Kirkland's, Inc.
Third-Quarter 2020 Earnings Call
Thursday, December 3, 2020, 9:00 AM ET

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

Analysts:
Jeremy Hamblin; Craig-Hallum Capital Group
John Lawrence; Baraboo Growth
Chris Sakai; Singular Research
Matt Schwarz; Maze Investments

Presentation:

Operator: Good morning, and welcome to the Kirkland's Third-Quarter 2020 Earnings Conference Call. [Operator Instructions] Please note this event is being recorded.

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

Tripp Sullivan: Thank you. Good morning and welcome to Kirkland's conference call to review results for the third 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, and quarterly reports on Form 10-Q filed on June 4, 2020, and September 9th of 2020.

I'll now turn it over to Woody.

Woody Woodward: Thanks, Tripp. And thank you to all of our Kirkland's team members who take care of our customers and each other in our stores, distribution center and home office. They make this success possible.

This quarter represents a continuation of the momentum we established late last year with steps we took to make the company nimbler than ever. We now have a better cost structure, a more efficient infrastructure, a merchandise mix that continues to improve and an overall far cooler plan. Our ultimate goal is to be a specialty retailer where customers can furnish their entire home on a budget. We're at the

beginning of a cycle where we are making that goal achievable at Kirkland's and making these improvements sustainable.

These are exceptional results we are reporting for the third quarter, which sets up well for what is typically our strongest quarter of the coming year. Unlike past years, when the third quarter was mostly about creating a launching point for maximum velocity in the fourth quarter, we were able to generate a positive store comp, an e-commerce comp of nearly 50%, an increase in our cash position to $37 million, GAAP earnings of $0.82 and adjusted earnings of $0.66.

The significant improvements in our merchandise and gross margin and the reduction in operating expenses were evident in the results, in addition to big contributions from e-commerce. We generated a 1.2% increase in net sales, with 51 less stores from a comparable period a year ago, with an 8.9% comp in total for the quarter.

For November we were able to maintain strong momentum, particularly in e-commerce, and continued to prioritize margin and profitability. While Black Friday has become more spread out over the month, we were still pleased with the sales that day and on Cyber Monday as well. The shift to online at the expense of store traffic that we had previously referenced was evident last month and we were able to capture that demand.

There are a number of well documented trends in the industry that are working in our favor with people staying at home, shopping online, as well as less store-based competition. We've gained market share, with several of these competitors in bankruptcy or liquidation, and our omnichannel presence has put us in the right place at the right time. We got the message that customers love to buy online and they are leading us to the right places. However, there are far more trends occurring within our business that we are creating, that are within our control and, more importantly, we believe are sustainable over the long term. I want to spend a little time this morning exploring these adjustments in our merchandise mix and model in more detail.

We have purposely brought our existing customers with us on this transition in our merchandising strategy. We didn't leave them behind while we grew the customer base. I recognize that was a concern for most brands that have undertaken a transition like we have taken over the past two years. But we didn't abandon our price points. We left our customers options to buy with better quality and have a relevant assortment at a great value. We've maintained a steady pace to improve quality with stable pricing because we've taken a portion of the savings gained from our direct sourcing strategy and put it into the quality of the merchandise. As I've noted before, the customers are already getting the improvements we're putting out there. They're seeing the improved quality and improved design as well. They're increasingly coming to us for their complete decorating projects instead of only buying the finishing touches.

A great example would be in our furniture assortment. Along with tabletop, furniture has been a runaway success for us. In that category we've been able to improve our product from non-wood to full-wood furniture at the same price point. The transformation we are making in our existing model is evident in our more effective marketing, to continued growth and profitability of e-commerce and the significantly improved margin profile and leverage inherent in our business. Our marketing is on point and we have a more mature way of handling promotions.

The big initiative we have been ramping up is the launch of our new loyalty program that took place the third week of October. In the weeks since that launch we are seeing an increase in sign-ups and we've already added hundreds of thousands of people to our loyalty program.

During the quarter, e-commerce accounted for almost 24% of our sales compared to 16% of total sales just a year ago. And e-commerce was profitable in every month of the quarter for the second quarter in a row.

Our ship-direct-from-vendor channel was up 122% for the quarter, with 480 basis points of margin gain. As we noted last quarter, in the very near future we expect to add some select brands in this channel as we grow with a focus on extending from where we've been strong in kitchen and tabletop. The dedicated group within Kirkland's that focuses on this channel has made a lot of progress since we formed it earlier this year and we expect to have more to report early next year and in the years to follow.

During the third quarter we replaced our existing e-commerce distribution center with 2 more-efficient hubs. These hubs should begin to help the profitability in our ship-direct consumer channel beginning in the fourth quarter. The store base is more productive, with 51 less stores. The growth in e-commerce is offsetting the lost sales from these closed stores, but we are still working to overcome the challenges with foot traffic in the stores. This is not a problem unique to Kirkland's and is more structural in nature. But we have a higher markup in an increased basket in the stores that we believe is sustainable.

We were clearly able to be more productive with a tighter inventory position than in past years. As Nicole will describe later, the tighter inventory is somewhat of a governor on our top line this quarter and next. This is partially a legacy of the orders we needed to cancel during the pandemic and also supply constraints across much of the sector. Though we might have fewer SKUs in the short term, we are selling at a higher price point, we are maintaining a promotional discipline and we are getting a larger portion of the newer products.

The leverage in our model is substantial, with the $45 million of annualized operating costs we have pulled out of the business through cost containment, the efficiencies and changes in our labor costs and staffing model. While the right way to think about this improvement is more sequential than a year-over-year basis in terms of our overall profitability, we believe our 2-to-3-year EBITDA margin targets are certainly achievable.

With the cash we generated this quarter, the level of cash we are now expecting at the year-end and the increased visibility of the business, the Board has authorized a new $20 million stock repurchase authorization. We noted last quarter that we wanted to see another quarter of results before we considered allocating capital to repurchasing. With our expectations that we will be debt-free at year-end and cash is expected to grow in our historically strongest quarter, we believe this is a good way to deploy a portion of our capital.

Nicole, why don't you walk us through our results in more detail?

Nicole Strain: Thank you, Woody.

What we saw in the third-quarter results was the incremental consumer demand that is benefiting many of our home decor competitors, but also the beginning of what our model can look like with the foundational changes we have initiated. Within the quarter we had strong e-commerce sales, with a year-over-year increase of 50%. Our store traffic improved from Q2 levels and outperformed our segment and ShopperTrak, which continues to be negatively impacted by pandemic-related challenges.

The changes we have made to improve the quality and design of our merchandise, as well as category shift towards higher-ticket items, continues to have a positive impact on our sales. We had early sell-through of our harvest seasonal merchandise and a similar trend in our Christmas collection, which led to a November sales comp increase of 5.5%, which included a year-over-year increase in e-commerce of

over 50%. We saw a significant increase in our gross profit margin of 840 basis points, which was driven largely by gains in product margin from simplifying our promotional message and also reducing the depth of offers and the inherent stacking of entire-store couponing. We will continue to move towards more targeted customer-specific discounting, while always having incentives to encourage customers to purchase.

We benefited from lower store occupancy costs from the closure of underperforming stores and negotiated rent reductions. We also saw favorability from lower freight costs from our DC to our stores, driven by lower inventory levels and a rate decline compared to 2019.

Gross profit margin was negatively impacted by e-commerce shipping, with online sales making up 24% of our total sales and the store-fulfilled node dropping to 35% of e-comm sales. We do expect the percent fulfilled in store to moderate closer to 45% to 50% in the midterm.

Finally, distribution costs increased year-over-year, driven by a capitalization entry based on inventory level and timing.

We saw the benefit of our cost reductions with the decline in operating expenses of 810 basis points, or $11.3 million, driven by the more efficient store labor model, corporate headcount reductions and a justification exercise for all overhead expenses. Excluding current-year performance-related compensation accruals, this represents a 25% reduction in operating expenses, which we expect to be largely sustainable.

We expect to continue to see improvements in profitability from higher margins and reduced costs, along with further leverage from continued growth in top-line sales, all of which should better position us to reach our long-term financial goals.

Breaking down the comparable sales increase of 8.9%, we had strong comp increases in the first 2 months of the quarter, driven by the earlier sell-through of seasonal harvest products, followed by a drop-off to a flat comp in October, with seasonal sales having been pulled forward into September. As a reminder, beginning in September of last year we were much more promotional, so we are comping that impact on both sales and margin.

The 49.9% e-commerce comp increase was driven by the direct-to-consumer channels. With our third-party drop-ship revenue up 122% and our own products shipped directly to customer up 77%, both of which were offset by lower increases in the store-fulfilled channels. During the quarter we closed 6 stores, resulting in a count of 381 stores. Year to date we have opened no new stores and closed 51 underperforming stores, or 12% of the store base since the start of the year. We expect roughly 10 additional closures near the end of the fiscal year, but we are still working through negotiations with landlords.

Gross profit was 36.1% of sales compared to 27.7% in the prior-year quarter. Of the 840 basis point increase, 940 basis points related to an improvement in landed product margin, primarily from reduced discounting. Direct sourcing accounted for roughly 100 basis points of the landed product margin improvement. In the latter part of the quarter we saw initial cost pressures from shipping constraint and rate premiums, specifically on products sourced from China. While we have clearly been able to navigate through these pressures and we expect significant year-over-year margin improvement in the fourth quarter, the negative impact on landed margin is expected to increase throughout the remainder of the fiscal year, causing year-over-year gains to be less than what we experienced in the third quarter.

Store occupancy costs declined by 300 basis points from the prior year due to the closure of underperforming stores, negotiated rent reductions and the leverage in increased sales. Breaking that down, 280 basis points was generated by rent restructuring and the remainder by sales leverage.

On the prior call I mentioned that close to a third of our leases had a term renewal in the next 6 to 12 months. We are actively working through those renewals and are continuing to have success in locking in lower rates.

Outbound freight, which is the movement of our merchandise from the distribution center to the stores, decreased by 70 basis points from the 2019 quarter, driven by reduced routes, rate decreases and sales leverage. The reduced routes were driven by store closures and fewer routes to continuing stores, primarily due to higher inventory levels in the prior year. We also saw a rate reduction of roughly 10% year-over-year.

DC costs increased 170 basis points, driven by the timing of inventory capitalization and the year-over-year decline in inventory. Excluding this timing effect, distribution costs declined by 20 basis points, with productivity improvements offset by the channel mix shift with labor costs of pick-and-ship e-commerce orders exceeding labor costs to ship cases to our stores as a percent of sales.

We completed the closure of the Jackson e-commerce distribution center at the end of September, reallocated a portion of our retail distribution center to fulfill e-commerce and stood up our second e-commerce hub within the quarter. This reduced our distribution center total square footage by over 200,000 feet, or roughly 16%, and placed e- commerce distribution much closer to the end customer, which will decrease parcel costs but also improve speed to the customer. We are still in a ramp-up mode for these new facilities and expect to improve throughput and efficiency in the upcoming year. E-commerce shipping costs increased 180 basis points as a percent of total sales due to the higher mix of ship-to-home sales.

Operating expenses, excluding impairment, improved to 27% of sales compared to 35.1% in the third quarter of 2019, or a reduction of $11.3 million on a higher sales base. Store operating expenses made up 600 basis points of the reduction, driven by the store labor model implemented at the beginning of the fiscal year and aided by our reduced operating hours, leverage from closing underperforming stores and the overall review of operating costs. E-comm operating expenses increased 10 basis points as a percent of total sales but leveraged 160 basis points as a percent of e-comm sales as dollars increased by only $167,000 on the $12 million growth in revenue.

Advertising expense declined by $1 million, or 70 basis points, compared to the prior year, which included advertising support for the new product category rollout. We continue to shift our spend heavily towards digital channels.

Corporate operating expenses decreased by $2 million, or 140 basis points, driven by reduced headcount, reduced corporate office space and an overall expense review. Performance-related compensation accruals in the current year account for an additional 100 basis points relative to the prior year.

EBITDA, excluding impairment and other minor non-operating expenses for the quarter, was $18.7 million, or 12.7% of sales, compared to a loss of $3.1 million in the prior-year quarter, or an improvement of $21.7 million.

For the quarter, our tax rate was based on a year-to-date discrete calculation further impacted by a valuation allowance. A normalized rate of 23.3% was used in the non-GAAP adjusted calculations.

Our earnings per share excluding non-cash impairments, normalized tax rate and other minor non-operating adjustments, was $0.66 compared to a loss of $0.53 in the prior year. The GAAP earnings, including these items, was $0.82 compared to a loss of $1.61 in the prior year.

We ended the quarter with $37.2 million in cash and no outstanding debt, which is a build of $9.6 million from the Q2 level and an increase of $33 million year-over-year, $58 million considering the revolver draw in the prior year. Combined with availability on our revolving credit facility we have total liquidity of $106.9 million. With our typical cash build in the fourth quarter, we expect to conservatively end the year with approximately $65 million to $75 million of cash. We do not anticipate any borrowings for the remainder of the year.

Inventory at the end of the quarter was $83.9 million compared to $140.2 million in the prior year, or 40% lower. The prior-year levels were elevated by the rollout of new categories and we currently have 12% fewer stores, but we are down approximately 20% to our plan.

The significant receipt cuts we made while our stores were closed in April, followed by vessel and port shipping constraints, has impacted our sales to some degree since the latter part of the second quarter. Because we protected seasonal buys, the inventory shortages have been in our core everyday products and have been much deeper in some key product categories. We expect to continue to see a sales impact in those categories in the fourth quarter, but expect to return to near-planned inventory levels by the end of the fiscal year.

Year-to-date cash provided by operations was $14.5 million compared to cash used of $62.4 million in the prior year, or a change of $76.9 million. The improvement is due to better operating performance in the second and third quarters, $42.3 million improvement year-over-year, and changes in working capital, $34.6 million year-over-year improvement. The working capital changes are primarily driven by lower inventory levels offset by lower related accounts payable. Additionally, we received a $12.3 million income tax refund from the CARES Act NOL carryback in the second quarter.

Capital expenditures were $7.6 million compared to $12.8 million in the prior year and were primarily driven by investments in supply chain and e-commerce. We still expect capital spend to remain below the low end of the initial range we communicated of $10 million for the year.

The financial goals we provided on the second-quarter earnings call continue to be low as we execute the transformation of our business over the next two to three years. We summarized those goals in our earnings release this morning. Rather than reading through those again, I'd like to reinforce the overall message we're communicating with our long-term annual financial targets.

Firstly, I'll indicate how we expect to achieve top-line growth, margin improvement and cost reductions over this multi-year period, with specific targets to improve our gross profit rate to the low- to mid-30% range, improve EBITDA margins to the high single-digit range and increase operating income margin to the mid-single-digit range. Second, it's worth noting that those are annual targets. With the seasonality in our business, we typically see stronger performance in the second half of the year compared with the first half. And, lastly, from a liquidity perspective our main goal will continue to be maintaining a healthy balance sheet.

Within this model we expect to generate excess cash annually and will allocate first to projects to drive growth and/or reduce costs, but are also happy to announce that the Board authorized a $20 million share repurchase program. We intend to be disciplined and opportunistic with our share repurchase program and will provide updates with each earnings announcement regarding activity under the plan.

And, with that, we are now ready to take questions.

Questions & Answers:

Operator: We will now begin the question-and-answer session. [Operator Instructions] And our first question will come from Jeremy Hamblin of Craig-Hallum Capital Group.

Jeremy Hamblin: Thank you and congratulations on the really strong results. I wanted to start by asking you about the composition within your same-store sales for Q3. What did you see on average ticket in the quarter and how was that split between average unit retail and units per transaction?

Nicole Strain: So we saw basically a 20% increase in the quarter in average unit retail. Our items per transaction held relatively consistent.

Jeremy Hamblin: Got it. And in terms of -- you provided so much great detail that I missed some of the things. But in terms of the components of the 840 basis point year-over-year improvement in gross margins, could you just run through those again?

Nicole Strain: Sure. So product margin, it was favorable by 940 basis points; e-comm shipping unfavorable 180 basis points; store occupancy favorable 300 basis points; outbound freight favorable 70 basis points; DC costs unfavorable 170 basis points. That was a timing in an accounting entry that will flip in the fourth quarter. And then miscellaneous other unfavorable 120 basis points.

Jeremy Hamblin: Okay, got it. And then just looking forward and kind of running through how those various components you expect to play out here in Q4. It sounds like, again, there is maybe some impact on your inventory levels and maybe not quite as much product margin benefit in the quarter. But can you run through kind of your range of expectations around those particular line items?

Nicole Strain: Yes. I think the only thing I would say there and the only real difference going from Q3 to Q4 is the inbound freight that we talked about. And, again, we still expect to see significant improvement. It may be closer to the Q2 level than the Q3 level. We will continue to have favorability in the store occupancy line. We will likely still have unfavorability in e-comm shipping, just based on consumer preference, that likely continues throughout the rest of the year. The DC costs, timing impact that we had in this quarter, we would expect to see some of that reverse into the next quarter. So that one will definitely flip.

Jeremy Hamblin: Got it. And I wanted to just get into the direct sourcing initiative here. That looks like that's been a big success improving quality of product and keeping prices low. What have you learned so far in the last 12 months from this initiative? And how do you expect -- because I'm guessing that you probably see margins that would be 500 to 600 basis points lower on the direct source versus third-party source. But how do you expect to use the potential benefits of that program? Is it going to be going to the consumer in the form of lower prices? Is some of that going to flow through to your bottom line in terms of higher gross margins? Any color you could provide on that?

Woody Woodward: Thanks, Jeremy. First of all, what we've learned so far on direct sourcing, since it's new for our company, is slow and steady is what wins the game. I mean, we might have gone a little faster on direct sourcing, but remember this is infrastructure change and it's a change to our company. There's been a couple unknowns that we've received from the direct sourcing. One of them was the sharper price points we got from our wholesale vendors that were knowing that they were now going to

compete with us if we were getting direct sourcing pricing. So there's been kind of a benefit on both sides. But the better pricing, certainly the better quality, has been out there for both sides of the fence, both the direct sourcing and the wholesale sourcing.

The other thing is that we are still in the ramp-up stage. This is a multi-year program that will help us. We've learned that we need to provide more design information to get the kind of products that we're looking for. And I would say that from a costing standpoint we're just at the beginning of realizing where those costs can be passed onto the financial benefits of the company, or whether we should be doing continued upgrades of quality. But we are further along on the quality upgrades, so more and more of the benefit, I think, comes just in a financial way as we grow that sector of the business. But like I said at the very beginning, slow and steady is the way to go on this sourcing, because there's lots for us to learn. Remember that most of our competitors do the majority of their sourcing through direct sourcing and we're still at the early stages of that. I do think that it's helping the look of our product in our stores with more exclusive and more cohesive and certainly more design-oriented. And we've been able to maintain prices and give better quality.

Jeremy Hamblin: Great. Thanks for that color. And then, in terms of thinking about -- you've got, I think, a 2- to 3-year target of getting to 40% to 50%. Can you give us a sense of where you might expect to be 12 months from now on your direct sourcing initiative? Are we going to be looking at 30%, 35%? Or how much progress can you make in 2021?

Woody Woodward: We'll make more progress in '21 because remember that in this year we had to cancel a significant amount of orders due to the pandemic and a lot of those orders were direct sourced. So I would say that growing it by 10, 15, even 20 basis points -- and we're going to let it happen naturally and organically. Because we don't want to force it, especially since our other vendors are coming through with such desirable price points and we need to make sure that they get the benefit of being long-term Kirkland suppliers. And so we're looking at it very evenly. But it is a huge opportunity for us over the next 2 or 3 years.

Jeremy Hamblin: Great. And then on your loyalty program, I wanted to -- you mentioned that you've gained a substantial number of customers here just in the last 6 weeks. Where does your total loyalty program stand? And are there additional benefits to thinking about -- additional color, I should say, on how those loyalty members are spending versus your non-loyalty customers in terms of ticket size, frequency of transactions, et cetera.

Woody Woodward: Jeremy, let me take the first part and then I'm going to turn it over to Nicole because she might have some very specific information on -- remember that our loyalty program is a multi-phase program. We launched it, but there's a lot more excitement coming as we learn more about what triggers customers' behavior, as we get more into the CRM aspects of our business. Our customers have always been loyal to Kirkland. And now, when we launched the program, we just kind of coasted for a while. But now that we've reinstituted it, we're getting a big surge of customers, and not only the current customer base, but it looks like a younger, more affluent customer. So we're excited about that and Nicole's got some possible specifics that she's looking up on her phone right now.

Nicole Strain: Thanks.

Woody Woodward: Oh, you don't have them? Okay.

Nicole Strain: I don't have -- I wasn't looking them up on my phone. So I think to the -- remember the loyalty program and active purchases. So roughly 7 million people in the plan. What I would say about -- historically when we've had a loyalty program before -- we changed it out a few years ago -- is we really

saw a lot more frequency of purchases in the top tier group. And when we changed the loyalty program and took away the points accumulation, we really saw a drop-off in that area. So that is really one of -- I think adding new customers is definitely a piece of it and having something that we can promote to push return visits. But having something that benefits that, the highest tier and most important customer, I think is going to be one of the biggest wins of reinstituting the program.

Jeremy Hamblin: Great. Thanks for that. Just a couple other things and then I'll hop back in the queue. Just shipping rates -- we've seen surcharges being placed by the key distributors. In terms of the impact that you're seeing, are you looking at your shipping rates in terms of what you're potentially charging for your customers for kind of sub-$100 orders? Any changes that you potentially implement to that to help offset some of the higher costs associated with higher surcharges?

Nicole Strain: Yes, a couple of things. So actually within the quarter, because we have done a lot of things with the hubs and getting closer to the customer even though our shipping costs were up, the shipping cost as a percent of shipped-to-home sales actually was favorable year-over-year. So we have been able to absorb that. I think a lot of the things that we're doing now on the direct-to-consumer channel in general is looking at the things that we ship via that channel, meaning historically we might ship an $8 item and pay $8 to ship it. And so really looking at that as a minimum AUR, how can we bundle things, how can we look at that a little bit differently. So we had already done a lot of those analytics beforehand. We are seeing rate increases to some degree. We're also seeing caps on pickups from our parcel partner, which has made us zone-skip and do additional things to try and get around that. But I would say all in all we are actively working on all options to offset cost increases and don't expect that to be material as we move forward.

Jeremy Hamblin: Great. And then you guys have made some changes to your operating hours and obviously reduced substantially the number of stores you have. What were the total number of operating hours down in Q3? And then, what do you expect in terms of operating hours to be down for Q4?

Nicole Strain: Yes. I don't know that calculation off the top of my head, but I can definitely work on that one and get back to you. I will say in general we have taken 3 hours out of every store when we reopened after closing down for COVID. We had made the decision in November and December that we would expand back out for peak. And so I would expect the decrease in operating hours to be much lower in the fourth quarter. But then, after Christmas peak we'll go back down to the hours that we had before, which was the 3 hours per store less than what we were last year.

Jeremy Hamblin: Great. Thanks for the color. I'll hop back into the queue.

Operator: The next question comes from John Lawrence of Baraboo Growth.

John Lawrence: Good morning. Woody, would you give a little more color on the product categories throughout the quarter and sort of how they wind up with what you told us for the first half of the year. And just when you came aboard and some of those projects, some of those new categories that you talked about, how they're working themselves into the mix and why you're excited about those.

Woody Woodward: Okay. Well, first of all, I'm going to go back to kind of the thing that we've been establishing over the years, and that's our seasonal product. It was exceptionally received, better quality, and we had very improved sell-throughs, both in our harvest product and now into Christmas with the Christmas products. So that would be one of the biggest wins. And that's something that we've learned we're good at. Customers recognize this is a great place to come and buy their seasonal product.

But underlying that we've seen some very, very impressive benefits to a couple categories. One, furniture. We've been able to improve furniture too, like we said on the call earlier, improve our quality and improve our design. And we redesigned some of our most -- some of our largest volume lines. And they're now just hitting the stores and being received. It's subtle. It's not dramatic. It's still going to be a best seller. But we were able to improve the quality and keep the price points the same. So our furniture has been kind of an overall runway success. And we have a lot of runway there. We have very big sights on the future of the furniture business within Kirkland's and, as we're learning how to deal with it through our infrastructure and learning how to source it in a more effective way.

The second category that has just been a runaway success is anything related to tabletop. We came out with our own exclusive line of dinnerware called Simple Things, some textiles called Simple Things. And it's just been a resounding success. And what's also been a success was the things that surround that, the glassware, flatware, just the ins and outs of that business. And so we're going to be expanding that in most of our stores, certainly testing it first in 30 or 40 stores and really expanding that tabletop assortment. But, to really show a little bit more dominance, this is probably where we're getting the benefit of one of our major competitors not being here and that was a huge category for them.

The rug category I'd say is still in development. It's improving as we speak. We're not giving up on it. It's been good. But we just needed to make sure that we were satisfying the customer with what they were really looking for.

Our core categories have probably been hit the hardest in terms of some of the inventory shortages. But I look at that as a real positive. We needed to make changes in our art and wall decor category, our mirror category. And the pandemic allowing us to lower the inventory, allows us to take fresh eyes and look to the future as to what do our customers really want from us in our -- we used to be a much more dominant player in our wall decor and art business and we're intending to gain that back. But we had to kind of do a pause and it's given us a chance to look forward. The assortments that are coming in for January and February I think are a spectacular improvement to what we had before in terms of look and design at the same kind of price point. So I think we're going to be giving our customer a real reason to shop. Hopefully they'll be using their gift cards that they're purchasing now in December and coming in January and February and March with a whole new fresh look of some well designed product but still in the line of our casual farmhouse style.

So does that answer your question or would you like me to embellish more?

John Lawrence: That's great. Thanks for that color. The follow-up to that is you mentioned some of these categories and the factories and some of your vendors that realize now that you're in this space. I assume that's what you're talking about when you mention better wholesale deals and obviously more or less pitting some of these vendors against each other. Is that fair?

Woody Woodward: Well -- or maybe not pitting them against each other, but them looking across the value and saying, "Hmm. I've got to sharpen my game." We had to ask for better packaging because we were having -- last year we had some damage issues and there's just no excuse for that. So we went back to all of our vendors simultaneously, both wholesale and direct shipping, and improved our packaging so we could get it to the customer in a more elegant way. And I think that everybody has just realized that we have a good opportunity here at Kirkland's and we should take advantage of the fact that some of our competition is gone and maybe we have a new opportunity to satisfy customers in a bigger way.

And I think the overall thing that's helping our vendors right now is looking at us as a holistic home furnishings resource versus just buying items, or key items, and trying to deliver that through high traffic. Traffic is an ominous and complex theme that we all have to deal with in retail right now. So we have to

come up with solutions of how do we win even with slack or declining traffic. And that's why we went on the basis of adding higher AURs and better design for the product so that we could sell more to each customer who walks in the door.

John Lawrence: Thanks a lot. Congrats on the progress.

Operator: The next question comes from Chris Sakai of Singular Research.

Chris Sakai: I just had a question. Currently what are you guys experiencing with in-store foot traffic due to COVID restrictions? And is it better or worse than expected?

Woody Woodward: That's a really good question because we all read all those articles that were in the news about that people were going to not shop on Black Friday. We did work very diligently to pull as many sales forward from the Black Friday weekend, not really knowing what do expect. And then, lo and behold, people came. I mean, I was in the stores on Friday and we were busy. And people were wearing masks and they were being respectful of each other's space. And I think that we're a little bit of a low-risk place to shop, because we're not one of those humongous warehouse stores that have hundreds and thousands of people. Ours is a little bit more paced.

But our stores were busy and we were proud of the results that we got from our Black Friday and then following Cyber Monday. I think people just love coming to Kirkland's because one of our messages is to bring happiness home and we try to be a happy place for our customers to shop. We really take that seriously. Our store associates have improved so much. They're doing such a great job and they are really embracing the fact that we've got to really offer the best we can to our customer every single day, every single customer.

Nicole Strain: Yes. I think I would just add to that we are definitely down more than we would like to be. We had improvement, as we mentioned, in Q3 and we are ahead of ShopperTrak, which is what we always measure ourselves against, and they also break that down into the home furnishings and ahead of that measure as well. But definitely are seeing pandemic-related traffic impact. And luckily are seeing a lot of that shift to online to support our e-commerce growth. So at this point just trying to make sure that we can offer the customer the way to purchase that is most comfortable for her and expect that things will settle back out to a more normalized pace once some things are under control with current issues.

Chris Sakai: Okay, great. And I guess to go to online, do you guys break out the online sales for the quarter?

Nicole Strain: Meaning the comp increase or the total dollars? What --?

Chris Sakai: Yes, I guess the total dollars, the total dollar sales I guess as a percentage of the total.

Nicole Strain: Yes. So total dollar sales just over $35 million. It was 24% of total sales.

Chris Sakai: Okay. And then I guess lastly, do you -- I saw curbside pickup growth -- has that been a success? And what are you experiencing there?

Woody Woodward: I'm going to give our stores such credit for this. During the first early couple weeks of the pandemic we didn't have curbside pickup and we also didn't even really imagine the contactless portion of that. But our stores' organizations rallied and within 2 weeks we got that set up. And, yes, it's been a huge success.

We will also be a benefactor if we do have certain stores that do have to close temporarily, as some way to satisfy our customers. We've gotten better and better at it. Now most of our customers are coming inside and picking it up versus being asking for curbside. But those customers that do ask for a more contactless way, we've set up signs and special parking spaces in front of our stores that if they just call a number, we will bring their product out to them and have no contact. So, yes, I think it's been a runaway success and there's been a lot of learning on how to get better and better at that.

Chris Sakai: Okay. Great. Thanks.

Operator: The next question comes from Matt Schwarz of Maze Investments.

Matt Schwarz: Congratulations. I've got a couple quick questions. So obviously the first quarter was rough on a lot of companies, including yours, with the dramatic sales decline due to COVID. So when I neutralize that number and just kind of throw a conservative Q1 in there, I already have your EBIT margins running for this year -- once I start to plug in some of these assumptions you gave for the fourth quarter, I get EBIT margins that are already well ahead of your targets, like approaching 8% EBIT margins and I guess the EBITDA margin would probably be something like 400 basis points better. So can you walk me through your assumptions with those margin targets? Because to me it looks like you're there and they're going to be substantially better than that going forward.

Nicole Strain: Yes. I think the thing that I would just say on that, Matt, is that there's a lot of unknown. We have a lot of moving pieces in the transformation that we're going through. I do think if everything works as we'd like it to, then we can hit those targets earlier in the window. And at this point we'll continue to update those as it makes sense, but there are a lot of pieces. There's a lot of unknown in the macro environment right now and what that may look like as far as top-line impact next year. So just want to make sure that what we put out there is something that we know we can achieve. And if all goes well I do think there's upside to that.

Matt Schwarz: Okay. Thank you. And then also, in terms of capital allocation I think it's great that you announced the buyback. I mean, certainly on my numbers your current multiple is still half of what your competitors are. And you're generating a ton of cash. So what are your thoughts on capital allocation for additional buyback even beyond what you've announced, or dividend or other?

Nicole Strain: So right now we are continuing to be somewhat conservative about how we look at that. And there will be dollars that we want to allocate to growth and to our own internal investments. Outside of that, the share repurchase I would say probably starts out somewhat conservative. But I do -- we all believe that our stock is undervalued and we'll continue to look at that as we move forward with the $20 million authorization. I don't -- I think at this point, again, if we hit the goals that we have in our model we will generate significant cash and we'll continue to look at what the right ways are to spend that money and have the best returns.

Matt Schwarz: Okay, great. And then lastly, obviously you've done a great job rationalizing the cost structure. Can you help us understand as your e-comm business continues to grow next year, how should we think about your ability to sustain your SG&A dollars next year?

Nicole Strain: The way that we are looking at that is -- I mean, I think it's important for us as we move forward for a lot of reasons to remain lean. I actually think we operate much better than we did before and have much more of a sense of urgency. So the way I look at that as we move forward is as the business evolves, we will need to reallocate dollars from one area to the next in order to support the right growth. But I'm not looking at SG&A as having any sort of significant increase based on that growth.

Matt Schwarz: Okay. All right. Thank you very much. Congratulations and I'll look forward to chatting offline.

Operator: Our next question is a follow-up from Jeremy Hamblin of Craig-Hallum Capital Group.

Jeremy Hamblin: Thanks for taking the extra question here. I wanted to get into your -- Nicole, I know you've got a third of your leases up for renewal and that you've been diligently working on it. I wanted to just get a sense for the conversations you're having with landlords. How effective -- and I know you can drive a tough bargain, but what percentage of those lease renewals are you seeing dollars and cents lower than what you had before? And can you give us any color on the types of maybe total rent reduction that you might expect for 2021?

Woody Woodward: I wonder if Nicole has ever imagined that she would have a master's degree in real estate negotiations, but I think she's earned it this year. So go ahead. Enjoy the benefits of that.

Nicole Strain: And we actually have a really dedicated person that works on this day-to-day. But what I would say is probably 90% of the negotiations we're able to get some benefit. In a lot of cases it's good real estate and they don't have vacancies. And so what we're getting in those is negotiating to continue with flat rent instead of the escalations that are built into the lease. There are a good percentage where we are getting significant, up to 50% rent reductions. And at this point, because we have worked quite -- we're through, I would say, the majority of them but don't have fully executed deals. We'd rather not put out a number on what that looks like, but we'll be able to do that in the near future, on what the year-over-year savings are for next year.

Jeremy Hamelin: Great. Thanks for the color. Best wishes for the holiday season.

Woody Woodward: Okay. Thank you, Operator. As always, we're available for follow-up over the next several days and weeks.

But before I sign off, I want to wish everyone on the call a wonderful holiday. Stay safe and healthy and we look forward to seeing you online and in our stores. Thank you.

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