Kirkland's, Inc.
First Quarter 2021 Earnings Call
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Officers and Speakers
Tripp Sullivan; SCR Partners, Investor Relations
Steven C. Woodward; President and Chief Executive Officer
Nicole A. Strain; Executive Vice President and Chief Financial Officer

Analysts
Jeremy Hamblin; Craig-Hallum Capital Group
Anthony Lebiedzinski; Sidoti & Company
John Lawrence; The Benchmark Company

Presentation

Operator: Good morning, and welcome to Kirkland's First Quarter 2021 Earnings Call. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Tripp Sullivan with SCR Partners. 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 2021. 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.

I'll now turn it over to Woody.

Steven C. Woodward: Good morning. Before we begin, I want to recognize the skill, commitment, creativity and innovation of the entire Kirkland's team. They've responded well to every challenge we faced and they've delivered on the opportunities to serve our customers, drive profitability and evolve the Kirkland's brand.

For the quarter, we generated a comp increase of 75.3%, which reflected a 95.1% increase in store comps and a 42% increase in e-commerce. GAAP earnings for the quarter were $0.11 and adjusted earnings were $0.12, our most profitable first quarter in over five years. As will become evident in our prepared remarks, this performance could have been even stronger absent the weather impacts and inventory constraints, and we are pleased with the profitability we're generating.

While we started off the quarter with a multi-week period of winter storms in our markets, we made a nice recovery in our comp trends in March and April. We were very deliberate in choosing profitability over promotions this quarter and maintaining our focus on key items. As the economy began to reopen with vaccinations and state restrictions dropping in most of our largest markets, we began to see a little more competition for the wallet share that we expect to be short-term in nature.

We're seeing signs that the big lift to home furnishings that was happening prepandemic and throughout the past year are sustainable due to the appeal of work from home and hybrid approaches to work. Other factors such as strong housing market and the decreased store-based competition further support the sustainability.

The momentum created by our evolution into a value-oriented specialty retailer continued this quarter. Our profitability is accelerating even with very deliberate pace of transformation. We've provided a strong foundation for our robust outlook over the next two years, or two to three years, so I want to spend some time this morning on what's driving our confidence in the business and our outlook.

Let's start with direct sourcing. Our goal for 2021 was to achieve 30% direct sourcing, and we already are well ahead of that target with 48% of our product coming primarily from agents in Vietnam, China and India. Diversifying our product by moving to Southeast Asia has helped us improve design and quality of our merchandise, but the tighter shipping capacity has affected overall inventory availability and inbound freight costs. We're managing through these challenges. While improving, we expect them to continue at least in the first half of this year.

All of our merchandise categories delivered strong comps, but overall we missed our expectations due to inventory shortages that negatively impacted our overall mix in ticket. Recall that we have been elevating our style and quality, allowing us to keep our opening price point, but gradually increasing our overall pricing threshold in key categories such as furniture. We've also streamlined the aesthetic of our brand with an eye towards improved design, efficiency and function. As expected, we continue to see very positive sell-through in each category as consumers are responding to our cohesive style point of view and elevated quality.

The best-performing categories in the quarter were holiday, textiles and fragrance. Holiday's success was driven by Valentine's and Easter, both of which we were in great inventory positions and exceeded expectations. Textiles was an all-around success with wins in pillows, throws and tabletop textiles. Fragrances had a strong quarter, largely driven by the continued success of our jar candle program.

We saw the biggest impact from availability of inventory throughout the quarter in wall decor, outdoor, housewares and furniture categories. Wall decor, outdoor and furniture specifically drive a higher ticket and the lack of inventory impacted the sales performance. We expect to be in better inventory positions in these higher-ticket categories early in the second quarter.

One of our strategic goals is to continue the transformation of Kirkland's brand into a specialty retailer where customers are able to furnish their entire home on a budget. We will continue to do the heavy lifting with our merchandise to slowly grow our better and best offerings while keeping us on the path for the upgrades in style and quality that are resonating with our customers. The addition of brands such as Cuisinart, KitchenAid and Viking to our website this quarter was a great example of this gradual improvement, along with very positive customer response and a specific benefit to our e-commerce business. We have a number of exciting things happening within our categories later this year that should provide momentum heading into the back half.

The digital transformation of our business is in progress and we'll continue to focus on our investments on improvements that drive the e-commerce operations. E-commerce was 30% of our sales in the quarter, up from 24% in the fourth quarter, and e-commerce profitability continues to be up year-over-year. We have prioritized our capital expenditures to fuel this digital transformation, and I'm pleased to note that these past investments, such as our e-commerce hubs and our ship-direct-from-vendor channels, are paying real dividends.

I'm going to ask Nicole to address the specifics, but it's been clear for us for some time and more directly evident in the quarters such as the one we're in that we're generating profitability when historically we couldn't. We are building a sustainable and formidable business model. The model is born of an intentional plan, a sustainable and efficient cost structure, improving execution and a distinct point of view in style and design. I will admit that we have been helped by charting this course at the right time; however, without the vision of all and the hard work during the past years, we would have been unable to fully benefit from the positive secular trends that continue to drive the home furnishings sector.

There is more growth ahead for Kirkland's and our shareholders, and we look forward to reporting on our progress throughout the balance of the year. Nicole, why don't you provide some color on the details and our outlook?

Nicole A. Strain: Thank you. As Woody mentioned, the evolution of our merchandise and the changes in our infrastructure and cost structure generated a profitable first quarter, which included some significant headwinds from supply chain delays and abnormally tough weather impacting our store footprint in February. Historically, our full year profitability has been heavily weighted to contributions in the second half of the year. While we have seen and expect to continue to see real improvements in profitability in the third and fourth quarters, we believe there is more room for earnings improvement in the first half of the year as we continue to execute this transformation.

Before I get into the details of the quarter, I wanted to make the overarching comment that the year-over-year comparisons for comp sales, percentage of sales and other metrics are heavily skewed by the necessary actions we took last year during the pandemic, with store closures, the channel shift to e-commerce and the macro trends that existed then and now.

Breaking down sales within the quarter, we had a comp decline of 3% in February with a strong start and finish for the month, but extreme weather in the Southeast impacting the two weeks in the middle. Our stores closed last year in the middle of March and most remained closed for the remainder of the quarter, resulting in a comp increase of 134% in March and 196% in April. The total comp increase of 75.3% included an increase in e-commerce of 42% on a 32% increase in the prior year. Excluding the impact of the COVID-driven store closures from the prior year, we had a total comp increase of just under 16%.

The sales impact of the weather in February and inventory shortages within the quarter was approximately $12 million. As expected, we started to see some year-over-year softness the back half of May due to the spike in demand in the second quarter last year and further elevated by some macro shifts in share of wallet toward entertainment and travel as the economy fully reopens, which we do expect to be a short-term headwind.

Our store traffic outperformed the retail segment of ShopperTrak and was in line to slightly down compared to the home furnishings subsegment, but with store closures impacting businesses differently in the prior year, it's tough to compare traffic year-over-year in the first quarter. Improving store traffic and converting existing traffic to our more elevated assortment will continue to be a main priority throughout our brand transformation.

We did continue to see the sales benefit of the changes we have made to improve the quality and design of our merchandise with a high-single-digit ticket increase in stores, but limited inventory in the furniture, outdoor and wall categories prevented us from reaching our expected sales level. Average ticket has increased in the later part of May as inventory improved and we expect to continue to see growth as we return to planned inventory levels in those key categories in June.

Our e-commerce comp increase continues to be driven by our third-party drop-ship channel with revenue up over 70%, which is significant considering the tougher comparison from the prior year when store closures forced a channel shift toward e-commerce. This channel made up almost half of our e-commerce sales within the quarter. Our fulfilled-in-store e-commerce sales for the quarter were just over 30%, compared to 35% in the prior year. Lower in-store inventory has continued to limit the volume of these channels and does restrain our profitability. We remain committed to the importance our stores as delivery nodes for 40% to 50% of our e-commerce sales, and there is profitability upside as we return to those levels.

During the quarter, we closed five stores, opened two new stores and relocated one store, resulting in a count of 370 stores. Of the closings, three were rollovers from year-end lease negotiations and closed in early February. One of the new store openings and the relocated store were opportunistic shorter-term leases we negotiated in locations that were previously Pier 1 stores.

Gross profit was 32.6% of sales, compared to 13.3% in the prior year quarter. The prior year included significant deleverage with the store closures and the current year includes approximately 400 basis points of incremental inbound freight costs. We expect to have a similar level of freight impact in the second quarter and continued impact throughout the balance of the year, with the degree of the impact in the back half unknown. We do not expect the Q3 and Q4 impact to be higher than the first half of the year, but have yet to see the softening in rates that we expected. With the long-term ease of freight rates and the continued push to elevate sales in the first half of the year, we expect upside in gross profit rates in the first and second quarters in the coming years.

Branded project margin was 57.4%, which shows growth from the first quarter of 2020 while absorbing the significant freight impact. The gains continued to be driven by direct sourcing benefits, simplifying our promotional message and also reducing the depth of offers and the inherent stacking of entire-store couponing. Delays in inbound freight that were consistently in China in the fourth quarter spread to India as that country struggled with the pandemic, impacting production and shipping levels. While we made progress on inventory, much of that progress was in the later part of the quarter and the mix of receipts was not as we had planned.

We missed the early part of the sales window for our outdoor collections, which included some testing related to larger-scale items, upgraded collections and outdoor dining tables, which will be a key learning for improving sales in the first half of the year. Also, lower inventory and higher-ticket furniture SKUs impacted the average ticket for the quarter. We do not expect a significant margin impact from the late arrival of these items, but also don't expect to fully recover the lost sales. With the unknown surrounding supply chain, we are pulling forward purchase order timing, specifically in the time-sensitive seasonal categories, which will have a short- to midterm timing impact on cash flow.

Store occupancy costs were 13.6% of sales. We remain on track with the additional 100- to 150-basis-point improvement in occupancy costs in 2021 relative to the same quarter in 2020, excluding the much larger benefit in the first quarter due to the incomparable sales.

Freight costs from our DC to our stores was 2% of sales and was impacted by sales deleverage and an unfavorable capitalization adjustment from lower store inventory, which will reverse as inventory increases. DC costs were 4.6% of sales and remained relatively flat to our expectations with the sales deleverage offset by reduced expenses from less inventory moves than expected.

For two quarters now, I've noted that the reversal of the 150-basis-point unfavorability in the third quarter of fiscal 2020 would reverse with improved inventory levels. We should see that reversal in the second quarter of this year.

We continue to see productivity and infrastructure improvements offset the incremental costs to pick and pack e-commerce orders and are pleased with the performance in the two e-com hubs we added last year. E-commerce shipping at 4.5% of sales increased year-over-year as the volume of ship-to-home sales increased, while we are seeing some rate improvement over the prior year as the average price point improves and we fully utilize the hubs. Again, as we improve the mix of in-store-fulfilled e-commerce sales and are able to ship a larger percentage of ship-to-home sales out of the closest distribution option, which was also impacted by lower inventory levels, there is leverage to be gained here.

Operating expenses, excluding impairment, at 30.7% of sales, or $37.9 million, was an increase over the prior year of $3.2 million due to reactionary measures taken while the stores were closed last year and some fully variable costs. EBITDA excluding impairment and other minor nonoperating expenses for the quarter was $7.7 million, or 6.2% of sales, a year-over-year improvement of $24.8 million. For the quarter, our tax rate was 16.1%, compared to 73.1% in the prior year period. Both periods were impacted by a valuation allowance. The normalized rate of 24.7% was used in the non-GAAP adjusted calculations for the current year and 23.8% for the prior year.

Earnings per share excluding noncash impairment, normalized tax rate and other minor nonoperating adjustments was $0.12, compared to a loss of $1.27 in the prior year. The GAAP earnings including these items was $0.11, compared to a loss of $0.53 in the prior year.

We ended the quarter with $72.3 million in cash and no outstanding debt, which is a reduction of $28.1 million from the Q4 level and an increase of $42.1 million year-over-year, or an increase of $82.1 million including the outstanding borrowing in the prior year. As mentioned on the prior call, we expected a reduction in cash of $30 million to $35 million as we rebuild inventory levels. With pulling up purchase order timing to offset supply chain constraints for the balance of the year, we could see this timing impact be closer to $45 million, but we will balance appropriate inventory levels with sales risk from missing set dates, specifically on the more time-sensitive seasonal buys.

Combined with availability on our revolving credit facility, which is based on our inventory position, we had total liquidity of $121 million. Inventory at the end of the quarter was $76.3 million, which was a build of $14.2 million from the end of fiscal 2020 and compared to $99.1 million in the prior year, or 23% lower. The prior year levels were elevated due to the store closures and continued receipts within the first quarter, and we currently have 9% fewer stores. We ended the quarter approximately $5 million down to our inventory plan, but with a surge in receipts to end the quarter, our store inventory had a larger gap to plan, with a significant amount of the inventory in transit within our domestic distribution network.

We repurchased 47,000 shares within the quarter for $1.4 million at an average cost of $29. In the month of May, we repurchased another 46,000 shares for $1.3 million.

We have seen tailwinds in consumer demand since early May of last year, which has allowed us to accelerate some of the more transformational aspects of our merchandise and pricing strategy. We have also seen significant headwinds with supply chain delays and incremental costs. Although our strategy has remained focused and unaltered, we have adapted our pace of change as the macro circumstances have allowed. We have a growing level of confidence that customers approve of where we are moving the Kirkland's brand and that a space exists within the market for higher-quality, curated merchandise at a meaningful value relative to other specialty retailers. Our business model is set to allow us to pivot as needed and still deliver profitable results to our shareholders.

We are now ready for your questions.

Questions & Answers

Operator: (Operator Instructions)

And the first question will come from Jeremy Hamblin with Craig-Hallum Capital Group.

Jeremy Hamblin: I wanted to start with just getting a sense around trends. And thinking about -- it sounds like there's been some kind of positive and negative takes in May. As we look towards your expectations on Q2 and recognizing that this quarter probably has the most noise, is there kind of a range of expectations that you're looking at based on the information you have now and understanding where some of the inventory constraints have been? Anything that you can call out in terms of your expectations on Q2 sales?

Nicole A. Strain: Yes, I think a couple of -- just to reiterate the positives, definitely, we're getting back into a better inventory position in those key categories, which really has the most impact overall on our average ticket increase that we expected year-over-year. And then on the downside, a piece of what we're seeing in the softness we expected, just as we're comping in Q2, pent-up demand and a lot of focus on home decor as being opened back up last year, but also, we had expected, at some point in time, that there would be a temporary reallocation of spend towards travel and entertainment as people felt more comfortable getting out. So I definitely think that we're starting to see some of that, but again, expected the Q2 comp to be tougher based on what last year looked like.

I think based on what we saw in May, which May was impacted similar to the first quarter with limited inventory until we got into the last week, I think it will be tough to comp, positive comp, last year in Q2. So I don't know if that helps give you any context. And some of that we expected when we planned out the year. We had that 77% increase in e-commerce that we knew we would be tough to comp year-over-year. So I think I would say from here, expecting to be slightly down from a comp perspective to where we were last year.

Jeremy Hamblin: Okay, that's consistent with our expectation. And in terms of -- I actually wanted to break it down into that e-commerce channel, where you have kind of endless aisle. You're driving towards that, and ship-from-vendor options that maybe are not as impacted with inventory constraint. But I wanted to just get a sense for performance with e-commerce throughout Q1, and whether or not that showed a little more consistency where weather impact's probably lower on e-commerce, and then as we are sitting here in Q2, is that a category or a channel -- again, you had huge performance, up 77% last year. Is that something where you're expecting e-com to be kind of flat or down here in Q2? Any color that you can share around that e-commerce business?

Nicole A. Strain: Yes, I think I'll start with the numbers piece and then Woody may have something to add about the third-party drop-ship channel, because we are definitely continuing to be pleasantly surprised by that channel. From an e-commerce comp perspective, I do think that we can comp positive; I just think it will be a single-digit to low-double-digit comp increase, and a lot of that driven by that third-party drop-ship channel. And to your point, we did not see the same impact from inventory levels in that channel. It was about 50% of our e-com sales for the quarter. And it also drives a significantly higher ticket. It was more than double our owned inventory e-commerce ticket in Q1 and has continued to add elevated brands, and think there's a lot of continued potential in that channel.

Steven C. Woodward: Yes, and Nicole mentioned about this particular ship-direct-from-vendor channel. They did experience some of the similar problems with inventory that we experienced in our owned inventory; however, because we can toggle between what we're showing up on the website, we can kind of make those adjustments that are invisible to the consumer.

But we're really pleased. We have built a team now that is really going after the endless aisle, curated endless aisle, and our whole assortment seems to be kind of coming to a much improved way that the store assortments look very similar to what we're doing from the ship-direct-from-vendor, so we're really optimistic that that's going to continue for the next several years and being a big opportunity for us.

Jeremy Hamblin: Got it, thanks. And then gross margins, I wanted to just see if we could hone in a little bit more. A lot of noise around gross margins; wanted to make sure that I understood the call-outs that you had. So freight impact, I think you called out, was 400 basis points' drag in Q1, and that you expect it to be a similar level in Q2; that you're going to have some positive impact from the inventory normalizing versus, I think, what you'd been calling out since Q3 of last year, and I think you called out that that would be roughly 100 to 150 basis points. Just in terms of any of the other items, and kind of -- I think typically Q2 has a lower gross margin than Q1. I think some of that's seasonality of the products that you sell. But any additional color you can point us to here in Q2 on gross margins?

Nicole A. Strain: Yes. I think based on timing of inventory and all of those things that you mentioned, I'd probably look at Q2 gross profit this year more similar to Q1 of this year than maybe it is in most years.

Jeremy Hamblin: Okay, great. And then also wanted to just ask about capital allocation. And you had a little bit of noise on the balance sheet, because I think you had inventory drag on your cash flows, which was expected based on where the levels ended at the end of 2020. But you also had a little bit of drag around your AP and accrued expenses. Do you expect that to normalize? Is that just kind of timing of when the quarters end and so forth? But should some of that be recaptured on the balance sheet? That's Part 1 of the question.

And then Part 2 is, your buyback program hasn't really gotten going yet, and I don't know if that's just being opportunistic, if there's levels you're looking at.

And Part 3 of the question is, are there other considerations when you have such a significant cash balance? Have you looked at things like a special dividend as a potential option?

Nicole A. Strain: Yes, starting at the first one. So when we ended the year with $100 million in cash, we had said there's about a $30-million impact as we rebuild inventory. And part of that was actual -- an increase in inventory and the other piece was that we received more of the inventory toward the end of the quarter so that we hadn't paid for it, the same that we would have in a normal cycle. So yes, I think what we're going to see this year from a timing impact is potentially a working -- a negative working capital adjustment just because we are trying to pull forward inventory to make sure we're not in the same place with sales misses because we didn't get inventory in. So yes, I think by the end of the year, that normalizes back out, but I think within the year, we're going to be trying to pull up orders within a two- to four-week time frame. So already in the Q2-Q3 time frame we're paying for some of the harvest and Christmas merchandise before we sell it, and so that will just be elevated. So I think there will continue to be a little bit of noise, but the number I called out is from year-end; that reduction to fund that may get to $45 million, but I think then we'll recover back from that.

And then on the share repurchase piece, I noted in Q1 we repurchased $1.4 million of shares, and we actually had a new, more aggressive plan that we put in place near the end -- actually, in the middle of the quarter. So I called out May being the same as the quarter, which again is $1.3 million, but in one month, more aggressive than we've been to date. And to your point, we are considering all options and will continue to do so, and if we don't need the cash, then we are looking at what are the right things to do with that, and definitely returning it to shareholders in either share repurchases or some sort of dividend are all on the table.

And I think, on just the third one -- what was it?

Steven C. Woodward: That was the third one.

Nicole A. Strain: That was the third one? Or the second one. Did I --

Jeremy Hamblin: Yes, you rolled it in together. I'll -- yes, appreciate you taking all the questions. I'll hop back into the queue, and congrats on strong execution.

Operator: The next question will come from Anthony Lebiedzinski with Sidoti & Company.

Anthony Lebiedzinski: I appreciate the color about the second quarter. Kind of looking forward to the back half of the year, the same-store comparisons get a little bit easier, especially in the fourth quarter, so with that in mind plus the fact that you are working hard to improve your inventory levels, would it be reasonable to assume that you will have positive comps in the back half of the year?

Nicole A. Strain: It is. And I think to that point, we expect it to sequentially increase quarter-to-quarter from Q2 to Q4, the comp.

Steven C. Woodward: You know, Anthony, one of the things last year that we experienced during the third and fourth quarter was significant inventory shortages, and we are recovering at this point, but the other section of that is trying to get the merchandise sort of -- all hands together, and it creates a very beautiful impact on the floor in terms of really showing the vision of the merchants in terms of the trends, and that should start regulating or start normalizing here in the second quarter. We're fully expected to be in great shape for the third and fourth quarter. But this quarter and next quarter are very important for our merchandise transformation in that this is where we accelerated some of the quality aspects, design aspects, the look, so we're really looking forward to this -- the back of this year.

Anthony Lebiedzinski: Got it, okay. Thanks for that. So -- and Woody, you mentioned that, as far as direct sourcing, you're at the 38% as of the first quarter. How should we think about the sort of balance of the year as far as where you think you'll wind up for direct sourcing and kind of the impact on margins that it'll have?

Steven C. Woodward: Yes. It's a very positive story. That 38%, though, represents the orders that we've written for the back half of the year, so that's a pretty good number to hang onto. It could be as high as 40%. And we're growing that in a way that we are taking advantages of any design opportunities or better pricing.

A couple aspects that I mentioned on the last call was that the unforeseen benefit that we're getting is with our -- some of our domestic vendors have really sharpened their price points. So we said all along that we would let this direct sourcing get up to about 50% of our purchases and then evaluate whether we want to go even higher; right now I would say that the agents in our countries that we're buying directly from are really hitting their stride. And for example, in this particular quarter, we're going to be landing our first upholstery from China, which is really an exciting -- it'll make our stores look more like a real home furnishings retailer, and the scale, while a little bit smarter, the price points are super sharp and the products look great.

So the direct sourcing is really a smart way for us to balance out our risk. As of last year, we were very dependent in China, and this year we're balancing toward Vietnam, India and other countries, and so you'll see our penetration in China going down and the penetration in some of the other countries going up, which should give us better opportunities to not be so dependent on one port or one supply chain.

Nicole A. Strain: And on the financial impact, getting to 38% to 40%, another 75 to 100 basis points of margin improvement. And I think specifically in Q3 we're comping some pretty tough margin rates just from early sell-through of seasonal, so I think that will help us to balance that out.

Anthony Lebiedzinski: Got it, okay. Thanks. And I guess the last question from me as far as the store opens and closings, so you actually opened a couple of stores in the quarter. You mentioned one of them, I think, was a former Pier 1 location. So how should we think about the -- as far as store openings for the balance of the year and also store closings as well? Thank you.

Nicole A. Strain: Yes, for the balance of the year we have one store that was -- it's not actually an opening, but it's been closed for over a year now because of a tornado in Arkansas, so that one will reopen back up. I think we'll have a handful, less than five, closures between now and the end of the year, and again, have another large portion of our leases coming up for renewal at the end of our fiscal year. So if we have increased closings, they'll be at the end of the fiscal year. So I'd say five or less within the year, and the others will be at the end of the year, and really, again, just like last year, depends on how much progress we're able to make in negotiations.

Operator: The next question is from John Lawrence with Benchmark.

John Lawrence: Woody, could you speak a little bit -- you mentioned -- I guess first thing would be competitive environment. Some people may be looking at price to drive traffic. Could you speak to that first, and then we'll go from there?

Steven C. Woodward: Yes. I think the competitive environment is working in our favor right now because remember that we lost our largest competitor, Pier 1, last year, and while that doesn't immediately fold into our sales, you start seeing that. Because home furnishings is one of those less frequent purchases, and so we're starting to see some benefits from that.

I think that overall, the part that we're the most proud of right now is that while we're doing this direct sourcing and it's helping us with our product margin, the real benefit to that is the look and quality of our products, and better packaging, and I think our customers are starting to really give us credit for maintaining value price point while actually giving the consumer a lot more quality and a lot more value in terms of design.

John Lawrence: Yes, great. And could you follow that with loyalty card, all of that, what -- an update there?

Steven C. Woodward: Yes, we've been very pleased with our loyalty program. In fact, since the launch, we're seeing the loyalty consumers spend around $10 more, or 27% more, per transaction when compared to the nonloyalty customers. And so far, new loyalty customers are spending -- the brand new ones are spending about $20 or 53% more than the nonloyalty customers. So like we said in previous calls, our loyalty program is a multiphased approach, so we've got a lot more what I would call bells and whistles coming to enhance that program and make us really the retailer of choice to our most loyal customers, and they represent a huge portion of our sales and our profitability.

John Lawrence: Yes, thanks for that. And the last question from me: You mentioned some of the new vendors, some of the new brands you've had on e-commerce. What can you say about negotiating with those vendors as far as -- with all the store closings within the industry? Are some of these vendors wanting to deal with you more because of the doors that you have? And what are you seeing from those vendors at this point?

Steven C. Woodward: Yes, I think there's probably two reasons. One, they're looking for distribution just because of some challenges in their distribution model and the lack of new stores opening. And so we're getting some of that. But the other side is the elevation of our store, and our store look and our website is now able to -- so you look at a KitchenAid or a Cuisinart, and our assortments look parallel with what they're offering, so it really is kind of a two-pronged approach. It had been very -- we have a lot more people knocking on our door saying, can we be part of your curated endless aisle, and we've been pretty pleased with the results so far. Of course, some of those vendors have also experienced some of their own inventory shortages and supply chain issues, but really and truly, we're pleased with the results that we're getting; we're pleased that the opportunity for the customer is where they can buy some of those great brands from their trusted store, Kirkland's; and then at the end of the day, we may evaluate whether there's a key item or two that we want to bring in to enhance fourth quarter gift-giving. So all items or all ideas are on the table and these vendors have been really great to work with.

Operator: And the next question is a follow-up question from Jeremy Hamblin with Craig Hallum Capital Group.

Jeremy Hamblin: So want to come back to direct sourcing here. You're clearly tracking ahead of prior expectation in terms of penetration of that business, generating strong margins, seeing really impactful results on what you're doing on the e-commerce side of your business, so I wanted just to get a sense of thinking about the long term; I think you'd spoken to direct sourcing getting to that 50% threshold, and then maybe pausing and revisiting after that. And then just thinking about where direct sourcing can go and the contributions in terms of both margin but also in quality of goods, should we be thinking about direct sourcing as potentially being a bigger portion of your total business?

And then along with that, kind of the same question along the lines of e-commerce. It sounds like drop-ship has been tremendously successful thus far. You're now at 30% penetration on e-commerce overall. Is that something where you may end up tracking toward what many of your peers do, where e-commerce is going to be greater than 50% of your business long term?

Steven C. Woodward: Well, let's -- those are both really good questions, Jeremy. Thank you for asking them. Let's start with the direct sourcing. Our goal was -- it started off a couple years ago, we hit the 20%, and then our goal this year is to hit 30%, and we'll probably hit about 38% to 40%. What we needed to do was make sure that our agent and supply chain gets a little bit more accustomed to this business model, and so we had some things to do on our side and some things to let them get up and running. But the result that we're seeing is spectacular merchandise at a great value.

And so I think that while we say that we'll pause at 50%, I don't know really see a reason why we would if everything is moving along as we projected. Remember that most of our competition has significantly more than 50% of their distribution, or 50% of their purchases, coming from a direct-source environment. So I would say that we'll pause, but for, like, two seconds, and then we'll say, let's keep increasing it again. We like what we're getting.

And then the other side of that, on the e-com becoming the larger portion, yes, we said that we'd like to get healthy with being in the 50-50 range, 50% store contribution sales and 50% e-commerce in the future, but that doesn't mean -- what that really says is that we're listening to the consumer and we're letting them kind of lead the way. This ship direct from vendor has been so successful for us, and they love that we have curated it so that it's not literally just a bunch of home furnishings, but they're home furnishings that look like they fit through the lens of what Kirkland's stands for from a -- kind of a casual home furnishings lifestyle look. So I think there's vast opportunities there. Like the vendors from the Cuisinart and KitchenAid, we have many more vendors approaching us now saying they want to be part of our direct ship, and yes, we have a few issues there with the systems and that we're working in the back of the house on it to make that more fluid and easier to manage. Nicole, did you have anything to add?

Nicole A. Strain: No. I think, before we had said 50 -- we thought we'd end up in that two- to three-year time frame, likely, 50% store sales and 50% e-commerce, but we're not driving to that number for the sake of getting to that number. It really is just we're pushing e-commerce as the growth engine of our company. And to Woody's point, the customer will dictate where we end up, if that's 45% or 60%, and we're just going to make sure that we are set up to be able to service those sales in a way that our customers expect, wherever they happen.

Operator: Ladies and gentlemen, this concludes our question-and-answer session. I would like to turn the conference back over to Woody Woodward for any closing remarks.

Steven C. Woodward: Thank you, operator. As always, we're available for follow-up questions over the next several days and weeks 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. You may now disconnect.