savings. As outlined previously, this includes reductions in marketing, G&A and stores. For business-critical spending, we have renegotiated contracts to lower our cost base and most recently secured a \$10 million reduction with a major vendor. Additionally, our transformation costs are quickly winding down as planned and we've largely exited our consulting relationships.

The fifth area of opportunity under our plan is store optimization. Our work with A&G Realty to address rent expense and determine the ideal footprint going forward remains ongoing. We have been holding active discussions with our landlords and are continuing to make progress in realizing occupancy cost reductions. We are encouraging those landlords who have not yet participated in discussions to work with us to achieve our goals. Thus far, we've decided to close approximately 70 stores in fiscal 2020 and expect that number to increase as we continue the dialogue with landlords. If we are unable to achieve our performance goals, sales targets and reductions in occupancy and other costs, we could close up to 15% of our portfolio.

In the second half of fiscal 2020, our customer will see a revitalized Pier 1 with on-trend merchandise and compelling marketing. We are closely monitoring early response to our fall reset, and anticipate we'll see our top line and margin trends begin to improve as we move closer to holiday.

We all know that turnarounds take time, but I want to assure you that our teams are working with a sense of urgency. The Pier 1 organization is passionate about the business, we recognize the value of this brand and remain committed to returning to strong performance over time. We are especially grateful to our associates for continuing to go the extra mile to make Pier 1 a success.

Now it's my pleasure to introduce Bob Riesbeck to discuss the financials. Bob?

Robert James Riesbeck *Pier 1 Imports, Inc. - Executive VP & CFO*

Thanks, Cheryl, and good afternoon, everyone. I've been at Pier 1 nine weeks now and I have worked diligently to get up to speed. We have a strong finance team and I am working with all of our functions to establish our fiscal 2021 planning process.

In looking at the second quarter, our financial performance was essentially in line with the expectations that management discussed last quarter. Net sales declined 14.3% to \$305 million and company comparable sales declined 12.6%. Store traffic and AUR remained soft during the quarter, offsetting higher UPT versus a year ago.

Second quarter gross profit totaled \$51 million versus \$94 million a year ago and gross profit rate came in at 16.7% versus 26.3% last year. The pressure on our gross margin rate is primarily due to discounting to clear through non-go-forward merchandise, as well as a 240 basis point deleverage of occupancy cost due to the lower sales base.

Second quarter SG&A dollars decreased \$11 million to \$132 million, which includes approximately \$7 million of transformation costs and \$4.3 million of store impairment. SG&A rate deleveraged by 300 basis points. Strict cost control remains a priority across the organization. For fiscal 2020, we are on track to reduce SG&A dollars by approximately \$90 million, which represents annual run rate savings of \$105 million to \$115 million.

Net loss in the second quarter totaled \$101 million or a negative \$24.29 per share, and EBITDA was negative \$81 million.

Turning to the balance sheet and cash flow. At the close of the second quarter, we had \$10 million of cash and investments. Inventories totaled \$329 million. That's down \$58 million or 15% compared to last year and reflects the success of our clearance plan. At quarter end, the level of clearance inventory in our stores has been significantly reduced.

Since my arrival in late July, we have relooked at the capital needs of the business and made the decision to reduce our cap-ex plan for this fiscal year from \$30 million to \$20 million. As of August 31, 2019, there was \$190 million outstanding under our term loan, \$50 million of borrowings under our FILO tranche and \$55 million of working capital borrowings under our \$350 million revolver. We continue to carefully monitor our liquidity position and believe we have sufficient resources to implement our fiscal 2020 action plan.

Separately, the Board's work to evaluate strategic alternatives remains ongoing and no formal conclusion has been drawn.

Before moving to Q&A, Cheryl and I would like to take a moment to mention tropical storm Imelda and Hurricane Dorian. First and foremost, we are grateful that all of our associates are safe. We experienced store closures related to both storms, but our stores did not suffer damages beyond minor flooding at some locations. The overall impact to the third quarter sales is expected to be less than \$1 million.

We appreciate your time this afternoon and I look forward to working with all of you going forward.

Now Cheryl and I would be happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Steven Forbes of Guggenheim Securities.

Steven Paul Forbes *Guggenheim Securities, LLC, Research Division - Analyst*

Maybe a follow-up on the new assortment, right, because it's been in there for I believe over a month now. Can you discuss whether you're seeing really a broader change in customer engagement trends, right, I think both traffic and conversion. You gave us some color, right, around Labor Day, which appeared successful, but how are these trends been since then? And is there anything to talk about regionally as it relates to the customer behavior trends as well?

Cheryl A. Bachelder *Pier 1 Imports, Inc. - Interim CEO & Director*

So a couple of things. We're really pleased with the engagement of the customer. Particularly, in the store, we've seen customers coming in with catalogs in hand that are dog-eared, looking for specific items, and it's been a while since we've seen that at Pier 1. So we're encouraged by the response to the fresh merchandise and the fresh marketing. I think I encourage you to go to pier1.com and kind of see the look and feel that we put forth this fall. It's fresh and proving interesting to our customer. But it's way too soon to talk specifics, Steve, around traffic, conversion, and transactions. It's going to be a measured transition, as we get fully deep into the inventory. I mentioned in the remarks closer to October-November, I think we will be in a better position to give indicators of a turn in the business. I think it'd be premature to do that today.

Steven Paul Forbes *Guggenheim Securities, LLC, Research Division - Analyst*

And then, just as a follow-up, right, because I believe you mentioned an expectation for, I guess, directional improvement, right, in comp and margin trends, but I also, given the cost savings, right, I also believe -- I thought the expectation was getting sort of back to the same level of EBITDA, right, absolute EBITDA performance last year, but obviously, year-to-date trends are slightly below that. So I don't know if you can help us conceptualize what you see as a potential path of EBITDA in the back half? What kind of sort of comp level you are anticipating, right, given the new merchandising resets? And if not, on that, just really, how we should think about the quarterly cash burn rate as we exit the year?

Cheryl A. Bachelder *Pier 1 Imports, Inc. - Interim CEO & Director*

I'm not going to guide forward on either EBITDA or sales into the third and fourth quarter. I think the point I'd emphasize in response to your questions, Steve, is that the majority of the margin degradation in the quarter, the second quarter, traced to clearance and we were very pleased with the exit of that non-go-forward merchandise. We think it put us in a very good position to see increasing performance in the second half of the year now that those goods have moved out of the stores.

Robert James Riesbeck *Pier 1 Imports, Inc. - Executive VP & CFO*

Yes, and Steve, this is Bob. So one of the things also that Cheryl had mentioned is, of the cost savings initiatives that we have in place for the current year, we've recognized about a third of those savings in the first half of the year, so the majority of those savings come in the back half of the year.



Operator

Ladies and gentleman, that is our only analyst question today. I'll now turn the question back to management for closing comments.

Robert James Riesbeck *Pier 1 Imports, Inc. - Executive VP & CFO*

We would like to thank all of you for your time today and look forward to keeping you updated in future quarters.

Operator

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

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