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Officers and Speakers

Cody Cree; External Director, Investor Relations
Steve Woodward; President and Chief Executive Officer
Nicole Strain; Executive Vice President and Chief Financial Officer

Analysts

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

Presentation

Operator: Good morning, everyone, and thank you for participating in today's conference call to discuss Kirkland's financial results for the third quarter ended October 30, 2021.

Joining us today are Kirkland's President and CEO Steve "Woody" Woodward; Executive Vice President and CFO Nicole Strain; and the company's External Director of Investor Relations, Cody Cree. Following their remarks, we'll open up the call for your questions.

Before we go further, I would like to turn the call over to Mr. Cree as he reads the company's safe harbor statement within the meaning of the Private Securities Litigation Reform Act of 1995 that provides important cautions regarding forward-looking statements. Cody, please go ahead.

Cody Cree: Thanks, Tom. 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 provision 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'd like to remind everyone that this call will be available for replay through December 9, 2021. A webcast replay will also be available via the link provided in today's press release, as well as on the company's website at kirklands.com.

Now I would like to turn the call over the Kirkland's President and CEO, Woody Woodward. Woody, over to you.

Steve Woodward: Thank you, Cody, and good morning, everyone. Thank you all for joining us today, and I'd like to extend my gratitude to our dedicated employees and stakeholders that continue to support our efforts in executing upon our long-term transformation strategy.

As we look at our performance during the third quarter, we had an unexpected softness in sales to the end of the quarter. Along with ongoing macro conditions related to supply chain and labor, made this quarter more difficult than we originally anticipated. However, this does not affect our unwavering commitment to executing our strategic initiatives and achieving our long-term financial targets that we have outlined.

So let's dive into the drivers of the quarter. Looking at sales, our total year-over-year comp was down less than 1%. This decline was primarily a result of two things: the late arrival of Christmas product, which began to significantly impact our sales the last two weeks of October, and challenges staffing up with seasonal employees to be able to execute getting that product on the floor.

On the first point, we entered this quarter knowing that Christmas would arrive three weeks late this year, but we planned to cover the marginal impact with excess inventory we had for harvest. However, harvest sales started the month of October slow, and then fell off the last half of the month. Our customers had already moved on from the harvest shopping season to that point to holiday entertaining and Christmas.

The other related driver of the miss was how the Christmas inventory flowed and our understaffed stores' ability to handle significant receipts late into October and early November. While for the most part the Christmas merchandise arrived in the timeframe expected on our last call, it arrived in stores not in the usual ways, but as we received it. For example, we received ornaments weeks before we had any trees, and as you can imagine, it's very difficult to highlight ornaments in stores without having a tree to hang them on. This led to our Christmas products not consistently being on the sales floor until mid-November, and not in normal presentations that help the customers know how to put it all together.

Combined with this, our store is struggling to hit their seasonal staffing goals. It became more challenging to unload the trucks and get everything in the store on display for customers to make purchases. Our in-store inventory is, on average, 37% better than the same period last year, but when you normalize the incremental freight cost included in those numbers, it's closer to 20%.

I would like to highlight that our third quarter two-year same-store sales comp was an increase of just over 8%, which was also a further improvement from the two-year same-store sales comp increase of 5% we reported last quarter. This is important as we think of how far we've come since embarking on this journey and our ability to sustain long-term growth with less stores and significantly reduced cost structures. Based on what our customers are buying, we are seeing great success with a higher AUR product in both seasonal and everyday categories, and our price increases have not seemed to impact purchasing decisions. This important data -- this is important data, as it underscores our confidence in our long-term merchandise transformation strategy.

Heading into the holiday season, we focused heavily on our new customer acquisition efforts, nearly doubling our marketing spend in the quarter. We believe this might have impacted the sales cycle with our current customers. In hindsight, the holiday quarters have such a compressed selling time frame that we've learned it may not be appropriate to rely so heavily on new

customer acquisition, particularly amidst our transformation journey during this period. To account for this, we pivoted in November to spend more on existing customers who have proven to be avid holiday decorators. We'll continue to focus on new customer acquisition strategy balanced with the current customer retention strategy, but we will wait to advance acquisition efforts until the first half of 2022 when we are adding new merchandise with our furniture and overall lifestyle assortments.

As we look at category performance across both channels, AUR, or average unit retail, for furniture in the third quarter increased 18% year-over-year to \$217 and AUR premieres increased 38% to \$90. Within the holiday assortments, we saw strong results with higher AUR items, including upgraded wreaths and garland. Despite the low inventory levels in our core furniture collection, the Jackson, we continued to see great sellthroughs of our new Wyatt collection, which includes the first sofa introduced in our stores. Lastly, four of the top 10 sellers in the third quarter were upgraded higher-AUR items that are new to the assortment. We also remain on track to source just under 40% of our product in 2021 direct from factories, and we have planned further expansion in 2022. We believe our strong focus on increasing direct sourcing for our products will continue to be a long-term driver of unique-to-Kirkland's, upgraded-quality merchandise that supports a higher AUR across the board.

Now, given that we're a month into the quarter, I wanted to discuss what we're seeing as we close out the year. November started off tough for the same reasons that October ended slow, with our comp for the month being down 9.5%. For the week of Black Friday, inclusive of Cyber Monday, our demand comp sales were flat. So we did see improvements from how we started the month.

Outside of the late Christmas arrival, there were other complementary products that have historically been strong traffic and conversion drivers, which our customers often use as gifts during this seasonal period, that weren't able to get onto the floor this year due to supply chain issues. One example of this was our holiday throw program. We had approximately 130,000 holiday throws on order that we had planned to promote at \$10; however, we simply didn't receive them in time for the holiday selling period and missed out on the boost in sales that we typically experience. So those throws and other late-arriving gifts will be held in our distribution center and included in Christmas 2022.

When we provided back-half guidance on our call in September, we expected significant upside from being in better inventory position in December and January than we were last year, specifically in furniture and wall categories, which have a higher AUR. After prioritizing Christmas receipts, we shifted focus to these categories and our spring set that we expected to be on the sales floor the day after Christmas. We were successful in getting that product on the water, but late October began to see a significant slowdown in moving this product through the L.A. port. As a result of the challenges we've experienced, we're revising our outlook for the remainder of the year, lowering our year-over-year sales and earnings expectations for the fourth quarter. We do believe there is upside to this guidance, and -- if we see improvement in the port throughput. Nicole will provide more detail regarding this outlook later on.

Looking ahead to the first half of 2022, we're incredibly excited for some of the initiatives that we expect to roll out. Now that Christmas shopping is already here, we're working on prioritizing the in-store floor set-ups for the first several months of 2022, in which we will be rolling out some great new products that we believe consumers will love. We initially expected to introduce our modular sofa with our Christmas collection, but given that we are still awaiting its receipt at the port, we plan to introduce this in early 2022. Consumers have expressed an appetite for this type of sofa, and we will be pricing it very favorably at \$1,500, versus \$3,500 at the competitors'. We expect this modular sofa to be a cornerstone of our furniture offerings in the first half of 2022, along with our Wyatt collection, and we look forward to introducing it to our customers.

Our goal has always been to become less dependent on the seasonality that comes with holiday shopping, which is why we have focused heavily on expanding our furniture and outdoor living merchandise that typically has higher sellthroughs in the first two quarters of the year. The third and fourth quarters are examples of how too much heavy reliance on the limited selling period can have a sizeable impact on the results if you don't have more balance selling throughout the year.

Additionally, we're excited to announce that we will be starting a brand awareness campaign to launch our rebrand of Kirkland's Home in the first quarter of 2022. This initiative will be a significant step toward our customer acquisition efforts as we look toward the bright future to give our company a brand name that more appropriately reflects our merchandise assortment while continuing to pay homage to our past. We look forward to sharing further details about these marketing efforts once we have officially launched the rebrand.

Our commitment to transforming Kirkland's into a specialty retailer where customers are able to furnish their entire home on a budget is unwavering. As we've begun refreshing our store base, introducing a higher quality and more stylish merchandise assortment, and bolstering our omnichannel capabilities, we believe we've started to make a meaningful impression on the current and potential customers. With a leaner infrastructure we've put in place and aggressive customer acquisition strategy, and continued progression in our sourcing efforts, we are in tune with customer buying preferences and can be quite nimble to evolve our assortments for when those preferences shift.

Overall, we remain confident in our long-term transformation strategy and the progress we've made since we embarked on this journey. Since I've joined, we've had a long-term vision for what we believe this company could become, and I remain incredibly proud of how far we've progressed in a relatively short period of time. It gives me the utmost confidence in our ability to continue executing on these initiatives even in the face of macroeconomic challenges outside of our control and quarterly anomalies that may arise from time to time. I look forward to continuing to share our progress along with this journey -- along this journey, and I hope that you all have a healthy and happy and safe holiday season.

With that, I'll now turn the call over to Nicole Strain, our Chief Financial Officer, who will provide additional commentary on our performance in the third quarter and future detail in our outlook. Nicole?

Nicole Strain: Thank you, Woody, and good morning, everyone. Before jumping into the numbers, I do want to reiterate what Woody shared. We are in the middle of transforming the Kirkland's brand, and although we are not happy with our results to end the third quarter and begin the fourth quarter, our plan and business model are solid, and we are even more confident that we're moving in the right direction. With merchandise assortment changes, average ticket increases, a channel shift toward e-commerce and an evolving customer base, we expect that we will have learnings along the way and will have to pivot in the pace or the execution of our strategy. To make all of these changes in the middle of unprecedented supply chain challenges, labor constraints and difficulty predicting pandemic-related traffic patterns only adds to the complexity of managing through short-term challenges. What we are happy with is the progress we are making on our long-term initiatives and the read we are getting on our new products when we have them in stock.

Now, getting into the details, net sales were \$143.6 million, compared to \$146.6 million in the year-ago quarter. The decline was primarily a result of the unexpected sales decline late in the quarter and our customers moving on from harvest shopping sooner than expected, along with 3% fewer stores.

Breaking down the sales within the quarter, we had a total comp decline of 5% in August, a comp increase of 0.5% in September and a 2.3% increase in October. Looking at this on a two-year comp to normalize some of the changes in buying patterns last year, August was up 5.5%, September up 13.8% and October up 3.1%. Within the month of October, we were trending closer to a 9.5% two-year comp increase and then fell off to a 13% decrease the last two weeks of the month. This all resulted in an overall total comp decline of 0.7%, which included an increase in e-commerce of 7.3% from the prior year. E-commerce accounted for 26% of our sales in the quarter, compared to 24% in the third quarter of last year. Our fulfilled-in-store e-commerce sales were 32% of total e-commerce sales, compared to 35% in the prior year.

During the quarter, we did not close any stores, so we remain at a count of 369. We expect eight store closures at the end of this fiscal year and still expect our store count to decrease over time to approximately 350 stores. This will include roughly 20 closures of declining stores, the relocation of 40 to 50 stores and refreshes across the remaining store base. As we stated last call, we expect these changes to take place over the next three to five years.

Gross profit was 34.7% of sales, compared to 36.1% in the prior year quarter. Landed product margin was 58.1%, compared to 61.1% in Q3 2020. We expected landed product margin to be lower than the prior year due to the early sellthrough of harvest last year and the approximately 500 basis points of incremental freight in the current quarter. Based on the slower sales of harvest moving into October, we did have to sell through the remaining seasonal product at a higher discount than expected. We were able to offset some of the 300-basis-point decline in landed margin with gains in store occupancy costs, distribution costs and store shrink.

E-commerce shipping increased 80 basis points compared to Q3 2020 due to the increase in ship-to-home sales and parcel rate increases. Echoing the statements from our prior calls, as our inventory position continues to improve, offering incentives for pick-up-in-store options will help these channels return to prior levels. Store occupancy costs improved to 11.5% of sales,

compared to 12.1% in the prior year quarter. We were short of the expected 100- to 150-basis-point improvement in occupancy costs for 2021 relative to 2020, due mainly to sales de-leverage within the quarter.

As we finalize the rent negotiations for the leases expiring at the end of the year, we expect another 60 basis points of savings next year compared to 2021 from rent negotiations and the channel shift to e-commerce. We have modified our approach with landlords now that all of our stores are four-wall EBITDA-positive to try -- trying to obtain rent savings while also locking in control of the space for multiple years.

Freight costs from our DC to our stores was 2.3% of sales, compared to 2.5% in the prior year period, as a result of moving less freight within the quarter than in 2020. DC costs were 4.7% of sales, compared to 5.6% in the prior year period. Operational costs were up 70 basis points as we staffed up to handle the late Christmas product, which also includes retention incentives due to hiring challenges. However, as inventory increased year-over-year, we had an offsetting benefit of capitalizing more of the cost into inventory.

Lastly, other costs of goods sold decreased 70 basis points, mainly due to unfavorable shrink results in the prior year quarter. Operating expenses, excluding impairment, increased \$0.7 million from the prior year period to \$40.3 million, or 28.1% of sales. Compared to Q3 2020, we had a decrease in store operating expenses of \$2.1 million from fewer stores and a favorable insurance claims adjustment, an increase in e-commerce operating expenses of \$100,000 and a decrease in corporate operating expenses of \$800,000, which helped to fund \$3.5 million of additional advertising expense.

The additional marketing spend was our initial investment in new customer acquisition. As Woody mentioned, we shifted the focus of the spend from acquisition toward existing customers in the middle of November based on learnings within Q3. We will relaunch customer acquisition efforts in the spring with our new furniture assortments and our rebranding to Kirkland's Home.

Adjusted EBITDA, excluding impairment and other minor nonoperating expenses, was \$14.8 million, or 10.3% of sales, compared to \$18.7 million, or 12.7% of sales, in the same period last year.

Our normalized tax rate in Q3 was 24.7%, compared to 23.3% in the prior year period.

Adjusted earnings per share, which excludes noncash impairment, normalized tax rate and other minor nonoperating adjustments, was \$0.51, compared to \$0.66 in the prior year. If we normalize the year-over-year freight impact within the quarter, our adjusted EPS would have increased by \$0.23, or 35%, compared to the prior year period. GAAP earnings per share, including these items, was \$0.51, compared to \$0.82 in the prior year.

We ended the quarter with \$26.5 million in cash and no outstanding debt, compared to \$100.3 million at the end of 2020 and \$37.2 million in the year-ago period. A reduction in cash was expected as we rebuilt inventory levels and repurchased shares. We expect to end the year with

\$50 million to \$60 million of cash, depending on the timing of receipts for the remainder of the year.

Inventory at the end of the quarter was \$115.7 million, which was an increase of \$53.6 million from the end of fiscal 2020 and an increase of \$31.8 million compared to the prior year third quarter. The current quarter includes \$17.6 million of in-transit inventory that is yet to be received by our domestic facilities. As direct sourcing increases, our inventory will grow as we take ownership of that product when it leaves the port of origin.

The quarter also included a more aggressive approach to our buyback program. We repurchased approximately 806,000 shares within the quarter for \$16.5 million at an average cost of \$20.42. In the month of November, we used another \$3.3 million of our authorization at an average cost of \$25.38, which leaves \$6.7 million available on our current authorization. Year-to-date through November, we have repurchased over 1.5 million shares, or 11% of our outstanding shares to start the year, for \$33.1 million at an average cost of \$21.44.

Now let's turn to our revised outlook for the fourth quarter and fiscal 2021. We previously guided up mid-single digits for the back half of the year, which was primarily driven by expected improved inventory in key furniture and wall categories with higher average retails. We were successful in getting a significant amount of that inventory shipped, as well as our new spring set that was expected to be on the floor the day after Christmas, but as Woody mentioned, we experienced a slowdown in receipts of the West Coast port starting about four or five weeks ago, which has delayed our ability to get these products into our stores and distribution centers. In fact, we currently have \$43 million of inventory on the water, but luckily, it's not time-sensitive product for our customers.

We are lowering our expectations for the fourth quarter to a mid- to high-single-digit same-store sales decrease due to the November same-store sales decline of 9.5% and the reliance we had placed on having the furniture inventory and the spring set in January. We do believe there is upside to this same-store sales expectation if the port congestion improves and we are able to get this inventory in stores within the quarter. If not, we look forward to selling it in the first half of 2022.

Additionally, we expect a mid-single-digit same-stores sales increase for fiscal 2021. With the expected sales decline and freight impact, we now anticipate earnings in the fourth quarter to be lower than the prior year period while still expecting year-over-year earnings growth of approximately 50% for fiscal 2021.

As we look to 2022 and beyond, we remain steadfast in our commitment to transform Kirkland's and continue to believe in our current position to execute on the long-term growth strategy. When we have challenging quarters like this one, it's a testament to the organization that we've created and our ability to absorb and adapt to unexpected changes in the macro environment. We are reiterating our one- to two-year targets with gross profit margins expected to be in the mid- to high-30% range, EBITDA margins in the low- to mid-double-digit range and operating income margin in the high single digits. We believe we can achieve these targets through top line growth fueled by an increase in our average ticket, new customer acquisition strategies, lowering our

freight rates, continued direct sourcing benefits, overall efficiencies in supply chain operations and continued disciplined cost control. We look forward to progressing toward our goal, and I'd like to thank all our employees, partners and stakeholders for their unwavering dedication to Kirkland's during this transformative stage.

And with that, operator, we are now ready for Q&A.

Questions & Answers

Operator: [Operator Instructions]

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

Jeremy Hamblin: I wanted to just start by going back into Q3 and understanding what the retail store same-store sales for the quarter. And then, as we look at the quarter-to-date period in Q4, what's been the split thus far of same-store sales for your e-com biz versus your retail stores?

Nicole Strain: For the Q3, the store comp was down 3.3%, e-commerce up 7.3%. For November, they're about equal. So I think e-com is down 9.6% and stores down 9.2%.

Jeremy Hamblin: Okay. And then --

Nicole Strain: What was the -- go ahead.

Jeremy Hamblin: No, that was helpful. And then in terms of thinking about where we go from here -- so supply chain, we got behind, we didn't get goods in on time, we didn't have staff in stores to get them on shelves quickly enough when they did arrive. How should we think about resolving those issues here in Q4? Are you going to bring in more staff to get the shelves in the shape they need to be in to make sure that Q4 isn't further burdened? Or are we kind of rolling forward here and kind of looking into the beginning of '22?

Nicole Strain: The actual store staffing improved throughout the month of November, so I think it really, for us, was the last couple of weeks of October and the first couple of weeks of November. The store sales and traffic improved throughout the month, and then as Woody mentioned, we actually had demand comp that was flat for Black Friday and Cyber Monday. So we have a hiring goal when we start staffing up; it's about a six-week exercise with the intention to have the stores be fully staffed by early November. That shifted later. We are actually over 90% of our hiring goal right now. So I think we've been successful; it just happened slower than we expected, and combined with a large amount of receipts coming during a busy period, just weren't able to keep up and get that product on the floor.

Steve Woodward: Yes, Jeremy, let me give some color on that, because generally over the years, with a high seasonal business, we've landed our products in three ways, and that's always worked because the intensity of getting that product through our system and to our stores has always been a fairly intense effort for the stores. And this year really and truly, it almost came in as one giant wave during the period of time where we will still staffing up. So it was kind of an

anomaly. We did do, I think, a fairly good job at getting it out of the ports in China and onto the water. I don't think that we did a good job anticipating the slowdown in the port and how hard that would be, getting the products through, until probably the second or third week of November.

Jeremy Hamblin: Okay. And then in terms of thinking about the impact here on gross margins in particular, so I think what I caught, Nicole, was an indication that freight had a \$0.23 drag -- no, that you indicated that EPS would have been up \$0.23 in Q3 if not for freight. Did I catch that correctly?

Nicole Strain: Correct, yes.

Jeremy Hamblin: Okay. So that's -- I mean, that's a pretty huge number. You're talking over \$0.35 of drag in the quarter from freight. Should we expect a similar impact here in Q4 and then plus the additional discounts or clearance selling that you might do because of the timing mismatch? Can you give us, maybe, a better sense on your gross margin expectations as a percentage in Q4?

Nicole Strain: Yes. For those details, we actually -- you know, we had to pay more for the Christmas product than we had paid for anything up to that point, so even though we had been running about a 400- to 500-basis-point freight impact for the first three quarters, in Q4, in some categories, it's 800 basis points. So it gets much more significant. We were able to take some pricing on Christmas product. The challenge is we took pricing, but we started off the season behind, so did have to add incremental promotions in order to help catch up on that sellthrough. So I would say the drag for the fourth quarter is higher than what it has been for the third quarter.

The good thing, I would say, is we are holding back some of the Christmas merchandise that came in later in our distribution center, so we don't expect -- we're not pushing that out to the stores, and we don't expect to have a significant margin drag at the end from discounting out of the product, but the freight impact is more impactful.

Jeremy Hamblin: Okay. But then some of that freight impact is going to carry over into '22's results, then, correct?

Nicole Strain: It will. What we're paying outside of Christmas, and it worked out that a lot of our Christmas is out of one port that had gotten backlogged, so we had to find other methods and pay extra costs in order to get that Christmas product here. What we ended up paying for furniture and the things that we'll sell in the first half of 2022 was back to what we were paying before. So more along the lines of 400 to 500 basis points. And we have now had time on furniture and some of those other categories to reflect some of that in pricing.

And some learnings during Q3 and Q4 is, it's a lot easier to offset the freight impact in pulling back discounting when it's furniture in everyday categories. When you're in the middle of a large Christmas or harvest buy with a really short selling season and you start off behind because of late arrivals, it's very challenging to offset that impact in limited discounting. If you don't get through it early in the season, you're going to have a much higher discount rate. So we were, in

the first half of the year, able to offset a lot of the freight impact with other things, and just harder to do that with seasonal products.

Jeremy Hamblin: Okay. Last one from me; then I'll hop out of the queue. In terms of just tightening up the actual total sales range, obviously you have store count changes and so forth, and not knowing the exact timing. I think, by my math, it looks like you're suggesting that sales are going to be in the kind of \$170 million to maybe high-\$170-millions range in Q4? Can you just confirm?

Nicole Strain: Yes. I think that's a good range.

Operator: [Operator Instructions]

The next question comes from Anthony Lebieczinski with Sidoti & Co.

Anthony Lebieczinski: So yes, first I just wanted to check in: So as far as your sourcing exposure, so some other retailers talked about Vietnam. I don't think you guys have much sourcing exposure to Vietnam, but I just wanted to make sure that -- what that is. And I think it's, for you guys, it's still predominantly China, but just wanted to first clarify that.

Steve Woodward: Yes, thanks, Anthony, for that question, because I mentioned in the script that we did have some shortages of our best-selling furniture group called the Jackson, and that's 100% out of Vietnam. And so we did get some of the pressure where it's actually produced; we just couldn't get it out due to some COVID shipping restrictions. Once -- and it's on the water, I think, at this point, so once that comes in, I think we'll be in pretty good shape. But it was -- it's hard to be out of one of your best-selling groups. And it was funny because that group was all actually moved from China to Vietnam to offset this kind of issue, and then Vietnam had some of the same issues that China had. So it just seems like it's a game of Whac-A-Mole. It's very hard to predict what's going to be happening in such a turbulent environment. But we have a lot of pent-up demand for that product, so I'm sure when it comes in we'll do really well with it.

Anthony Lebieczinski: Got it. Okay, thanks for that. And then as far as the price increases that you have put in place, I know you've had to adjust some of your promotional activity because of that, but just wondering what the level of price increases was for the -- in the third quarter and plans going forward to try to offset some of these inflationary issues?

Steve Woodward: It's hard to predict because it depends on the category that you're looking at. We were able to take Christmas products up in price and we didn't seem to get any resistance when the product was on the floor to our higher price points. I think the consumer is expecting that price points will be higher. Our -- some of our furniture increases that we've already taken have not caused an impact or a slowdown. So I guess it's the toggling between making sure that we have the appropriate price increases mixed back with the appropriate amount of discounting. And both of those, for the healthiest brands out there, you do less discounting on better products, and that's one of the hooks that we have and one of the things that we're experiencing.

Nicole Strain: And just to add some numbers to that, Anthony, we really didn't take pricing on Q3 product, just based on the timing of when it was produced and when the price -- the labels were added at the factory. In Christmas and in Q1 and Q2 of next year, I'd say we've offset 150 to 200 basis points of the freight impact in pricing.

Anthony Lebiezinski: Okay. That's good to hear. And then -- so as you prepare the stores for the new furniture and outdoor products, which categories will you be de-emphasizing?

Nicole Strain: For the full year, and I think we talked about this before, our Christmas buys we don't expect to go down from a dollar perspective, but we do expect harvest and Christmas to be a smaller part of the assortment, and there's some other categories within wall, making sure that we've got the right amount of wall and decorative accessories and some other smaller-ticket items that we will reduce, but at this point, really hoping that if we change the way the stores are displayed, it's not a significant reduction in SKU counts; we're just treating it differently on the floor.

Steve Woodward: But [indiscernible] furniture and more home furnishings.

Anthony Lebiezinski: Right. Okay. And lastly, as far as this brand awareness campaign that you're planning for next year, any sort of ballpark estimate as to how much will that cost, and will that more digital or more TV? What media channels will you be using for that?

Nicole Strain: Yes, so I think a little bit early to kind of give details of what that looks like, but for this year, we're going to finish with advertising at about 3.8% of sales, and we did cover some of the increase in '21 with pullbacks in other areas while we were doing tests. I think going into the year, we'll start out with a very similar budget as a percent of sales and then we'll pivot as needed based on the results that we're seeing. But I do think long-term, the brand awareness campaign likely does include a combination of many of those channels. Definitely digital, but also channels that are much more mass media and can get us in front of other people. But we'll continue to update you on that as we have more of that plan laid out.

Operator: The next question comes from John Lawrence with Benchmark Company.

John Lawrence: Yes, Woody, would you just take a step back here and -- obviously on the freight situation and in the marketing situation, if you could -- it's a little unfair because of things moving around, but if you had a chance to replay the tape again, and what decisions would you have made differently, say, September, October, and some of this information didn't come till late October, but anything there that you could have pivoted a different way or what you would have thought differently?

Steve Woodward: Yes, I really feel like probably on one side of the coin, we did a good job of getting our products out of the very highly constrained ports of China, knowing that we'd have to pay more, and being very diligent on making sure that we shipped out the most time-sensitive products of seasonal. I don't think we anticipated as well, and maybe it was because it was a changing environment, of how long it would take once it got out of the port in China and sitting in the water outside of the port of L.A. That seems to be the part that surprised us, both in

products -- for example, I think we used that example of 130,000 throws. It's not the dollars of those throws, but those things become our traffic builders perennially every year as people come in and buy a wonderful \$10 throw, and we just didn't have it this year because we had prioritized, or it was in the wrong container -- it was in a container more with home furnishings versus seasonal.

So I think this has been the big learning for us that we might have been more conservative on the timing that it was going to take, and we had hoped that once we got it out of China it would kind of flow through the system, and our system seemed to move from a problem in China to a problem here.

John Lawrence: Right. And Nicole, to make sure, just to clarify, what was the impact -- you just mentioned it. The impact on the freight was \$0.23, is that what the number was?

Nicole Strain: Yes, it was closer to \$0.35; \$0.23 was just if we normalized that, how much we would have been over last year.

John Lawrence: Wow, okay. Closer to -- and then obviously, not to beat a dead horse there, but the advertising decision obviously, if you'd have known, that could have been a couple of million more that would have been saved along with the freight, correct? So that number, without that spending, the number would have been much higher?

Steve Woodward: Yes. And that was a decision that we felt like had the store been set with -- exactly the way we wanted it to be set, bringing in new customers to show them what we're all about is a good idea, but we -- after we realized that the customers were still very thinking of us, especially at the time of the year, as a seasonal retailer, we had to pivot back. And so that was smart that we pivoted, but we had started that campaign, possibly, a bit early. We're going to pause on that for a little while and wait until January, February, to start the awareness back up.

Nicole Strain: Yes, I think the overall -- two things related to that. So the advertising wasn't necessarily incremental. Yes, we could have stopped it and flowed that through to the bottom line, but we went through an exercise internally where we said, we really want to try this; where else can we take dollars from? And so we did an intentional exercise to try and re-shift expenses so that it wasn't fully incremental. But I think the other thing, and it is learnings, and we'll continue to, as we go down this path, learn things, and then -- and pivot and change, but I think if we use the first half of the year when we have new product to focus on customer acquisition, then when we're in the seasonal time period, we really can work on trying to get those new customers back in again, as well as our existing customers. So just kind of learnings on our model and how this will need to work for us going forward.

John Lawrence: Yes. And the last question from me is the e-commerce demand. You made mention in the release about sort of a decline. Any thoughts there?

Nicole Strain: Yes, e-com, interestingly -- so stores in November picked up week to week. E-com was soft in the middle of the month and then actually was a big part of why we were flat in Black Friday/Cyber Monday week, and even into early December. And again, that's just a

handful of days. Have continued to see e-commerce perform better than it did in Q3 or November, so again, we are providing guidance based on things that are somewhat out of our control, but we do hope to exceed those numbers, and that's where our focus is.

Operator: This concludes our question-and-answer session. I would now like to turn the conference back over to Mr. Woodward for closing remarks.

Steve Woodward: Thank you, Tom. We'd like to thank everyone for listening to today's call and we look forward to speaking with you when we report our fourth quarter and full year 2021 results. Thank you for joining us.

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