Event Name: Kirkland's Home Second Quarter 2023 Earnings Call
Event Date: Wednesday, September 6, 2023, 9:00 a.m. Eastern Time

Officers and Speakers
Cody Cree; External Director, Investor Relations
Ann Joyce; Interim Chief Executive Officer
Amy Sullivan; President and Chief Operating Officer
Michael Madden; Executive Vice President and Chief Financial Officer

Analysts
Jeremy Hamblin; Craig Hallum Capital Group
John Lawrence; Benchmark

Presentation

Operator: Good morning, everyone, and thank you for participating in today's conference call to discuss Kirkland's financial results for the second quarter ended July 29, 2023.

Joining us today are Kirkland's Home Interim CEO Ann Joyce; President and COO Amy Sullivan: EVP and CFO Mike Madden; and the company's External Director of Investor Relations, Cody Cree. Following their remarks, we'll open the call for your questions.

Please note, today's conference is being recorded.

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, Rocco. 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 would like to remind everyone that this call will be available for replay through September 13, 2023. 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'd like to turn the call over to Kirkland's Home Interim CEO Ann Joyce. Ann, over to you.

Ann Joyce: Thank you, Cody, and good morning, everyone. Before we jump into the results, I want to start by expressing my gratitude for the tireless work our associates at Kirkland's are putting in to return our business to profitability. We knew these efforts were not going to translate into immediate success, and we remain up against difficult macroeconomic headwinds, but I am confident we are doing all the right things to right the ship and return the company to profitability.

As expected, Q2 was a difficult quarter, with challenging sales comparisons due to prior year inventory liquidation activity. On a macro level, inflation remains a challenge, as our customers continue to spend a large portion of their disposable income on necessities and experiences. This shift in consumer behavior that began after the pandemic continues to impact our traffic levels as the battle for share of wallet has become even more competitive. As a result of the difficult year-over-year comparisons and decline in traffic throughout the quarter, Q2 comparable sales were down 9.7%.

As we discussed on our last call and as part of our efforts to better engage our customers, we refocused our brand voice toward value and emphasized seasonally relevant home décor, which has historically been a focal point for our brand, and as a result, our decorative accessories category delivered a strong comp increase. We expect continued growth in this category in the quarters to come. Additionally, we had a highly successful Christmas in July promo that drove increased demand in early-season Christmas décor, which is typically a strong indicator for the back half. The performance in these categories led us to a higher year-over-year conversion rate in both channels, and that trend has continued into Q3.

During the quarter, we saw promising indicators from our pivots in the marketing strategy. We shifted our brand voice, getting back our value roots, and while we were more promotional than planned, we were able to leverage our customer data platform to better target our offers. This approach, along with the initial product shift, to emphasize seasonally relevant value décor and a normalizing supply chain, enabled us to expand our merchandise margin by 320 basis points, the key driver in our overall gross profit margin improving by 140 basis points. We also implemented win-back campaigns to target our lapsed customers, and we are encouraged with the initial response from the customers who were quick to reengage.

Through the success we experienced with these merchandise and marketing shifts, our team is already planning to expand these initiatives next summer to capitalize on the additional opportunities in floral, outdoor expanded holiday products, and a reintroduction of back-to-campus. We believe these product assortment changes, along with a revitalized marketing strategy, has the potential to drive more consistent traffic and stronger demand during our historically weakest quarter.

Shifting the focus to operations, I'm proud of how well our organization has managed inventory. With 30% less inventory on the balance sheet compared to the end of Q2 last year, we successfully reduced overhang, resulting in lower borrowings year-over-year. Our network inventory flow has improved and we have the appropriate levels of inventory on hand and in time for harvest and for holiday. Cost containment remains critical for our operations, and in the second quarter, we were able to reduce our operating expenses by over $5 million compared to the prior year period. We continue to manage expenses tightly as we aim to increase the efficiency of every dollar going out the door and improve profitability for the future.

Overall, we anticipated the quarter would be a challenge. We knew this would be a time of transition as we performed an extensive deep dive and identified near-term strategies to return to profitability and growth. Some of our initial changes were promising, but we are still up against difficult headwinds. The home sector remains generally soft and the consumer is under pressure from persistent inflation, mounting credit card debt and higher interest rates. However, we are working diligently to combat the issues outside of our control and significantly improve the areas of business that are within our control.

Over the last three months, we have done a great deal of work to strategically reposition ourselves for success. We've restructured our teams to be a flatter organization with the ability to be nimble. We are listening closely to the voice of the associate and the voice of the customer directly, through connections that are direct, surveys, social listening and more. We've candidly analyzed numerous aspects of our business, including our brand positioning, customer behavior, marketing tactics and our overall operational effectiveness. We worked with industry experts to help drive our assessment, and frankly, also dusted off some of the work previously conducted at Kirkland's and modernized what we believe worked. While this process is still ongoing, we have already discovered many issues to address and our teams have begun executing these near-term initiatives. Overall, I remain confident in our team's ability to deliver upon the expectations that we have set for ourselves. We are committed and driven to return the company to profitability.

Now I would like to turn the call over to our President and COO, Amy Sullivan, who will provide a more detailed commentary on the results of our diagnostics and health checks, as well as our near-term improvement strategies.

Amy Sullivan:  Thank you, Ann, and good morning, everyone. There is no doubt that we faced a challenging quarter in Q2, but we remain focused on the future and our overall vision for the long-term success of our brand.

As Ann discussed, we have been performing a deep dive into many areas of the organization to do a thorough health check of the business, a necessary step in returning to profitable growth. At our core, we are a value-based, specialty home décor retailer, which means we need to constantly provide our customers with a product assortment that has a distinct point of view and includes the latest styles and trends at a great value. Most importantly, we need to make sure we're communicating our style and value to the right customers while delivering an omnichannel experience that meets her expectations when and where she wants to shop.

As we recalibrate our core strategy, we needed to reaffirm why our customers choose Kirkland's Home and the competitive advantages we have in the marketplace. As we've discussed at length, we strayed from what historically resonated with our loyal customer base and we suffered because of it. Our entire team has done an excellent job of getting back to the basics to ensure we are keeping our finger on the pulse of our customers at all times.

As discussed in the last call, we disappointed our core customer in recent years, and it is our top priority to reconnect with her. We have spent time with our customers and associates in stores, online, across social media channels and through quantitative surveys to ensure the voice of the customer is at the core of every decision we make. Our core customer finds joy decorating her home and entertaining her family, especially around the holidays. Celebration is at her core, and her favorite product types are seasonally relevant décor and textiles. She makes her shopping decisions based on style and value. She is motivated by promotions and coupons, especially right now, as macroeconomic factors are top of mind in her day-to-day life. I am proud to say we are committed and more engaged with her than ever before, and we are building a strategy to retain, win back and attract new customers.

To achieve this level of customer engagement, our marketing is undergoing a complete overhaul and we've inserted new leadership within this department to help drive those changes. We must be more targeted in our approach and get back to some of the basic strategies that we know drive omnichannel traffic for our customer.

As a result of the marketing health check, we discovered that broad-based media tactics were being overused and marketing dollars weren't allocated effectively for a specialty retailer of our size, location and customer base. We are better served by targeting the customers within the geographic areas that align to our store footprint. We believe this will more efficiently use our marketing dollars to drive traffic and demand. The vast majority of our e-commerce shoppers are also within 15 miles of a Kirkland's Home storefront, so localization within our marketing campaigns is now a top priority.

Speaking of the Kirkland's Home storefront, we had also pulled back on traditional brick-and-mortar marketing support such as internal and external signage. We believe this impacted our customer experience and conversion, and we plan to return to an increased in-store strategy for the remainder of this year and going forward to engage the customers from the parking lot throughout the store. We intend to make sure that our curated looks and great value promotions are clearly communicated to the customer throughout her shopping experience.

Direct mail was formerly a key tactic in our customer communication strategy; we used to send four to six direct mail pieces a year to coincide with the new product launches, seasonal holiday sets and key promotional events throughout the year. We brought this strategy back in Q2 with a limited audience of both loyal and lapsed customers. Based on the results, direct mail is now planned to be a key driver in our go-forward marketing strategy. In fact, we have one hitting homes this week with our Fall Back in Love with Kirkland's campaign and will launch another campaign for the holiday season. We will leverage our loyalty program and customer data platform to target our most valuable customers, announcing product launches and delivering exclusive, limited-time coupon offers through direct mail.

I am excited by the renewed commitment to our customer. Our full frontal marketing strategy will be built with the goal to reach new customers, drive omnichannel traffic and engage with lapsed customers to increase their purchase frequency. We will leverage geo-targeted advertising to reach omnichannel customers within 15 miles of each store location. We believe creative enhancements will improve the customer's in-store and online shopping experience through seasonal story-telling and clear value messaging. We plan to have a strong, active presence on social media by sharing curated content to inspire her passion for decorating and entertaining.

Last, but certainly not least, we are planning to enhance our K Club loyalty program. We have confirmed we are still beloved by our loyal customers and we are committed to delivering the product, value and experience she expects from us. Maximizing our loyalty program benefits for our customer will help solidify our commitment to her for years to come. We look forward to sharing more about this initiative in the coming months.

With our customer at the center, we took the same diagnostic approach in other areas of the business and are committed to recalibrating our strategic priorities with a back-to-basics mentality. I'd like to share some of the learnings from our omnichannel health check. We are embracing a digital-first omnichannel strategy as our foundation for the future. This starts with a unique optimized product strategy both online and in brick-and-mortar stores. Our growth in large-scale, higher-priced furniture cannibalized our seasonal and décor categories in brick and mortar; however, furniture is a key driver of sales and profitability for e-commerce. As we redefine our assortment strategy, furniture has been and we believe will continue to be an important part of the business, but we will be rebalancing our pricing strategy to ensure we are true to our value heritage.

We have renewed our focus, our organizational structure and our tools to ensure our product category strategy and product flow is uniquely optimized for each channel. I'm incredibly proud of the work our merchants have done in this short time to adjust our category mix and pricing strategy to renew our commitment to value home décor. As Ann said earlier, we saw promising demand in Q2 in decorative accessories and holiday. Halloween in particular is currently driving strong demand, which we believe will be a good indicator for holiday products later this year. We are committed to evolving our product assortment strategy, allowing our customers to have a unique but cohesive curated experience both online and in stores.

As we solidify our merchandising channel strategy, we are wrapping up a full end-to-end assessment of our e-commerce platform. We are assessing short- and long-term roadmaps to ensure we have a modern platform that meets the expectations of today's shoppers. We look forward to sharing more about our long-term e-commerce roadmap in the future, but in the meantime, I'm happy to report that we've seen traffic and conversion improvement directly correlated to the pivots in our overall brand and product strategy, as well as our renewed marketing tactics. Most recently, we drove the highest online conversion since 2021 through the right combination of marketing tactics and seasonally relevant product focus to drive demand. These wins provide further clarity to the future of our channel strategy to support long-term e-commerce growth.

I'd like to take a moment to talk about our in-store experience. I've had the pleasure of dedicating time each week to store visits and calls with our incredible store teams. These teams are the heart of the brand, and they are committed to creating community for their customers and their stores. I am committed to ensuring that we simplify and optimize our operational efficiencies to improve the in-store experience for both the customer and the associate.

In partnership with our new supply chain leaders, we are resetting standards for product flow and delivery. Our teams are traveling to stores and to the distribution center to work and review every step of their discipline and its impact on our customer and associates to ensure we are constantly striving for operational excellence. Our IT team successfully upgraded our POS system in Q2, which is an excellent foundation for our future growth as we strive to have a seamless omnichannel experience.

In addition to improving operational efficiencies to the store, we are excited to support our store teams this holiday season by rebalancing payroll and introducing new incentives and contests to keep our associates engaged and rewarded for their incredible dedication and passion for our brand and our customer.

As a brand, our teams are more aligned than ever before around our five near-term strategic initiatives that drive our path to profitability and growth: one, we are committed to keeping the voice of the customer at the center of our brand. We are in the process of resetting our brand voice and marketing tactics to acquire, reactivate and retain her. Two, we are committed to being product obsessed, delivering curated on-trend and seasonally relevant home décor at a great price. We plan to be known for always something new to ensure we drive demand all four quarters. Three, we plan to deliver an omnichannel strategy that meets her whenever and wherever she wants to shop. This will drive a path to profitable growth unique to stores and e-commerce. Four, we are committed to remaining disciplined in our operational effectiveness through supply chain efficiency and performance, tech enablement and cost containment. This is the foundation for sustained profitability and value for our shareholders. And five, we are driving to have a high-performance culture built for success and continuity with the voice of our associates at the center. We are revitalizing our company culture day by day and I have seen a new energy in this organization that I'm proud to be a part of.

Before I turn the call over to Mike, I'd like to reiterate my gratitude to our associates, vendors and stakeholders who continue to support our journey. It is not yet apparent in our financial results, since we just started this transition a few months ago, but we are making tangible progress in diagnosing and evolving every function of the business. It won't be easy and will likely be challenging in the near term, but we remain committed to delivering long-term value to all of our shareholders.

With that, I'd like to turn the call over to Mike, who will provide detailed commentary on our financial performance in the second quarter. Mike, over to you.

Michael Madden: Thank you, Amy, and good morning to everybody. For the second quarter, net sales were $89.5 million, and that's compared to $102.1 million in the prior year quarter, which included a 5% decline in the average store count and a comparable sales decline of 9.7%. The decrease in sales was largely driven by traffic declines both in store and online, partially offset by an increase in conversion rates. The average transaction value was down 4% for both channels, comprised of small decreases in the average unit retail and items per transaction.

Breaking down sales within the quarter, comps were down 10% in May, down 13% in June and down 6% in July. E-commerce was 27% of total sales during the quarter, compared to 28% in the prior year quarter. Stores outperformed e-commerce on a year-over-year basis with comps down 7% versus 17% for e-commerce.

From a merchandise perspective, our outdoor category had the largest decline compared to the prior year. This was primarily due to later receipts in the prior year that caused a shift in the selling period from the first to the second quarter in 2022. We also saw declines in higher-ticket categories with wall and furniture having the largest declines compared to the prior year. These declines were offset partially by gains in holiday and decorative accessories.

Sales performance was relatively consistent across geographic regions, with slightly better results in the Southeast and Florida and weaker results in Texas and in the West.

Gross profit margin increased 140 basis points to 19.5% of sales, compared to 18.1% in the prior year quarter. The key components of this year-over-year change are as follows: First, merchandise margin increased 320 basis points to 51.2% versus 48% in the prior year quarter. Lower freight rates and lower inventory levels, along with improved product flow, drove the increase in merchandise margin.

Second, central distribution costs increased 110 basis points to 6.1%. The increase as a percentage of sales is largely due to de-leverage from the sales decline combined with lower capitalized costs this year versus last year. On a cash basis, distribution costs were $1.7 million lower than the prior year quarter, reflecting improved labor efficiency and lower inventory storage costs.

Third, store occupancy costs increased 200 basis points to 15.5%. The increase as a percentage of sales is primarily due to deleverage from the sales decline. Actual rent was up slightly versus the prior year quarter.

Fourth, outbound freight costs, including both store and e-commerce shipping expenses, improved by 70 basis points to 8%. The improvement is primarily due to a reduction in shipping activity resulting from lower inventory levels. As a result, we ran fewer routes to the stores than in the prior year.

And lastly, depreciation included in cost of sales decreased by 60 basis points to 2.1%.

Total operating expenses excluding impairment charges declined by $5.6 million to $34.5 million, or 38.6% of sales, compared to $40.1 million, or 39.3% of sales, in the prior year quarter. The decrease was primarily the result of reductions in corporate overhead and marketing expenses, along with tight expense control of store and e-commerce expenses. Impairment charges related to underperforming stores and technology assets were $1 million for the quarter, compared to $200,000 for the prior year quarter.

Adjusted EBITDA, excluding impairment, stock compensation and other minor expenses, improved to negative $13.5 million versus negative $16.4 million in the prior year quarter. Our operating loss improved to $16.6 million versus $20.8 million in the prior year quarter.

Our income tax rate was an expense of 3.5%, compared to an expense of 16.4% in the prior year period.

Moving to the balance sheet, our inventory levels are under control and flowing according to plan. We ended the quarter with $98.9 million in inventory, versus $84.1 million at the end of last year and $141.7 million at the end of the prior year period. We had borrowings outstanding of $46 million, compared to $55 million in the prior year quarter. Our holiday inventory has largely arrived in our distribution centers and is in the process of being distributed to stores.

Moving to our outlook for the remainder of the year. We are continuing our policy of not providing specific guidance given the difficulty in forecasting visibility around the macroeconomic environment and its impact on our traffic and conversion trends. However, we do want to provide some color around our expectations for key areas.

Early into the third quarter, the environment remains challenging. Traffic continues to be a significant headwind and customers are scaling back on higher-ticket purchases. We faced difficult comparisons early in Q3 due to excess inventory clearance in the prior year that are proving to be more challenging than anticipated. However, on the plus side, we are seeing strong improvement in our conversion rate in both channels, which provides us with some optimism that our merchandise adjustments are gaining traction with the customer.

We expect sales to stabilize toward the end of Q3 and begin to improve in Q4 as our marketing and merchandise adjustments take hold. The comparisons are positive on the margin side, with less inventory to clear and a merchandise assortment that is well positioned for the holiday period. We continue to expect merchandise margin improvement in the back half, particularly as we get deeper into the holiday season.

Our supply chain efficiency continues to normalize with lower inventory levels, which should also help improve gross profit margins in the back half.

We continue to manage operating expenses very tightly as we focus on doing more with less. The level of year-over-year decline in operating expenses for the back half will moderate somewhat as we begin to anniversary heavy expense reductions from the prior year as well as strategically fund areas such as store payroll and marketing.

In terms of our overall profitability for '23, our goal has been to return to positive adjusted EBITDA while generating sales momentum for a stronger start going into 2024. Achieving that goal for the full year will be more difficult now, given the second quarter results and the current trends, but we expect to be adjusted-EBITDA-positive for the back half with the bulk of the improvement coming in the fourth quarter.

When it comes to our balance sheet, we expect to reach peak inventory levels between $110 million to $120 million and peak borrowings around $60 million toward the end of the third quarter. This would be an improvement over the prior year, and the composition of our inventory, with a deeper seasonal component and a reintroduction of giftable product, should provide us with more ammunition to drive sales gains.

Looking beyond 2023, our goal is to get back to mid- to high-single-digit adjusted EBITDA margins, which has been our historical average. To do this, it starts with improvements in the top line. Amy talked about the activities under way to restore and grow the customer base and create sales momentum. These efforts will take some time to bear fruit, particularly in a challenging consumer environment, but we are building off historic lows. Our current average store volume is around $1 million. Prior to the pandemic, our average store was doing around $1.4 million. Making up only half of that lost ground on our current store base would yield over $65 million in additional revenue, which would translate to over $25 million in adjusted EBITDA potential.

E-commerce improvements provide additional top line potential. We have already taken steps to enhance our sourcing capabilities, improve supply chain efficiencies and remove fixed costs from our distribution facilities. While still early in the process, we are beginning to see improvements in our merchandise margin and our supply chain cost structure because of these efforts. We are addressing additional ways to streamline our operating cost structure. Significant reductions have been achieved over the last several years, but we believe there are additional areas to address and redeploy. The combination of these factors provides a pathway to returning to historical adjusted EBITDA levels. In the coming quarters, we will provide updates on our progress in each of these areas.

Lastly, I would like to reiterate our priorities for capital allocation. We continue to focus first on reducing borrowings and reestablishing a level of liquidity that allows us to operate the business with more flexibility. As that milestone is achieved, we will focus our efforts on reinvesting in the business with strict return parameters. From there, we can start looking at share repurchases and dividends as additional ways to return value to shareholders.

On that note, I'd like to express my gratitude for our employees, our partners and stakeholders for your support and commitment to the Kirkland's Home brand. I am confident that our collective efforts will pave the way for long-term success and create value for our shareholders.

That concludes our prepared remarks. Operator, we're now ready for some Q&A.

Questions & Answers

Operator: [Operator Instructions]

And today's first question comes from Jeremy Hamblin with Craig Hallum Capital Group.

Jeremy Hamblin: I wanted to see if we could get a little bit more color here on the commentary on trends, same-store sales trends, because it sounded a little mixed, that you were encouraged by the early response to seasonal goods, but I sensed some caution here in terms of what you saw in August, so I was hoping you might be able to provide a little more detail, maybe, on what the combined same-store sales was for August.

And then also, you noted that compares do get a little bit easier from here; wanted to see if you could gauge for us what the magnitude of the compares easing is.

Michael Madden: Sure, I'll start, Jeremy. This is Mike. And Amy can fill in. But as to trends so far in the third quarter, they continue to be tough, as I said in the prepared remarks. And I would think about it along the lines of how we performed in Q2, but keeping in mind that we are up against the initial part of the inventory liquidation; the really deep phase of it was really kicking in, in August this time last year. And so even over the Labor Day weekend, we had a really strong one last year with a lot of liquidation effort, so we're going to be coming out of that time frame where compares for the rest of the quarter do ease up a bit. We had -- and then kind of going deeper into the year, November was a relatively strong month for us last year, but December was very weak, and so we see more opportunity in that time frame as we've got a better assortment and we've got a giftable assortment coming in that will support that December time frame, and we really just didn't have the product last year to really compete. So that's kind of how the compares play out for the rest of the year, and Amy --

Amy Sullivan: Jeremy, the only thing I would add to that would be, as you know, we're making pivots to our category mix, and so the impact we were able to have on Q2 results and even this first part of Q3 is relatively small, so the optimism that we're seeing in categories like decorative accessories and holiday become more fruitful in the back half because we were able to make larger pivots in the category penetration of those key categories as we moved later into the year.

Jeremy Hamblin: Got it. Thanks. And then in terms of -- you noted that you thought that if you returned to, like, $1.2 million in net sales per store from the $1-million run rate, and that you had a goal to get back to mid-single-digit to high-single-digit EBITDA margin, in terms of just realistically, it seems like that's still going to be a challenge in 2024 unless you really see a massive acceleration in comps. Is that something that you're thinking more of, like, 2025 type target, or 2026? Just wanted to make sure that expectations weren't for, like, a 2024 turn of that magnitude.

Michael Madden: Yes, I'll -- Jeremy, I don't think we can sit here and say we'd be at that level for '24 knowing what's going on in the environment and where we stand in trying to get our customers back in the fold and all the activities that we just talked about on the call here. But I do think we can see market improvement in '24 relative to '23 as we have a full year's effect of the assortment changes and the marketing changes that we're talking about, so that we can get back to a positive EBITDA position in '24. How strong of a position that is will depend on just the top line and our progression there, but to get back to that mid- to high-single, just -- I don't think we're ready to say that's going to happen so quickly, but we are confident as we build on this next year we can get there beyond '24.

Jeremy Hamblin: Got it. And then in terms of just borrowing cost expectations and thinking about where the interest rate environment is, you guys made moves earlier this year to kind of shore up or extend out your maturity dates; how should we be thinking about kind of those interest costs here on either a quarterly basis or an annualized basis with where kind of rates are currently?

Michael Madden: Yes, I would think, like -- I'm looking at the back half last year. We had interest of about $1.2 million. This year that's probably going to be up a few hundred thousand dollars, maybe half a million dollars, on top of last year, for the back half, just knowing where we are and where the rates are today. I do think our borrowings are going to peak out lower than last year because our inventory levels are in very good control relative to last year, so the borrowing need this year is a little bit less as we've built up here in the season. But the rates are higher, and to your point, that will be a little bit more expense for us this year in the back half versus last year.

Jeremy Hamblin: Got it. And then last one: In terms of the pivot on marketing and noting that you used to have four to six direct mailers, bringing that back to some degree, how do we think about that in terms of your operating expense budget here in the back half of the year? It sounded like you still think it's going to be down year-over-year, but only maybe modestly, versus last year. Any color you can share on that?

Amy Sullivan: Sure, Jeremy, I'll take that. And our marketing expense year-over-year is down roughly $5 million, and we are self-funding within that current marketing budget these pivots that we're making in the marketing strategy. As I mentioned before, just more efficiently using the dollars and targeting them to our core customer in ways that we've used in the past. We're able to self-fund those for the balance of this year, and they'll be strategically built into a relatively flat budget as we plan for next year as well.

Michael Madden: Yes, we're kind of aiming for about a $13-million, give or take, marketing number this year. We may, depending on what we see happen over the next couple of months, that number may move around a little bit, but I think that's where we'll end up. So that'll be down year-over-year.

Operator: [Operator Instructions]

Our next question today comes from John Lawrence with Benchmark.

John Lawrence: Could you give me just a couple of thoughts as -- Mike, you talk about that -- what's been impacted in some of those categories that you were pleased with -- it's small -- in the third quarter as far as holiday and harvest, and if we move forward, just what's the delta as we get to the maximum holiday period? If it's X, what you've seen so far, to what extent does it move up into the mix as we get into peak holiday?

Amy Sullivan: Hi, John, it's Amy. I'll start and Mike can add any color. As we move into the back half of the year, we did plan our most significant comp growth in our Christmas assortment within holiday. Other growth would really come from the decorative accessories and giftable parts of the business. So as we mentioned earlier, we're obviously making sort of live pivots throughout the quarter, but I would say the Christmas growth of about a 5% year-over-year comp is really getting it back to a healthy percent to total, the bigger component of that being this December opportunity to really maximize on the décor and gifts, while at the same time, as I mentioned, furniture still being an important part of our business, getting it back into the teens within our brick-and-mortar assortment so that it allows space and opportunity for the holiday and giftable businesses to really shine.

Michael Madden: Yes, it's going to be a noticeable shift in terms of the penetration of these categories that -- the seasonal, the dec access that we've talked about in Q4, and we did a, I think, a really good job of trying to go deeper in some of those key items for the season as well, so that's something we just didn't have in place last year, so we're optimistic about that.

John Lawrence: And to follow that, are there any guideposts of some of those areas you've really touched -- I guess they were positive toward -- can you give any -- kind of sort of quantify to what extent they were positive and sort of returns on that, how you're looking to measure that particular category as far as success?

Amy Sullivan: Yes. If you look specifically at the Q2 period and even early sales in the beginning of Q3, decorative accessories delivered a double-digit comp increase year-over-year, and so that category in particular will continue to grow in its penetration as we get through the balance of the year. And then the other indicator I would share that gives me a lot of optimism for our holiday products in general is we saw really fast turn and success early in the season in Halloween, and as you know, our seasonal business is really our high-low, and we promote them effectively and still end at a solid margin rate at the end of each season, but the Halloween products in particular sold with minimal discount, and we took the same approach in the pricing strategy and the assortment mix to Christmas, that gives me just a lot of optimism that we should see some of that early season selling come through as we get to the latter half of this quarter in our holiday product.

John Lawrence: And the last question from me: Amy, as you looked at that -- some of those marketing efforts, trying to bring back some of those customers and direct mail pieces to those longtime shoppers, what was your sort of bounce-back rate or sort how did you view that sort of -- I know you're changing some things and all that, but how did you view that sort of spend to do that?

Amy Sullivan: Our approach was several different layers, and so we started with a customer survey that we saw really fast and high levels of reaction to of our customer that was six to 12 months lapsed, that was really willing to engage and give us feedback on what she was missing from us.

Additionally, the Q2 direct mail piece, which in our past we would normally have targeted to solely our top customers, we sent it to a mix of lapsed and top customers and saw a really promising response to both with a higher-than-average conversion rate on that coupon offer.

And then the last example I would share would be, we sent a customer letter acknowledging that we are back to our heritage roots and that she can expect seasonally relevant, high-value décor from us for years to come and offered her a coupon offer with that, and these were our most lapsed customers, and we really saw a solid response to that conversion as well.

So I think where that leads us is, we have a very active loyalty base, some who are currently spending at her normal rates and others who have been lapsed longer than we like, and we're really encouraged by her willingness to come back as we get the assortment and the pricing strategy right.

Operator: Thank you. At this time, this concludes our question-and-answer session. I would now like to turn the call back over to Ann for closing remarks.

Ann Joyce: Again, I just want to reiterate our gratitude for the support of our teams, the hard work from our teams, as well as our vendors and our stakeholders. Thank you all for joining today. We'll talk to you next quarter.

Operator: Thank you, ma'am. This concludes today's teleconference call. You may now disconnect your lines at this time, and thank you for your participation.