Kirkland's, Inc. [KIRK]
Q1 2020 Earnings Conference Call
Thursday, June 4, 2020, 9:00 AM ET

Company Representatives:
Tripp Sullivan; SCR Partners, Investor Relations
Woody Woodward; President and Chief Executive Officer
Nicole Strain; Executive Vice President and Chief Financial Officer

Analysts:
John Lawrence; Baraboo Growth

Presentation:

Operator: Good day, and welcome to Kirkland's First Quarter 2020 Earnings Call. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Tripp Sullivan of Investor Relations. Please go ahead.

Tripp Sullivan: Thank you. Good morning, and welcome to Kirkland's conference call to review results for the first quarter of fiscal 2020. On the call this morning are Woody Woodward, Chief Executive Officer, and Nicole Strain, Chief Financial Officer.

The results, as well as notice of the accessibility of this conference call on a listen-only basis over the Internet, were announced earlier this morning in a press release that has been covered by the financial media. Except for historical information discussed during this conference call, the statements made by Company management are forward-looking and made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements involve known and unknown risks and uncertainties which may cause Kirkland's actual results in future periods to differ materially from forecasted results. Those risks and uncertainties are more fully described in Kirkland's filings with the Securities and Exchange Commission, including the Company's annual report on Form 10-K filed on April 10, 2020.

I'll now turn it over to Woody.

Woody Woodward: Thanks, Tripp.

I'm proud of how nimble and resilient our team has been throughout the last several months. Many of our customers were at home looking at their walls through this period and decided to make some changes. When they were ready to shop, we were ready for them. The adjustments we made to our business model, the rightsizing and the significant upgrading of our merchandise assortments all came together at the right time. I would also like to acknowledge the continued support and partnership with our vendors, who enabled us to work through this unprecedented time. They deserve much of the credit for the improvement in our trends.

We've learned a lot about ourselves, our customers and what our team is capable of achieving during one of the most challenging periods in the history of retail. There are many aspects of the home furnishings industry that are already returning to normal. But, as we have seen with a number of announcements of store closings, competitors liquidating and consumers adopting new shopping behaviors and priorities, there are many aspects of the business that might not ever be the same again.

We think that's a good thing for the future of Kirkland's. We started 2020 with tremendous momentum from the significant year of transformation achieved in 2019. The key priorities we outlined a few months ago continue to guide us through 2020 and beyond and provide the foundation for the confidence we have in our business for the balance of the year.

Before I get into what's driving that confidence level, let me update you on where we are with these priorities. Recall that our goal is to be in the consideration set for a complete decorating project, in addition to the finishing touches. We want our customers to see us as the resource for furnishing a home of any size on a budget, and we want to continue to move away from the mass merchant retailers to be the value home retail store within the specialty world. That all starts with further accelerating our product development to reinforce quality and relevancy.

For the balance of the year we will continue to build on the tabletop and other select furniture pieces and we continue to test upholstery. These new assortments are resonating with our customers, and as Nicole will discuss later, are selling at a higher margin rate than a year ago.

We also set a goal to improve omnichannel via website enhancements, incremental digital spend and expanded online assortment. We also want an in-store experience that closely is aligned with our omnichannel capabilities. Based on the strong e-commerce sales before, during and after the pandemic, especially in fiscal May, I believe e-commerce will remain a key driver of our overall business strategy. With buy-online/pick-up-in-store now in place in all of our stores and the improvements we've already completed in our supply chain with the replacement of our distribution center with three more efficient hubs operating by third quarter, we can support that growth with better speed and profitability.

While we expect to keep our overall marketing spend flat with last year, we're investing in improvements to the customer experience to drive customer acquisition and brand awareness. Over the next several months we are relaunching our loyalty program and will offer extended credit options and broader delivery options beginning this quarter. Additionally, we will utilize our hard won, leaner infrastructure to be nimbler in our response to changes in customer preferences and buying behaviors. These last few months have brought us closer to the customer. They've told us, and the results bear it out so far, that they've missed Kirkland's and they've really leaned in to the stores they like. And, lastly, we'll continue to preserve our capital to invest in the business. Nicole will describe in a moment the extensive measures we took to keep us on track for our year-end goal of no debt and positive cash.

Now, in closing, let me spend a few moments on four reasons why we're confident about the direction of our business for the balance of the year. First, we took the opportunity to right-size the Company and make it nimbler than it's ever been. That capability was on display very early on and in the pandemic, when we were one of the first in the country to stand up contactless curbside pickup to great success.

Second, we have less store-based competition. With the ongoing liquidation of Pier 1 and last week's announcement of Tuesday Morning's bankruptcy and the closing of a third of their stores, we are seeing a significant amount of our stores lose competition within their markets.

Third, we entered the pandemic with strong trends in the stores and online and those accelerated online while the stores were closed. And the trends have returned in both channels since the stores have begun reopening.

Fourth, our online business is being fueled by margin-friendly promotions and first-time shoppers.

Collectively, these four factors have had a positive effect on our results to date in the second quarter. While there is much work ahead of us to continue to translate this confidence and nimbleness into sustained results, we believe we have a more favorable environment in which to operate and innovate going forward.

Now I'll turn it over to Nicole Strain, our Chief Financial Officer.

Nicole Strain: Thank you, Woody. I would like to begin by also expressing our appreciation for our store employees, our distribution center employees and those in our corporate offices. The past few months have been more challenging than we ever would have expected and I am proud of the strength, flexibility and the loyalty of our teams. You are the core of Kirkland's and the reason we will be successful. I would also like to thank our vendors, landlords and other partners. What we have asked of them during this time has been difficult and, in many cases, added hardship to their businesses and we are grateful.

Our first-quarter results were significantly impacted by the temporary closure of our stores for the second half of the quarter. I want to touch on a few highlights of the quarter and the first month of our second quarter, and then move to the actions we have taken and how we expect those actions to benefit the remainder of this fiscal year and beyond.

For the quarter, our comparable sales were down just under 40%, with February flat to the prior year and the other two months impacted by the slowing demand in early March, followed by the store closures on March 19. The positive comps and momentum we experienced in the fourth quarter continued into February, which gives us confidence that the merchandise changes we made are working.

The e-commerce comp for the quarter was 32.3%, with a slow March as consumer demand focused on essential products, and increasing to 97% in April. Our third-party dropship revenue has been particularly strong, with an over 80% increase for the quarter and over 200% in the month of April. During the quarter we closed 27 stores. Product margin for the quarter was down 340 basis points from the prior year, and down 140 basis points in the month of April, which included the shift to a higher mix of e-commerce sales and, more specifically, dropship sales.

We recorded an impairment charge within the quarter of $3.2 million, which included $2.2 million related to fixed asset impairment at 16 stores whose carrying value exceeded their fair value, and $1 million for right-of-use asset impairment at 6 stores.

The results of the quarter also include the continued pay of certain employees while the stores were closed, as well as fixed occupancy, distribution center and corporate overhead expenses. Further, we continued to pay merchandise and freight costs and other essential payables.

Our earnings per share for the quarter was a loss of $0.53 compared to a loss of $0.62 in the prior-year Q1. The tax benefit allowed by the net operating loss carryback provision of the CARES Act had a significant benefit on the quarter. Adjusting for store closing costs, severance, asset impairment, the tax benefit from the net operating loss carryback and the tax valuation allowance on our remaining state deferred tax assets, the adjusted loss per share was $1.29 relative to a loss of $0.51 in the prior year. We did not adjust for the store closures or any additional impacts of the pandemic. As of the end of the quarter we had $30.1 million of cash, $40 million drawn on our revolving credit facility and $22.6 million remaining availability on this facility.

Now for a quick update on where we stand today and some preliminary results for the month of May. We continue to be encouraged by our sales and margin trends. For the month of May we had a flat comp, which included an increase in e-commerce sales of 95%. This comp increase is with less than half of our stores open to customer traffic going into the month, with stores adding as stay-at-home orders lifted.

We used the limited overall demand during the store closures to reset our mindset on discounts and the results continue to be encouraging. We have, and will continue to offer, incentives to purchase and offers to drive traffic to our stores and our website, but with lower depth of offer and limited stocking. For the month of May our product margin exceeded the prior year by over 150 basis points. We intend to continue this discipline as we move forward.

As of today we have 357 of our 404 stores open to customer traffic, with reduced hours of operation; 43 stores with curbside pickup only; and another 2 stores in the process of permanently closing. We have over $17 million of cash and have repaid $20 million of the $40 million draw on our credit facility. Other actions taken during the store closures include: We paid our part-time team members during the first two weeks of store closure and continued to pay our store managers and key employees at reduced rates for the entire period of closure. This allowed us to reopen our stores quickly as stay-at-home orders were removed. The furlough of part-time store employees and the reduced store hours upon reopening resulted in a $5.6 million reduction of labor expense compared to the prior-year quarter. We expect the reduced store hours and more efficient labor model to have a significant benefit for the remainder of the fiscal year.

We permanently reduced a third of our distribution center indirect labor and furloughed additional direct labor according to demand, which resulted in a $900,000 reduction in cost in Q1. We utilized the remaining distribution center resources to ensure our supply chain projects remained on track, which include the implementation of the warehouse management system, consolidation of our 2 Jackson, Tennessee distribution centers, and the stand up of 2 regional e-commerce hubs, one in each of the second and third quarters. These projects will benefit supply chain costs and speed of shipment to customers ongoing.

We significantly reduced store transportation expenses, with limited deliveries to stores and the delay or reduction of merchandise receipts, which resulted in $5.2 million of expense reduction relative to the prior-year quarter.

In April we reduced our corporate office headcount by 18% in addition to the 14% reduction in January, for a total annualized expense reduction of $8.4 million. We temporarily reduced the salary of the executive leadership team and our board of directors. We reduced our corporate office space by a third and implemented a further reduction across all corporate overhead expenses. For the quarter alone, the result was a $3.1 million reduction in expense relative to the first quarter of 2019.

We realigned advertising expense to 2019 levels as a percent of sales and further shifted the funding to digital, which has been effective over the past 2 months, driving sales and introducing new customers to Kirkland's. Our merchandise team worked tirelessly with our vendors to cancel or delay orders, which removed over $80 million of merchandise received from our plan, which were heavily weighted to the second and third quarters. This will allow us to sell through our current inventory without reaching levels significantly above our plan and also open up receipts for our important seasonal merchandise. These receipt reductions will have the largest benefit to our cash flow in the second and third quarters.

We have, and continue to work with our landlords to negotiate rent abatements or deferrals during the period when our stores were closed. As we reach agreements with landlords, we are paying current for the terms of the agreement. We expect to have these completed in the month of June and be back to normal payment timing. As part of the landlord negotiations, we do expect further store closures in this fiscal year as we exit out of unprofitable locations and continue to optimize our brick-and-mortar footprint.

Lastly, related to benefits provided by the CARES Act, we have filed our 2019 tax return, taking advantage of the expanded net operating loss carryback provisions and expect a refund in excess of $12 million within the third quarter. We recognized a payroll tax credit in the amount of $1.4 million in the quarter through the qualified wages credit for wages paid to employees not working and we will continue to defer the employer portion of payroll taxes for the remainder of the year, which we expect to exceed $2 million and must be repaid half in each of 2021 and 2022.

With our expected sales trends and the actions we have taken to reduce expenses and improve cash flow, we expect to continue to build cash throughout the year and end the year with positive cash and no outstanding borrowings. We further expect the leverage of the actions taken and the acceleration of our infrastructure changes to return Kirkland's to profitability.

And, with that, I'll turn it back to Woody for some closing comments.

Woody Woodward: Thanks, Nicole.

I want to thank our employees, who work so hard every day to make Kirkland's a special shopping experience, and our customers who are visiting our stores and online. With that, I'll turn it over to any questions you may have.

Questions & Answers:

Operator: We will now begin the question-and-answer session. [Operator Instructions] Our first question will come from John Lawrence with Baraboo Growth.

John Lawrence: Woody, would you start off just a little bit -- and you talked about, I guess in February, continuing the momentum from the fourth quarter. You gave us a lot of information at the end of the year about some of those categories that you stood up. Just can you sort of continue that discussion a little bit on the things -- the tabletop, I guess the bedding and just some of those trends? And obviously once it got into March everything changed, but just some of those merchandise categories that you feel good about and those changes, if you don't mind.

Woody Woodward: Sure. Good question. Thank you, John. I think that the answer has probably got two parts to it. One part is the ongoing upgrade of our design and style over all categories and the effort to really improve quality. One of our initiatives over the past couple of years has been to start doing some direct sourcing. And that allows us to have more exclusive merchandise at better price points. And rather than take all that margin benefit, we've put a lot of that back into the quality. And I think we're getting noticed from the customer that our products are better quality and still reasonably priced. And so that's kind of the overall.

The other part of it is -- before I talk about the new categories -- is that furniture has continued to be strong for us. And part of that is the upgraded quality and more concise direction and really a look that we're starting to own in the marketplace, and not looking like we're trying to please everybody. But we've got a really special look in our stores right now and it's resonating with the customer.

On the new categories the runaway success has been the tabletop. We entered that category because we knew that that was strong in other retailers and we were not in that particular category. So our dinnerware, tabletop textiles, glassware, flatware have all been a runaway success. And for the third and fourth quarter we are expanding the space within our stores to show a widened assortment of those goods. They're margin-rich. They build a relationship with the customer in that they can buy products and then come back and add to it and layer on for the holidays. So it's a really great category for us to be successful in.

A little bit less successful, but still doing well, was our rug category. And we're just finding our way and making sure that we have the right looks for our stores. We're very committed to it. We put a rug fixture in the stores. And that's one of the ones where we're kind of editing and changing the assortment to be more relevant to what the customers are asking for.

The third one, bedding, has been our slowest to come around. But it is still an opportunity for our future. And so we're fully committed to that and we are editing the assortment and adding and subtracting. And it's been overall a fairly good success, but not a runaway success like the tabletop.

The last one, and our add for this year, is our add of upholstery. We've got a grouping of four recliners that we have in all stores and they're doing very, very well. And it's something that the customer can really relate to and they have kind of a cool, casual look that looks farmhouse-related. And they come from a vendor that's really well known -- Lane -- in the industry for making a really great quality recliner.

And then we're also testing in several stores a full blown upholstery program that we will monitor very closely and roll out to stores as appropriate. We needed to get some other things in place to make the upholstery category, the full upholstery category, successful. And those would be -- we mentioned in our call -- the addition of credit programs so that people can finance for 12 months with no interest, delivery programs where it's just a simple delivery within the marketplace or a white-glove delivery, per the choice of the customer.

And so all these things work hand in hand. But I think the one thing -- and when we're talking about merchandise assortment and relevancy -- is the clarity of direction in our stores. We picked a color. We picked Lane. We are not trying to be everything to everyone. We're just being really successful in that casual American farmhouse look and that gives us a lot of legs to be able to be flexible and continue the program going forward.

So thanks for the question.

John Lawrence: Thanks. And just to add on to that, some of the old traditional categories I assume continue to get squeezed. Is that correct?

Woody Woodward: Well, yes and no. So we had to go through a real process of looking at every category and doing a financial look at everything. And so some categories did get expanded. We're really well known for our harvest and our Christmas programs, so those have expanded. Our candle category has really expanded because it's something that customers are telling us they love.

Other categories were probably over-spaced. I will tell you that we were able to get our entire upholstery presentation in our stores that are testing that program without reducing -- taking categories out of the store. So I felt really good about that. So I think we were just oversized.

Art is an area that we're now getting some pretty good responses on. But it took a little bit of a space reduction. And then lighting was something that we had been struggling with to be differentiated in. So we took some spacing away from lighting.

John Lawrence: Great. Thanks.

Operator: Showing no further questions, I would like to turn the conference back over to Mr. Woodward for any closing remarks.

Woody Woodward: Just thank you for calling or coming on the call today. We appreciate your attention and we look forward to the balance of the year. Thank you.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.