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PIR - Q3 2016 Pier 1 Imports Inc Earnings Call

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OVERVIEW:

Co. reported 3Q16 total sales of $473m and net income of $11m or $0.13 per share. Expects FY16 EPS to be $0.42-0.46 and 4Q16 EPS to be $0.18-0.22.

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to the Pier 1 Imports third quarter FY16 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 Incorporated - Director of IR*

Thank you, and good afternoon, everyone. Today, after market close, we issued an earnings press release which included the detailed financial results for the FY16 third quarter. In just a few moments, we will hear comments from Alex and Jeff about the results, our strategies and outlook. This will be followed by a question-and-answer period.

Before we begin, I need to remind you that certain comments made during this call may be deemed to include forward-looking statements that are based on management's current estimates or expectations of future events or future results. These statements are not historical in nature, and can generally be identified by such words as believe, expect, estimate, anticipate, plan, may, will, intend, and similar expressions. Management's expectations and assumptions regarding future results are subject to risks, uncertainties and other factors that could cause actual results to differ materially from the anticipated results or other expectations expressed in the forward-looking statements included in the press release mentioned earlier, and this conference call. These risks and uncertainties include, but are not limited to, consumer spending patterns, inventory levels and values, the Company's ability to implement planned cost control measures, expected benefits from the real estate optimization initiative, including cost savings and increases in efficiency, and changes in foreign currency values relative to the US dollar.

These and other factors that could cause results to differ materially from those described in the forward-looking statements made during this call can be found in the Company's annual report on Form 10-K, and in other filings with the SEC. Refer to the Company's most recent SEC filings for any updates concerning these and other risks and uncertainties that may affect the Company's operations and performance. Undue reliance should not be placed on forward-looking statements, which are only current as of the date they are made. The Company assumes no obligation to update or revise its forward-looking statements.

The Company will also discuss non-GAAP financial measures on this conference call. Pursuant to the requirements of Regulation G and item 10-E of Regulation 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 Alex Smith, Pier 1 Imports' President and Chief Executive Officer. Alex.

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

Thanks, Bryan, and good afternoon, everyone. Also joining me on the call is Jeff Boyer, Executive Vice President and Chief Financial Officer. Other members of our senior leadership team are in the room with us as well.

As you can see from our revised forecast, FY16 is a challenging year from a financial perspective. This is the final stretch of our three-year omni-channel transition, which positions us for long-term success in the new era of retailing that is upon us. One of the more pronounced changes we've been observing for several quarters now within our business and throughout the broader retail sector is the decline of casual store visits. At the same time, the home furnishings category has become increasingly price driven. These dynamics are changing the way our teams think, react, strategize and plan.

We've invested wisely over the past three years, and developed the capabilities that will help us compete effectively as shopping patterns continue to evolve. Our decision to double down on our omni-channel model in FY15 was absolutely the right one. The acceleration of investments in mobile, digital marketing and customer data excellence positions us well in the current environment. Where it is imperative to know your customer, let her shop how and when she wants, and have the ability to track her shopping patterns throughout the purchasing cycle, whether it's in store, on her PC, or on the go through her mobile device.

Our customers are digitally connected, love to shop and want to experience a balance of value and inspiration, both in stores and on our sites. Our job is to deliver a great shopping experience through our associates, our product, our marketing, and our technology, which we're doing. Our conversion rates, both in store and online, tell us our merchandise assortments are resonating. It also tells us that our associates are doing a good job engaging the customers coming in our door. And the continual improvements we're making to the website are benefiting completed orders.

Our investment in the mobile redesign last year has translated to substantial increases in traffic, demand and conversion, with the most pronounced growth coming from phone versus tablets. Our known customers, i.e. those in our database, are shopping us with more frequency and their spending rates are at an all-time high, and our rewards credit card penetration is stable at around 35% of sales. Currently, we know and can talk to customers accounting for over 70% of our sales. This is a strong number, given the size of our store fleet and our current level of eCommerce penetration.

So how do we reconcile all of these positive factors with the top line pressure we're experiencing? Our disappointing third-quarter sales results are largely attributable to decreases in store traffic. Company comparable sales were essentially flat, down slightly on a reported basis and up slightly on a constant currency basis. ECommerce remains strong, especially direct to customer, which grew by 29% in the quarter. Our eComm gains were driven by growth in online traffic, conversion and average ticket. Total brand traffic remains healthy, up 7% year to date. While shopping patterns continue to evolve for the industry as a whole, stores are essential to the Pier 1 Imports brand proposition. ECommerce orders, either placed in store or picked up in store, represented a little over 50% of our eCommerce sales in the third quarter, reflecting the growth in our direct-to-customer business. In total, 93% of our third-quarter sales touched a store.

Looking forward, reports of brick-and-mortar sales in home furnishings forecast to remain at the heart of home shopping. As strong as growth in eComm continues to be, it will never displace stores and the experience they give our shopper. Our task at hand is to drive incremental customers to the brand, and most importantly to our stores. And we believe this can be accomplished through a combination of strategic and tactical marketing initiatives.

First, our ability to talk to our customers in a more personal way continues to improve. Our new database, which was built from the ground up and is the backbone of the entire program went live in the third quarter. We're building on key learnings from our new campaign management tool, which includes versioning our direct mail books and daily e-mails to ensure that when the Pier 1 Imports brand is in front of her, our messaging is highly relevant. We have new segmentation tools which we're utilizing to gain deeper insight into customer behavior and preferences. We now have the ability to develop a broader understanding of our customer, and where she is in the purchasing cycle. It's actionable data that will help us increase our number of known customers going forward. And next year, we'll roll out our multi-tender loyalty which will complement our private-label rewards program and help grow our database with an even greater number of known shoppers.

A second area of opportunity is the refinement of our media mix. This year, we directed a greater portion of our marketing spend towards customer retention and frequency. We increased our catalog circulation and page count by 25%, and enhanced our digital, social and e-mail strategies to ensure we're engaging our known customers. Our Indoor Living book was mailed to more than 2 million households in September, and generated good response. The performance of our November retail catalog and Holiday Look Book, which dropped the first week of November, exceeded our plans. We're particularly proud of the Holiday Look Book which is new this year, such beautifully done and shows off one of our core strengths, doing holiday really well.

We anticipated these initiatives would enable us to increase the frequency of purchasing among our best customers, and they have. Our most recent data shows both retention and transactions per customer increasing year over year. So we're pleased with the results we're seeing around retention frequency, frequency of transactions and average spends of our core and loyal customer. But it is clear we need to restimulate casual shopping traffic to our stores by adding mass media back into our mix.

Our absence from television this fall and holiday occurred at a time when store visits from the casual and unknown shoppers, who account for about a quarter of our sales, began to decline more precipitously across the industry. At the same time, price-driven competitors increased their presence on air. We believe this confluence of events played a role in our traffic declines in the third quarter. The customer universe we target has a specific psycho-graphic and demographic composition. It includes a very loyal group of Pier 1 aficionados, who give us a big share of their wallets. It also includes regular but less frequent shoppers who also shop extensively at other brands. Some of these shoppers are primarily motivated by price, others more by value and the shopping experience itself. We've talked about these swing customers before. We need a bigger share of their wallet.

In this highly fragmented market, many players can flourish. It is not a zero sum game. Our job is the same as it's always been, to understand our competitors and their positioning, and use this knowledge to help us to become a better version of ourselves, secure in our market position and brand strength. We know there is ample opportunity to win our share of the market. In FY17, we are planning to rebalance our marketing spend to meet our jewel objective of retention and frequency increases from our known customers and growth in new customers. With the strength of our omni-channel offerings and the capabilities we've built over the last three years, a more holistic focus on driving sales growth should result in a strong mix between our stores and eCommerce. What the final mix turns out to be, our customers will determine.

In addition to innovative strategies around digital, social and e-mail, we'll be focusing on reexposing the brand to a broader audience through mass media. This will include a return to television beginning in the spring. We're also testing a number of tactical initiatives including store events, bounce backs and other activities around loyalty to encourage and reward store visits. We monitor very closely both shoppers and purchasers' views of our brand positioning, and of our major competitors. And while the competitive environments have intensified, the Pier 1 Imports brand still scores extremely well, both on an unaided and aided brand awareness.

We know from our annual exit surveys and frequent brand tracker research that the vast majority of visitors to our store and site have an extremely positive view of our product and shopping experience. We also know that our ability to convert unknown shoppers to known shoppers is good, and will only get better with multi-tender loyalty. We've been conducting detailed exit surveys since 2009, and have very rich data around what customers love about Pier 1 Imports. We're pleased with this year's results, seeing stability or slight improvements across all our data points. We're especially pleased with the responses around merchandise, value, and other brand health metrics, as well as overall satisfaction and likelihood of referral. The November brand tracker reconfirms these positive trends.

So as we approach the end of the current fiscal year, we're reflecting on the issues that impacted our performance, using the learnings to shape our tactical strategies and future plans. To recap, consumer shopping patterns have shifted rather dramatically, and we need to continue to evolve and refine our marketing programs. The competitive environment has intensified, especially as it relates to price. We need to recognize this and remain competitive.

We're in the process of completing our omni-channel transformation. And we encountered supply chain difficulties, stemming from an aggressive sales forecast that resulted in excess inventory and added costs. We're making inroads towards bringing inventory levels down to an acceptable level this year, and driving supply chain efficiency over the long term. At the end of Q3, inventories were down about 6% over the year, which puts us on track to conclude the year with inventory levels down approximately 10%, in line with our previously stated forecast. Michael Benkel and his global supply chain team are making progress in stabilizing the performance of our DCs, which as you know, have been disrupted by our extremely high inventory levels. There's still much work to do to get productivity levels back to satisfactory, and we have engaged third parties to help us with the process.

From an expense perspective, we've made significant progress in reducing costs. Our store team did a good job to drive efficiencies around payroll expenses in the quarter. Another important component of the cost-reducing effort is the opportunity to rationalize our store portfolio. We are on track to bring the store base down by about 30 net locations this year, with the majority of those occurring in the final weeks of the year. As we look ahead, we recognize that the evolving retail landscape requires us to evolve our cost structure as well, and we'll be looking at all areas of the business for productivity and cost efficiencies.

Turning now to the holiday season. Our results around the post Thanksgiving weekend were consistent with industry reports. We saw strength in our direct-to-customer business, which was offset by fewer store visits, so we started from a lower base. But traffic has been building week on week which is what we would expect to see at this time of year, given our reputation as a holiday destination. Store conversion rates are also improving in the weeks leading up to Christmas. We're pleased with the sales of our holiday assortment, and customers are responding well to the newness. Of course, we still have some very big days ahead of us.

I don't want you to think from anything I've said that I'm happy with our results. We are dissatisfied with our financial performance, and we recognize this has been a trying period for our fellow shareholders. What I've tried to do today is to set our results within a context, great strategy, some poor execution, some industry challenges. I want you to know we are responding to the issues with a sense of urgency, and working hard every day to emerge stronger. We have a deep and experienced team who have previously steered us through even more challenging times. Many of us worked hand in hand to turn around our Company through the 2008 recession and post recession years to become one of the more profitable brick-and-mortar retailers in our space. We've since embarked on the long-term strategic move into omni-channel. All of us fully intend to return to a positive record of growth.

I'm grateful to our team members and associates who represent the Pier 1 Imports brand with enthusiasm every day, and have a remarkable determination to succeed. Our management team and Board have a clear vision of the path forward, and we remain committed to creating long-term shareholder value. We appreciate your time and interest today, and now I'll turn things over to Jeff to discuss the financials.

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

Thanks, Alex, and good afternoon, everyone. Though we made good progress in the quarter by cutting expenses, improving our supply chain, and reducing our inventories, as Alex mentioned, the third quarter was disappointing for us as store traffic weakened versus the first half of the year.

Total sales in the third quarter decreased 2.5% to $473 million, while Company comps decreased about 1%. On a constant currency basis, total sales were down 1.4%, and Company comps were up 50 basis points. This was below what we expected, and primarily reflects softness at the store POS level. ECommerce remains strong, with sales penetration at 16%. That's up from 12% penetration in the third quarter of last year, and represents growth in eCommerce of about 25%.

Third quarter merchandise margin dollars declined to $263 million from $288 million a year ago. While the merchandise margin rate came in at 55.7%, compared to 59.5% in the third quarter of FY15. The year-over-year decline of 380 basis points was driven by three factors. First, approximately 100 basis points is due to the higher promotional activity in the quarter. As we expected, the clearance impact lessened significantly from Q2. However, the level of discounting and promotional activity in the home furnishing sectors has continued to increase and we had to respond. We have factored higher promotional levels into the full-year guidance we're providing today.

Second, approximately 200 basis points of the merchandise margin contraction is related to the recognition of incremental supply chain costs as the affected inventory is sold. These added costs are due to increased handling, expenses and detention penalties for the elevated inventory levels we had for much of this year. Lastly, the remaining 80 basis points of merchandise margin contraction is primarily related to the antitrust settlement from Visa MasterCard reflected in merchandise margin results for the third quarter of last year.

Though our team is making solid progress against the supply chain issues, there's more work to be done. We've brought down inventories considerably, service levels have improved and overall productivity is moving in the right direction. In fact, four of our six DCs have returned to acceptable levels of efficiencies. We are pleased with this progress, but the inventory costing effect of these issues will continue to impact margins in the fourth quarter and into the first quarter of FY17.

Moving now to occupancy. In the third quarter, store occupancy costs deleveraged by 30 basis points as a result of softer than expected top line results. Delivery and fulfillment net costs increased both in dollars and as a percentage of total sales. We are, however, continuing to leverage these costs as a percentage of fulfilled sales. In the third quarter, we saw approximately two-thirds of our eCommerce sales fulfilled to the customer through either parcel or in-home delivery, which is consistent with what we saw in last year's third quarter.

We delivered strong expense control in the third quarter. Total SG&A was down substantially, both in dollars and as a percentage of sales. For the quarter, SG&A was $146 million, reflecting 230 basis points of leverage compared to the prior year. Very low expenses for the quarter came in at 21.8% of sales, down from 23.9% a year ago. This reflects about $13 million of reduced expense. The majority of the savings was split between compensation for operations and marketing. On the marketing piece, about half of the $6 million reduction to last year represents a timing shift from the third quarter into the upcoming fourth quarter. So the fourth quarter of FY16, we do see marketing dollars modestly higher than in the fourth quarter of last year. Fixed expenses for the third quarter were down slightly versus last year at 9.1% of sales. Third-quarter EBITDA totaled $33 million, which compares to $44 million a year ago. Depreciation for the period increased slightly, coming in at approximately $13 million. Q3 operating income totaled $20 million, and net income was $11 million or $0.13 per share.

Moving to the balance sheet. At the close of the quarter, we had $49 million in cash and cash equivalents. Recall that we had $60 million in cash borrowings under our revolver at the end of Q2, our peak cash borrowing level this year.

We repaid $25 million of that during the third quarter, and the remaining $35 million subsequent to the close of the period. Through yesterday, we have approximately $82 million of cash and cash equivalents on hand. Inventory at quarter end totaled $503 million, representing a decline of 6% versus a year ago and a considerable improvement from the first and second quarters of this year. We continue to expect that year-end inventories will be down approximately 10% from last year.

Capital expenditures in the third quarter totaled $13 million with approximately $7 million allocated toward technology initiatives, $4 million towards stores, and the balance toward distribution center investments. Looking at our capital needs for the balance of the year, we see the opportunity to reduce investments by about $5 million, and now expect capital expenditures for the year to be around $55 million. During the quarter, we repurchased approximately 3.3 million shares of our common stock for a total of $24 million.

Turning now to our financial guidance for full year FY16, we are forecasting the following. Company comparable sales are expected to be approximately flat to last year. Merchandise margin as a percent of sales is expected to be approximately 55%. SG&A is expected to leverage by 80 to 100 basis points. And EBITDA margin is expected to be approximately 6.5% to 7%. Depreciation will be approximately $51 million, and operating margin is expected to be approximately 4%. Earnings per share are now expected to be in the range of $0.42 to $0.46, and capital expenditures are planned to be approximately $55 million. Our guidance for the fourth quarter includes a decline in Company comp sales of approximately 2% to 4%, and earnings per share in the range of $0.18 to $0.22. For modeling purposes, assume a full-year effective tax rate of approximately 38% and net interest expense of $12 million.

We are in the midst of our planning process for FY17. And as you can appreciate, it's a bit early in the process to provide specific FY17 guidance at this point. However, given our performance and outlook for FY16, I will let you know we are taking a conservative planning posture for next year. Though we are putting strong programs together to drive top line growth in FY17, we will plan sales levels conservatively and will pursue every opportunity to improve our efficiency and margins, take out unnecessary costs and further reduce inventory.

Before I turn the call back to the operator to begin the Q&A, I have one housekeeping item of note. Beginning this year, consistent with our home furnishings peers and many others across the retail landscape, we are discontinuing our practice of reporting the holiday sales in early January.

Thanks for your attention this afternoon. And, Melissa, we can now open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Your first question comes from the line of Brian Nagel with Oppenheimer. Your line is open.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Hello, good afternoon.

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

Hey, Brian.

Brian Nagel - *Oppenheimer & Co. - Analyst*

So the first question I had was regard to marketing. And you spent a lot of time, Alex, talking about this in your prepared comments.

But, go back and explain the decision to pull back on marketing. What went into that decision? And then does the timing of -- maybe more the specific timing of when Pier 1 will be backing to a full marketing campaign, and how should we think about that as a driver of traffic to the stores as opposed to just an overall sales driver for the Company?

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

So what we decided to do this year, Brian, is we wanted to focus on a couple things. We wanted to focus on retention, frequency and spend with our core customers, and we wanted to make sure that we drove enough traffic to our site through our digital marketing, particularly to really establish our e-Comm business. And to do that, we decided that we would -- we'd pull out of the mass media, which as you know is -- it's not at all targeted.

So that's what we did, and our acquisition spend was done this year through our direct mail programs. So we bought lists so that we could drive new customers through that vehicle. So that's what we did.

And we were pleased with the results in the first part of the year. But as we've moved into the third quarter, we started to see two things which we talked about in the prepared remarks.

Firstly, the ongoing deterioration in the casual shopper, number one. And then secondly, just the increased volume of advertising from other home retailers, specifically the price driven ones.

So we feel we got just a little drowned out in terms of share of voice. So obviously, we're regrouping from that.

We're looking at where we can become more efficient with our prints and digital next year, with what we've learned this year. We know we have opportunities to reduce circulation without losing efficiency. So we'll do that.

We know there's areas where we can reduce page counts without losing the effectiveness of the books. So we'll do that. And we'll repurpose that money with a little bit more and put it back into mass media.

Brian Nagel - *Oppenheimer & Co. - Analyst*

So the traffic declines you saw, the weaker traffic you saw in your stores, was it consistent across the chains or were there pockets geographically that stood out?

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

That's a good question. Because of course, there's never a direct correlation between either of these things. You can't say if you would have done A, B would have been the consequence.

They are other smaller impacts that we're seeing. Jeff, do you want to talk about some of the regional impacts and things that we're seeing?

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

Brian, it's Jeff here. We do see variability in the regional performance, in particular, we had a few regions that performed well but a number that fell under our expectations. In general, I would tell you that traffic was fairly consistently an issue across the business model, so that's the concern and why we're looking at the media spend.

When you do look at the US in total, it's interesting. The US comp store sales as a group were flat. Canada was actually up in the mid single digit, which was nice.

But because of the currency issue, we actually had the reported comp store sales decline. So the performance is actually an interesting comparison when you take a look at the regional performance, and we have opportunities in a number of regions to do better. But largely, it was a traffic issue that we're focused on you now as we go into FY17.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Just one final question. I spent a lot of time in your stores lately.

It definitely seemed to me that there's been less clearance activity in the stores. So the question is, is that a fair assessment and is that directly tied -- if that is correct, is that directly tied to now inventories (inaudible) better positioned?

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

Well, on a -- truthfully, Brian, on a really historical level, we've still got more clearance inventory than we used to have. But the amount of new clearance that we put into the file will continue to fall as we bring our inventories back into line.

So when we think about next year, and as Jeff said, we're at very, very early stages in that process. But we do expect markdown discounts to come down a little bit next year, which will hopefully give us some flexibility on promotional discounts.

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

I'd just add to that, Brian. I think sequentially, you're accurate, in that in the third quarter, there was less clearance volume than the first and second quarter. We had a lot more clearance activity going on.

Unfortunately, what we did do, was we shifted some of those spending dollars out of clearance sellers into promotional dollars, and that's where we had a bit of a margin hit for that promotional intensity. But the clearance level is lower now than it was earlier in the year.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Got it. Thank you very much.

Operator

Your next question comes from the line of Budd Bugatch with Raymond James. Your line is open.

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

Good afternoon, Alex, good afternoon, Jeff. Couple of questions. One, if my math is right and looking at your guidance for the fourth quarter, the merchandise margin expectation for the quarter is about 53% or so, also down around 300 basis points year over year. Is that a fair way to think about it?

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

Yes, I think that's an approximate good number to back into, Budd.

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

Okay. Just to make sure we understand that, how much of that do you think is promotional intensity versus the inefficiency in the DCs? You say that's getting better, so does it flip-flopped this quarter and in the fourth quarter?

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

Yes, and we gave you the guidance in this quarter. There was about 100 basis points of promotional activity, and about 200 basis points supply chain. It actually does flip-flop on us in the fourth quarter where it's a bit more promotionally intense given what we're doing right now in the fourth quarter, and we get a little bit less of a drag on the supply chain.

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

And then just parching that promotional intensity, how much of that is clearance and how much of that is environment and promotional intensity of the overall environment? So therefore, might be having a capacity to extend into 2016 and beyond?

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

I would say that most of that promotional impact in the fourth quarter, it's promotion, it's not clearance. It's more promotion dollars than clearance dollars.

And I think as we mentioned in the comments, we do recognize that the industry has gotten more promotional, and that we need to compete in that promotional environment. So we are anticipating our plans next year will have to have a component of that promotional intensity in them.

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

So that leads me, Jeff, to something that's been out there for a while. I think, Alex, correct me I'm wrong, the goal has been to have a 57% to 59% merchandise margin kind of a natural level.

And now does that then go back to a 55% to 57% just looking at the environment? Is that a better way to think about it?

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

No, I think the long-term goal, still, Budd, is to get back. Again, we've mentioned before, it probably won't be at that 59%, 60% level that we've seen in the past just given the promotional intensity. But we still think the high 50%s is a very, very doable metric for us.

If you think about the fact that we've had 100 basis points or so over the year of supply chain inefficiencies, and those will structurally go away as we don't have detention demurrage and all the handling charges. And also on the promotional element, while there's a higher promotional piece of it, a good piece of that is higher clearance.

As inventory comes down, the clearance liability will also improve as well or go away, and we think both of those are worth substantial basis points. Can't give you an exact number now or exact timing given where we're at in the plans. But the goal is still to get to that high 50%s I would say merchandise margin, 57%, 58% and get out of the mid-50%s that we're at right now.

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

I don't want to beat this to death, but this says that there's not a structural change to that original expectation. Is was just thinking about that from a promotional environment. Okay.

Couple of other quick questions. What caused the timing shift of marketing? Was that a management -- a discretionary decision or were there issues that just in the way that certain things, programs came together, and does that -- does half of that $6 million delta go into the fourth quarter?

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

On the second part of it, fairly accurate on the adjustment going into the fourth quarter. That's a fairly close number to use.

In terms of the timing issue on it, it's probably a matter of the vehicle that we use. When we use television advertising, television advertising tends to get expensed when we first run the advertising. It tends to be a little bit more front-end loaded, so it happens more in the third quarter.

This year, as you know, we didn't do television, we did direct mail. That's more specific to the direct mail vehicles, and obviously we had some big holiday ones that dropped in December. So you get a natural shift between the vehicle that happens is the majority of the shift, Budd.

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

I am excited about your going back into television. I think that's a good decision. I wasn't exactly thrilled that you went off of that media, so I'm happy you're going back to that.

And my last issue is just one of the store count going forward. I think we've got our three-year program for 100 store reduction.

I think, Alex, if I remember an answer you gave several quarters ago is you'll address it later. But now with your seeing the environment, you're maybe getting a little bit more data. Does that 100 go up, and if so, at what cadence or something you maybe care to comment about now?

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

I think the first thing I'd say is what we've said before, which is we're going to close the first tranche of stores, see how the sales transfer materializes versus what we've actually planned and that will impact our decisions going forward. But in terms of the total size of the chain, then I don't think there's really any change to our thinking.

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

Okay. Thank you. Good luck on the balance of the year and into next year.

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

We appreciate that, Budd. Thank you.

Operator

Your next question comes from the line of Laura Champine with Cantor Fitzgerald. Your line is open.

Laura Champine - *Cantor Fitzgerald - Analyst*

Hello, there. Could you be a little more specific when you talk about the potential for cutting costs into next year, given the current sales and margin environment? What do you think you could do, and how aggressively do you think SG&A expense could be reduced as we move into next year?

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

Laura, probably we'll just defer that question to a little bit later on it. We're working through those programs right now, and it would be a little bit premature to give you a number.

So we think there's substantial opportunity, and I would tell you it's actually throughout the entire business structure. So it's sourcing opportunities, it's supply chain opportunities.

While we're shifting marketing around, it's marketing efficiencies and how we look at those, as well as the corporate SG&A pieces. So it's really a product base across the entire enterprise looking at productivity and taking dollars out so that we can invest those dollars in the most (technical difficulty - microphone inaccessible) we can.

Laura Champine - *Cantor Fitzgerald - Analyst*

If we could look at e-Commerce as a standalone business today, would that be a profitable business?

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

Yes.

Laura Champine - *Cantor Fitzgerald - Analyst*

Thank you.

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

Thanks.

Operator

Your next question comes from Adam Sindler with Deutsche Bank. Your line is open.

Adam Sindler - *Deutsche Bank - Analyst*

Yes, hello. A couple questions here. First, on the fixed expense piece, you said down from last year at 9.1% of sales, but last year it was 8.7% of sales.

I think there was an issue with this the last quarter too. So 9.1% of sales would represent 40 points of deleverage in the quarter. I need to -- (multiple speakers).

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

On the definition of it, there's a underlying schedule that we do. Probably have you chat with Brian (multiple speakers).

Adam Sindler - *Deutsche Bank - Analyst*

Fixed expenses were $47 million last year, right? That's 8.7% of sales. Have you recategorized anything, or -- I'd just like to try and close that gap, because it's important.

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

We just need to probably reconcile with that offline on it where those differences are. We do a variation here, an analysis here, of what's variable and what's fixed on it and we're referencing that definition.

Adam Sindler - *Deutsche Bank - Analyst*

Maybe for modeling purposes, right, was that -- that's okay. All right, fine. Next question, TV ad costs.

So I know that in the past you've tried to keep it at around 5% of sales going forward. I know you spoke with it a little bit here on the call, and that some things were going to be shifting around.

But obviously national TV is significantly more expensive than other forms of media. Should we expect that as a percent of sales, especially with the top line being a little bit light, that that should pick up a little bit next year?

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

Directionally, we think it may, Adam, on it. I know we think that we will do everything we can from an efficiency standpoint with our current programs. But we still like the retention frequency elements of that, so many of those fees are going to stay in place.

The digital has been working well for us as well. So at this point, we think there might be -- that 5% number has been a good target, but we might go above that in FY17.

Adam Sindler - *Deutsche Bank - Analyst*

Okay, all right. And then just lastly on e-Commerce, 16% of penetration would imply something of a growth rate closer to about 25% in the quarter, down from about 80%, 95% in the first part of the year. Is that accurate? Just wondering how things dropped off so quickly.

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

That is accurate. We were doing closer to 70%, 80% in the first half of the year. A lot of that was because of new applications and new functionality we brought to the mobile app, and we introduced that in late last year, October, November, so what we're doing is we're cycling against that largely.

So we had the benefit of that for a good portion of this year. And even cycling against it, we're doing the 25% growth rate on it.

So we feel pretty good about the growth rate, but we did have an accelerated growth rate in the last part of last year and first part of this year on it. So your numbers, your growth rates, are fairly correct.

Adam Sindler - *Deutsche Bank - Analyst*

Okay. I appreciate it. Thank you.

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

Thanks, Adam.

Operator

Your next question comes from the line of Jessica Mace with Nomura Securities. Your line is open.

Jessica Mace - *Nomura Securities - Analyst*

Hello, good afternoon.

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

Hey, Jessica.

Jessica Mace - *Nomura Securities - Analyst*

My first question is on the comp guidance for the fourth quarter of down 2% to 4%. I was wondering if you could tell me what overall growth rate for the market that assumes?

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

We don't really do a market analysis. We're really looking a at our internal performance to do that, Jessica.

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

Really we're just looking at our trends, recent trends, and just projecting those forward. So there's no direct correlation to market.

Jessica Mace - *Nomura Securities - Analyst*

I guess asked another way, are you seeing any major shifts or is there something you can call out in the underlying environment that's contributing to your performance?

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

I think it's the things we talked about in our prepared remarks, really. It's just the lack of store traffic which we've seen in the back end of the third quarter and carrying forward into December. Starting really with the Thanksgiving weekend, our results over that weekend were pretty much what you've heard people report in the industry, which was very good business online, particularly direct to customer, and a fallback in store traffic.

What's happened since then is from that lower base, if you like, the Christmas cadence is pretty much what we normally see. We're getting day over day, week over week growth as we approach the biggest weekend of the year, which is coming up but it's still at a rate below last year.

Jessica Mace - *Nomura Securities - Analyst*

All right. Understood. And then on some of the mix and marketing that you're beginning to implement, are there any early reads or feedback you can tell us as you can see maybe this ramp you're talking about as the holiday season progresses?

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

Well, what we can tell you is, again, just to reiterate what we said in the prepared remarks, our main expenditure this year has been on prints and digital. And the response that we've got from all of that, from our books and from our digital marketing, have been more than satisfactory. We're really very pleased with those.

So next year, the job is to make them more efficient in the ways that we've discussed and then we can free up some funds to reinvest in mass media. So very pleased with what we've done, but we now need to broaden the media mix.

Jessica Mace - *Nomura Securities - Analyst*

Great. Thank you for taking the questions.

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

You're very welcome.

Operator

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

Dan Binder - *Jefferies & Co. - Analyst*

Thank you. With regard to your comments about the casual shopper traffic slowing, I'm just curious how much of that you really think is a marketing issue versus just having less footsteps out there as a result of the broader shift online?

As you consider increased marketing in Q4 as a result of the shift, but the decline in comp store sales as well as the conservative plan for next year as you up marketing. Just how confident you are that a marketing solution is really a fit here versus changes in the product mix or pricing.

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

Well, the truth of the matter is, it's all of the above. There is never one thing that you're going to do which is going to move the needle just on its own.

So we would expect to get -- and to back up, sorry. The deterioration in traffic, how much of that is due just to different customer behaviors and how much could be attributed to a change in the media mix. You never know.

You just have to look at the trends and make your best judgments, and see what's happening out there in the industry. But as we, sorry, Jeff, did you want to -- ?

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

I was just going to add that the marketing mix should help drive some level of traffic on it.

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

So the media mix will do some. Pricing strategy will do a little more. And clearly, the quality of the product will also do a bit.

So it's all those things have to work together. It's many, many knobs and levers we have to pull.

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

And I'd just add to that is I think the marketing element will drive the traffic. We're seeing with our pricing and our promotional element improvement in conversion, which has been very helpful. Those two things should drive most of it.

Our brand assessment is actually telling us that our product quality and our value is actually pretty good. It's coming back pretty well on that. So those three elements as we continue to work them should drive the overall numbers in FY17.

Dan Binder - *Jefferies & Co. - Analyst*

And what tools are you using to assess the product quality, value? Is it just customer surveys, or is it something other than that?

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

It's customer surveys. We do a quarterly brand tracker sequentially over time, we measure that and we measure it versus competitors. It's a good picture of what the consumer believes our product is like from a value, a quality, all those elements.

Dan Binder - *Jefferies & Co. - Analyst*

And then my next question was regarding inventory reduction. Obviously, this plan of being down 10% gets a little bit tougher when the sales are running behind where you were thinking 90 days ago. So I'm just curious given the lead times, how you're managing to still hit that plan?

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

Our merchants are doing a great job of managing what's left of their open to buy to bring that down. So we're doing a good job of flowing product, and if we've needed to hold back on orders for a quarter or two, we've been able to do that. We've feel pretty confident about that being down 10% at the end of the quarter.

Dan Binder - *Jefferies & Co. - Analyst*

And then lastly on the promotional environment, can you point to where you're seeing most of that promotional activity? Is it traditional bricks and mortars, is it more of the pure play online players or both?

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

I'm sure you look at these things as closely as we do, and it's everybody. It's the online only guys. It's the brick-and-mortar only guys.

It's the high end specialty. It's the big box guys. It's the mass merchants.

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

You name it.

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

It's the home improvement guys. It's everybody. There is not anybody who is not doing substantial discounting, which is unfortunate, but it's the world we live in.

Dan Binder - *Jefferies & Co. - Analyst*

Thanks for the answers.

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

Okay.

Operator

(Operator Instructions)

Your next question comes from Denise Chai with Bank of America-Merrill Lynch. Your line is open.

Denise Chai - *BofA Merrill Lynch - Analyst*

Thank you so much for taking my questions.

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

Hey, Denise.

Denise Chai - *BofA Merrill Lynch - Analyst*

Hello there. First question is about CapEx and the opportunities that you see to reduce it. If you could give us a little bit more color about that.

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

Jeff, you want to talk on that one?

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

Absolutely. Just as we looked at our spending levels coming through this point in the year and where we're at, we determined that we could reduce some of the spend we had in some technology and some corporate spending on it. The stores and the DCs really kept that intact.

They've done a good job managing their initiatives and spending on that. We had some opportunity at the corporate as well as the IT side to be a little bit tighter on the spend, so we took that opportunity to reduce our spend for 2016.

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

Don't forget, Denise, we've had fairly elevated levels of CapEx for the three previous years as we invested in e-Comm and getting our site up and running on our new fulfillment centers. So it was appropriate that we pull back a little bit.

Denise Chai - *BofA Merrill Lynch - Analyst*

Okay. So is $55 million a run rate going forward do you think?

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

I'd say, again, that's probably a little bit too soon to say. We'll have a better idea in another couple of months when we get back to you on the FY17 plan, where we'll give you an idea of what that looks like. Still work to do on it.

Denise Chai - *BofA Merrill Lynch - Analyst*

Perfect, great. Thanks. Just to follow up here. So you said your known customer is spending more frequently, and their spending is at an all time high. So could you give us a bit more color on how the mix of sales between your best customer say compared to the casual shopper has changed, and maybe just what kind of decline you're seeing in that casual shopper?

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

So our known shoppers are accounting for that over 70% of our business, and so the casual shopper is 25%-ish. So what we are seeing is that our known shoppers are taking a bigger -- our known shoppers are a bigger percentage of our total volume than they have been because their spend is at an all-time high.

Denise Chai - *BofA Merrill Lynch - Analyst*

Okay. So I'm sorry, but just for the casual shopper then, what sort of declines have you seen?

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

If you think about the comps that are down were flat to the third quarter and if you think that we're getting some growth out of our known shopper, therefore, we're going to be down on our casual shopper. But I don't want to break out the mix between the two.

Denise Chai - *BofA Merrill Lynch - Analyst*

Okay, great. If I could slip this in. If we could get a little bit more color about the multi-tender loyalty program that you're launching next year.

How it complements your reward program? Is it geared more towards frequency or tickets, and is it targeting the casual shopper or your best customers?

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

It's targeting signing up those customers who don't want a rewards card. So being a non-tender loyalty. So there is no -- to sign up you just have to sign up, nothing is checked.

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

No credit application.

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

No credit application. So it's a very easy thing to sign up for, and when we talk to you in Q4 we'll give you some more details as to what the program will look like. But the idea is it is enhanced -- to enhance and sit parallel to our rewards card customers.

Denise Chai - *BofA Merrill Lynch - Analyst*

Got it. Thank you very much.

Operator

Your next question comes from the line of Seth Sigman with Credit Suisse. Your line is open.

Seth Sigman - *Credit Suisse - Analyst*

Okay. Thanks for taking the question. Couple follow-ups here. First, as you think about the sales challenges in the quarter, you pointed to traffic weakness.

Just wondering if you can elaborate on some of the trends you're seeing within the store? If there's any difference between high ticket versus low ticket, furniture versus textiles, any element here where maybe the assortment is not resonating like it used to? Are you seeing more competition for a similar assortment, and just how you're thinking about that?

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

Well that's a very interesting question, and because although our store traffic has been down, most of the other metrics within the store have been remarkably consistent. So our conversion rates, as we said in the prepared remarks, are stable and we're seeing improvements in those as we move through December. There is -- we saw a slight increase in our average transaction value through the quarter, but really not significant.

So we have stability there. So what that tells you is that there's no significant change in our retail mix between our furniture and our non-furnished departments. So no is the answer to the question.

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

There's not a large variability across the categories in total.

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

There really isn't. The water level has fallen pretty much evenly across the whole piece.

Seth Sigman - *Credit Suisse - Analyst*

Got it. Okay. And then as you look at supply chain, I think the impact this quarter was a little bit bigger than expected and above prior quarters. Can you just elaborate on what the status is of some of those issues that have plagued you to date?

And do you think those issues are fixable, and that you'll be able to recoup some of that next year from a margin perspective? Or I guess, Jeff, I know you've been involved in that as well. Are there bigger changes that are going to be needed there to address some of these issues?

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

Very, very fixable, and actually very good progress on fixing them. We're getting to the point where hopefully soon, very soon, we'll be able to say that six of the six DCs are operating at good efficiency levels.

Most of it was getting behind and having challenges with the high inventory levels. Those have largely been cleared up now, and we're beginning to see some improvements there.

Alex did mention in his remarks in the near term, we've also hired an industrial engineering firm to help us with some of the short-term efficiencies and we believe that's going to help us as well. So we do think in FY17 between having the absence of some of the penalties we had from detention demurrage, having some of the excess handling costs that we've incurred on it, we have a good opportunity for some recapture of the margin, a reduction in expense, recapturing in the margin in FY17.

And then longer-term plans to look structurally at what we need to do, but that's long-term. I think there's a lot we can do in the short term looking at the supply chain.

Seth Sigman - *Credit Suisse - Analyst*

Okay. And then just one final question. As you think about capital allocation following up on a prior question, specifically the buyback, you guys have been pretty aggressive this year. How are you thinking about that in light of current trends in the business and some of the pressure that you're seeing?

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

We're still thinking that the dividend program we have is appropriate. The share buyback program is one that's appropriate when we have excess cash to buy back our shares at the kind of value we're looking at.

So we continue to evaluate that. We haven't finalized the plans for 2017, but those elements are always in the mix and we will consider continuing those programs like we have in the past at some level.

Seth Sigman - *Credit Suisse - Analyst*

Thank you.

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

Thanks, Seth.

Operator

Your next question comes from the line of Michael Lasser with UBS. Your line is open. Michael Lasser, your line is open.

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

Melissa, we may have lost Michael.

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

Should we move on?

Operator

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

Seth Basham - *Wedbush Securities - Analyst*

Thanks and good afternoon.

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

Hello, Seth.

Seth Basham - *Wedbush Securities - Analyst*

My first question is just around real estate. You guys have relatively short-term leases compared to many other retailers. As you think about the outlook to reduce expenses, and particularly lease expense, how quickly can you go about taking down some of those costs?

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

Let's just talk about -- just go back first of all to the fact that our stores are very central to who we are, and that over 90% of our sales are still touching a store. So that's our starting point. After that, Jeff, you can talk him through the program.

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

I would say that it's not that we really have short-term leases. What's happened because we've been in business for such a long time, we're in the option period. And really about every seven years, we turn over the store base or have the opportunity to touch stores.

So that creates in any one year 1,000 stores divided by 7, 150 stores a year that come up for lease negotiations and discussions. And we're always out there for a couple of years. So really there's -- any time 300 leases we're working on any year to determine what we want to do.

So it does give us, Seth, a lot of flexibility. But I will tell you it's very much a chess game that you play here just long term, figuring out the best location, possibly issues you have in your current store that you want to correct and move on or consolidate in some way. So we consider it a very important asset, but it's an asset we have to figure out how we can use most productively going forward.

We've been pleased were the results so far with the store process and consolidation. We'll continue to look at that and continue to have a long range plan on it. But as Alex says, stores are very important to the mix, so we'll continue to balance that with opportunities to be more productive with the asset base we have.

Seth Basham - *Wedbush Securities - Analyst*

Got it. Even for store leases that you are renewing, are you having any success in reducing the lease expense for those stores?

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

Yes, I should have added that. That's a good question.

We have gone through a negotiation process in the past six, nine months or so that has netted out a combination of cost reductions and cost avoidance, which is helpful to the lease equation. I will tell you we've actually just transitioned from using an outside organization to do that to actually deciding to do that more internally with our internal guys.

They face 150 to 300 leases a year on it, and there's opportunities every single time to go in those leases and get some cost you avoidances. And I've been here you now for about five months, have been impressed on a monthly basis with the kinds of opportunities they're coming up with with savings.

So I think in addition to the pure exit or consolidation play, there is a lot of lease negotiation. And I will tell you within the real estate environment right now there's a lot of opportunities for leverage in it, so we are seeing some good progress there. So in addition to consolidation, lease negotiation is a big opportunity as well.

Seth Basham - *Wedbush Securities - Analyst*

Okay. That's helpful. And then bigger picture question just on your merchandise margins.

Understanding that you're aiming for around 55% this year and your goal is to get back to 57% to 58% longer term. How quickly will it take or how quickly can you get back to that goal? What's your perspective there?

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

I probably wouldn't say necessarily a year. Optimistically, but I think in a couple of years we could get back to that through our promotional effectiveness, through supply chain efficiencies, reducing inventory and clearance levels, all those pieces would come together as well as what we do from a pricing and a sourcing standpoint. So lots of opportunities there, Seth.

Seth Basham - *Wedbush Securities - Analyst*

Given how price driven the market is and that may persist for a while to come, do you think that your merchandise margins are appropriate, given how high they are relative to many of your competitors?

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

I'm not sure that that's a correct statement that our margins are higher than our -- all of our competitors. I think if you're talking about the off-price guys, then certainly we are higher than them.

But if you're talking about the specialty retailers, our margins are very comparable, if not a bit lower, frankly. So I think that different channels have different margin structures, and our margin structure is very competitive within that specialty retail arena.

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

I would say, Seth, as we're looking out to a goal for merchandise margin in the future, we are factoring in the fact that it is going to be more promotional. So even with that, we still think that we can absorb that promotional intensity and still get our margins back to a high 50%s number.

Seth Basham - *Wedbush Securities - Analyst*

Very good. Thank you very much.

Operator

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

David Mann - *Johnson Rice & Company - Analyst*

Yes, thank you. Good afternoon. Another question on your store performance.

Given the decline in store traffic as well as I think you indicated less e-Commerce going through at the store level. What metrics or change in metrics would it take for you to accelerate the store closings beyond what you've already talked about?

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

Well, first of all, I think we've addressed that the smaller volume stores, that our stores are highly productive, very profitable. So even with a slight fallback in sales revenues, it doesn't push any of our stores into a negative contribution. So there is no impetus or need to think of a more drastic program really.

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

We always take a look at the economics of it and do an MPV on the closure and the transfer of the sales, and if it makes good sense economically on it then we'll do that. If it doesn't, and like Alex said, so many of our stores are profitable and highly profitable, so we'll continue to work through that.

We still think the 100 store target out there for about three years is an accurate number. But don't think there's an acceleration on that at this point.

David Mann - *Johnson Rice & Company - Analyst*

And then in terms of the store traffic and e-Commerce penetration for the fourth quarter, what might you be expecting at least directionally for the fourth quarter comp relative to what you saw in the third quarter?

Alex Smith *- Pier 1 Imports Incorporated - President & CEO*

Can you just say that again for us?

David Mann *- Johnson Rice & Company - Analyst*

Okay. The decline in store traffic and penetration of e-Commerce metrics maybe for the fourth quarter, directionally, how would you expect those to go, given your comp expectation?

Alex Smith *- Pier 1 Imports Incorporated - President & CEO*

Well, tomorrow I think or today is the last day we ship for Christmas. So the e-Comm participation does fall now for the next little while until after Christmas, and then it will pick up again in January. And that's obviously factored into our sales.

So relatively speaking, for the month of December, the stores become more important than e-Comm than they have been for the rest of the year, and then that will flip back again after the new year. So I didn't answer that very clearly, but I think you got what I meant.

Jeff Boyer *- Pier 1 Imports Incorporated - CFO*

The penetration levels will likely be somewhat similar to what they were in the third quarter, they're probably the same number. Good growth from last year's penetration in the fourth quarter of 12%, 13%. We showed some good growth on that, and it will get us to a similar penetration that we had this year of 15%, 16% e-Comm penetration in the third quarter.

David Mann *- Johnson Rice & Company - Analyst*

And then if I can ask a question about inventory. Your inventory levels, when you're talking about for year end, those will be down nicely. But they're still up about 15% versus a couple years ago.

So how should we think about that from an efficiency level? Should we -- is there more opportunities to take inventory down, or should we -- are theses the levels that you think are appropriate?

Alex Smith *- Pier 1 Imports Incorporated - President & CEO*

I think when we've spoken to you about this on previous occasions, we reminded you that for many years, we managed to keep inventory and sales growing at approximately the same rate. And then over last 18 months or some we got out of whack.

So our plan is to keep -- we'll get the inventory down this year, and then we'll bring it down a little bit further in FY17. So that over the next 18 months we're back to our normal trajectory where sales and inventory are in sync. So that's the plan.

David Mann *- Johnson Rice & Company - Analyst*

Great. Thank you very much.

Operator

Your next question comes from the line of Matt Nemer with Wells Fargo Securities. Your line is open.

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

Afternoon. Thanks for taking my questions.

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

Hey, Matt.

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

So I just wanted to go back to the exit surveys and the brand tracker research that you do. And I'm wondering if you can give us a sense for where the casual customer might be migrating to? What channels or specific retailers have been taking share?

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

Well I really don't want to give you the specifics of what we see in our research. But what I will tell you is this, is when you look at where customers shop other than our stores, it's not just one or two places. It's many places.

Because for a lot of customers, taking outside our very core customers who shop almost exclusively with you us, the rest of the enthusiastic home shopper, shops pretty much everywhere. She shops the other specialty stores, she'll shop the off-price stores, she'll shop the big box stores. So you don't see a preponderance of customers shopping in only one place.

It's very broad. And what our trackers tell us, they're not giving us specific market share data. They're just telling us other places where people shop.

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

Understood. The reason I'm asking, and this goes back to the margin structure question earlier. Is we're getting a lot of questions around whether Wayfair is a contributing factor to all the promo activity in this category. And if they are and they're running a 24% margin with 12% advertising, is that a structural change in the sector that causes us to be more permanently promotional and causes maybe more structural change in the industry?

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

Well I think what you have to think about is the types of shoppers there are. And there's been some pretty decent work put out about all of this, and this is the sort of thing that we look at. So if you take comparable women of the same income level, they don't all have the same attitude to how they shop.

Some, and I think I said some of this in the prepared remarks, some customers are exclusively price driven, and they'll go for price over everything else. And they won't be particularly loyal to where they shop. They'll just go for where the best deal is.

Other home shoppers are more interested in inspiration and experience as well as decent value. And those are the shoppers who predominantly are shopping with people like ourselves, where it's the totality of the experience, it's the value of the product, it's the value of our aesthetics of our marketing, and it's just a totally different experience. So I don't agree with the premise that one retailer is going to change the dynamics of the whole industry, because I don't believe that's the case.

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

Okay. Appreciate the comments. Happy holidays.

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

Thank you.

Operator

Your next question comes from the line of Kristine Koerber with Barrington Research Associates. Your lines is open.

Kristine Koerber - *Barrington Research Associates, Inc. - Analyst*

Good afternoon, or good evening. So I was just wondering as we think about the promotion of the step-up in promotional cadence going forward, do you expect to do more across the board discounting? Or do you plan to go deeper in select categories, what you've been doing in the past?

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

As you know, we've experimented with various a approaches to that, and I think the answer is it's going to be some of each. I think there are going to be some occasions when we want to do across-the-board promotions. You may have seen that we had a family and friends event in November where we did a percentage off regular price, and that was successful for us.

But then also as you see, we're doing now in Christmas where we've got percentages off categories. We feel that that's more appropriate to channel customers towards the categories that are important for the time of year. So I do think it's going to be a blend, but I would say on balance, we veer towards category promotions rather than blanket discounts.

Kristine Koerber - *Barrington Research Associates, Inc. - Analyst*

Okay. And then what is the timing of the return to television advertising?

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

Spring, first quarter.

Kristine Koerber - *Barrington Research Associates, Inc. - Analyst*

Okay. And then lastly, you talked about trends around Thanksgiving holiday. Can you give us some idea what the monthly trends were during the quarter?

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

Sure. It's September and October, we were reasonably happy with. November we were not happy with.

Kristine Koerber - *Barrington Research Associates, Inc. - Analyst*

Okay. Thank you.

Operator

We have time for one final question. And that question comes from Cristina Fernandez with Telsey Advisory Group. Your line is open.

Cristina Fernandez - *Telsey Advisory Group - Analyst*

Thank you. Good evening. I just had one question. Can you share with us what the sales transfer rate has been of the 26 stores you closed in the first half of the year, and if that is meeting your original expectations?

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

I'll tell you what the blended transfer rate is, and it's as much an estimate still at this point given we're still measuring that actual. So we use an estimate of transfer rate really of anywhere from about 10% to 20%.

It tends to balance out on average for the stores that are being consolidated to actually the mid-teens on it. So it ends up being a blended rate of close to 15% for a rough number to use.

Cristina Fernandez - *Telsey Advisory Group - Analyst*

Are those sales mostly going to other stores or is the bigger part of it going online?

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

Our estimate is mostly going to other stores when we're doing that estimation.

Cristina Fernandez - *Telsey Advisory Group - Analyst*

Thank you and good luck this holiday.

Jeff Boyer - *Pier 1 Imports Incorporated - CFO*

Okay. Thanks, Cristina.

Alex Smith - *Pier 1 Imports Incorporated - President & CEO*

Okay. Well, thank you everybody for listening, and we'll talk to you in the new year. Thank you.

Operator

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