

Event Name: Kirkland's Home First Quarter 2022 Earnings Call

Event Date: Tuesday, May 31, 2022, 9:00 a.m. Eastern Time

Officers and Speakers

Cody Cree; External Director, Investor Relations

Steve Woodward; President and Chief Executive Officer

Nicole Strain; Executive Vice President, Chief Operating Officer and Chief Financial Officer

Analysts

Jeremy Hamblin; Craig Hallum Capital Group

Anthony Lebedzinski; Sidoti & Company

John Lawrence; Benchmark

Barry Haimes; Sage Asset Management

John Lewis; Osmium Partners

Presentation

Operator: Good morning, everyone, and thank you for participating in today's conference call to discuss Kirkland's financial results for the first quarter ended April 30, 2022. Joining us today are Kirkland's President and CEO, Steve "Woody" Woodward; COO and CFO Nicole Strain; and the company's External Director of Investor Relations, Cody Cree. Following their remarks, we'll open 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: [Indiscernible] for historical information discussed during this call, the statements made by company [indiscernible] forward-looking and made [indiscernible]. Forward-looking statements involve [indiscernible] which may cause Kirkland's actual results in future periods to differ materially from forecasted results. Those risks and uncertainties [indiscernible] described in Kirkland's filings with the Securities and Exchange Commission.

I remind everyone that this call will be available for replay through June 7, 2022. The 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 to Kirkland's President and CEO, Woody Woodward. Woody, over to you.

Steve Woodward: Thank you, Cody, and good morning, everyone. It has certainly been a challenging start to the year. Like many of our peers, our first quarter results were significantly impacted by lower customer demand and higher costs associated with various supply chain constraints. Anyone who's been paying attention to the consumer commentary over the last few weeks knows that the broader retail landscape is being notably affected by several concerning macroeconomic trends, including rising interest rates, elevated levels of inflation, the ongoing

geopolitical conflict between Russia and Ukraine, and increased supply chain costs stemming from higher freight costs and transportation rates.

Kirkland's is not immune to these issues; in some ways, we're feeling it more than our peers in the home furnishings space. It appears our value-focused customer is more negatively impacted by these macroeconomic issues compared to the wealthier customer bases that shop at premium store brands and have more discretionary cash to spend. We believe our consumer has shifted some of their discretionary spend to experiences, such as going out to eat or taking a vacation, given that the pandemic's restrictions are being largely lifted. Simply put, our customers are not prioritizing their discretionary spending on home furnishings and décor right now.

When you combine waning customer demand with wage inflation and a hypercompetitive hiring environment, and heightened freight and transportation costs, you have the perfect storm that makes it exceptionally difficult to generate meaningful sales momentum. Executing upon a meaningful transformation strategy within this environment is even harder. However, we will remain -- still remain steadfast in our commitment to becoming a premier home furnishings retailer offering value, quality and design throughout an omnichannel experience. As we discussed a few months ago, we'd slowed down our pace of change as we weather the storm and wait for a more opportune time to put our foot back on the gas pedal to accelerate sales growth and expand our customer base.

All this being said, we're still making progress on initiatives that are within our control. We launched our advertising tests in April across two key markets, Nashville and Atlanta, to drive brand awareness and generate new customer interest. While we only have just begun to roll out these marketing programs amid a challenging environment, the initial feedback has been positive. We will continue to gather data from these tests to glean insights on whether these initiatives could work on a broader scale across our national store footprint once customer sentiment begins to rebound.

We also recently test-launched our in-home delivery service to better serve our customers looking to buy bulky items such as furniture and outdoor items, with a full national rollout scheduled in the next month. As we've discussed on previous calls, this was an imperative next step in becoming -- in improving our omnichannel capabilities. We continue to expect this to be a welcome enhancement within our overall customer experience and will continue to look for ways we can better serve our customers going forward.

We are also in the final stages of cleansing our customer data to start actioning our consumer data platform. As we have said on previous calls, this will give us much needed insights on customer behavior, as well as the ability to segment our customer base and target different groups with different offers and messaging. This capability will be especially critical as we navigate through the dynamic consumer backdrop we're experiencing.

Given the volatile macroeconomic environment and our performance to start the year, we will balance and pace our -- we will balance the pace of our transformation in 2022 with prudent expense management, which Nicole will cover in more detail. Historically, we've relied on strong sales from holiday season in the back half of the year to generate cash flow we use to

bolster our balance sheet, especially since we burn cash in the first half of the year. While we are positioning our furniture and outdoor categories to allow for more balanced sales throughout the year, we aren't there yet, and with the challenging consumer backdrop, maintaining an adequate cash balance and appropriately using our credit facility is our top priority. Nicole will go into more details regarding our near-term capital allocation priorities, but we plan on operating as efficiently as possible.

We believe the strong inventory position that we built was necessary to ensure that we had our shelves stocked when our holiday season arrived, and that we weren't leaving any sales on the table due to simply not having the product in time. We are cautiously optimistic that our upcoming holiday season in the back half of the year will help augment our financial results for the year. However, we're also planning on being more promotional than we had originally intended to be in 2022. We believe this will allow us to fuel sales momentum with our core customer base and work through our inventory stockpile to generate cash flow.

We discussed at length in our last call about our customer acquisition challenges and how we're having to slow down from our efforts to allow the market to fully understand our enhanced merchandise assortment without losing our dedicated and loyal customer base. While the challenging consumer backdrop is impacting our results, I think it is relevant to note that Kirkland's has historically performed well during recessions or periods of stagnant growth. As customers get over the initial shock and begin value-hunting for ways to upgrade their home furnishings and décor without breaking the bank, we do believe there is an opportunity to capture attention from the new customer and begin to increase market share.

With our new assortments that feature elevated design concepts and higher-quality materials at a value price, we believe Kirkland's Home is the perfect place for consumers to stylishly furnish their home on a budget. For this reason, our unwavering commitment to executing our transformation will continue during these challenging times. Our strategic goals remain the same and we're doing everything we can to maintain our course and hit our objectives.

Our shareholders are always top of mind when we're evaluating our strategic direction and ensuring that we're making the best decisions to generate as much long-term value as possible. We plan on conserving our cash and being prudent stewards of capital as we weather the difficult environment, and we anticipate coming out of this even stronger than before.

As always, I'd like to recognize our dedicated employees and stakeholders that continue to believe and support our efforts in executing our transformation strategy. It certainly has been -- not been an easy road over the last few quarters, but their perseverance continues to inspire me every day. I firmly believe that we have only just begun to scratch the surface of Kirkland's true potential within the home furnishings space, and I look forward to what the future holds for us as we continue making progress on our transformation initiatives.

With that said, I'll now turn over the call to our CFO and COO, Nicole Strain, who will provide detailed commentary on our performance in the first quarter and our outlook. I'll be back during the Q&A to answer any questions you may have. Nicole, the floor is yours.

Nicole Strain: Thank you, Woody, and good morning, everyone. Before getting to the details and numbers, I wanted to summarize what we saw in the first quarter and how it impacted our business.

Comps continued to decline within the quarter, driven mainly by lower customer traffic. Our landed product margin came in better than expected, down 90 basis points to 2021, due to less discounting and taking retail price increases. We've talked in the past about how much of our costs are fixed in the first half of the year, which is in line with our goal to shift our assortment mix to products with stronger selling in the first two quarters, and fortunately, the first quarter shows deleverage of our operating model at this sales level.

Moving into May, we have begun experimenting with our promotional levers to stimulate customer demand and churn through excess inventory. To date, we are seeing sales improvement from what we saw in March and April, but still down double digits. We do expect to continue to be more promotional in the near term, which will impact our margins.

Given that the second quarter has historically been our toughest quarter, we expect Q2 earnings to decline from Q1.

Lastly, our plan to finally be in stock from an inventory perspective and bring in product for Q1 and Q2 sales early had a negative impact on our working capital. That was compounded by the slow sales in the first quarter, which resulted in a \$35-million draw on our revolving line of credit. I'll get more into our cash flow and how that impacts our capital allocation plan a bit later.

Jumping into our results for the quarter, net sales were \$103.3 million, compared to \$123.6 million in the year-ago quarter, which included a comparable store decline at 15.8%. The decline was exacerbated by macroeconomic conditions impacting the home furnishings industry and driving down traffic and conversion in both our in-store and e-commerce channels. Breaking down sales within the quarter, we had a total comp decline of 5% in February, a comp decline of 19% in March and a 22% decrease in April. E-commerce accounted for approximately 28% of our sales in the quarter.

Gross profit was 27.4% of sales, compared to 32.6% in the prior year quarter. The decline was mainly due to de-leverage of fixed infrastructure costs.

Landed product margin was 56.6%, compared to 57.4% in the prior year period, with lower discounting offsetting some of the expected incremental freight year-over-year. Store occupancy costs increased to 15.9% of sales, compared to 13.6% in the prior year quarter, due to the lower sales base. DC costs increased to 5.1% of sales, compared to 4.6% in the prior year period, from wage inflation and reduced productivity from higher inventory levels and implementation of a new warehouse management system. Outbound freight costs from our distribution centers to our stores increased to 2.4% of sales from 2% in the prior year due primarily to rate and fuel inflation. E-commerce shipping costs remained relatively flat at 4.4% of sales, compared to 4.5% in the prior year quarter. Lastly, other costs of goods sold increased 120 basis points, mainly due to increased damages with the higher inventory.

Operating expenses excluding depreciation and impairment were \$37.7 million, or 36.5% of sales, compared to \$36.3 million, or 29.4% of sales, in Q1 2021. Wage increases specifically impacting store labor, along with increasing employee benefit costs, were the primary drivers for the increase in operating expenses.

Adjusted EBITDA, excluding impairment and other minor non-operating expenses, was negative \$5.8 million, compared to \$7.7 million in the same period last year.

Our normalized tax rate in the first quarter was 25.5%, compared to 24.7% in the prior year period.

Adjusted loss per share, which excludes noncash impairment, normalized tax rate and other minor non-operating adjustments, was \$0.62, compared to an adjusted earnings per share of \$0.12 in the prior year. GAAP loss per share including these items was \$0.63, compared to earnings of \$0.11 in the prior year.

We ended the quarter with \$5.4 million in cash and utilized \$35 million in borrowings on our revolving credit facility. As mentioned before, we shipped and paid for the bulk of the inventory we expected to sell for the first half of the year during Q1, which resulted in us tapping our revolving credit facility. With slower sales in our harvest and Christmas inventory arriving in the second quarter, we expect to be further drawn on the credit facility through the third quarter. We expect to reduce the borrowings significantly as we sell through this holiday inventory in the fourth quarter and right-size our overall inventory position.

We have taken a series of actions to reduce our reliance on the credit facility, which includes reducing expected inventory receipts by approximately \$50 million in the back half of the second quarter through the remainder of the year, implementing operating cost reductions in the remainder of the fiscal year of \$12 million to \$15 million, and increasing our level of promotion to churn through existing inventory at a faster pace.

Inventory at the end of the quarter was \$130.9 million, which was an increase of \$54.6 million from the same time last year and up \$16.9 million compared to the end of the fiscal year. We expect our inventory levels to peak in August and decline to under \$100 million by the end of the fiscal year.

We continued our share buyback in the first quarter with approximately 480,000 shares repurchased for \$6.3 million at an average cost of \$13.03 per share. At the end of the first quarter, we had a cumulative authorization available of \$26.3 million. We continue to believe in share repurchases as a valuable component of our capital allocation strategy; however, given market conditions and our current forecasted reliance on our credit facility for the upcoming quarters, we are focusing first on making sure we maintain the liquidity needed to support the business. Additionally, our credit facility places certain restrictions on share purchases while in a borrowing position. We will revisit this program as cash flow allows.

Our transformation efforts remain, and I believe we've built a strong operational foundation that will carry us through this challenging environment. Although we are operating with macro

headwinds, we remain confident that we are on the right track and executing according to our strategic transformation. We will continue to focus on the areas we can control and on unlocking the potential of Kirkland's as a specialty home furnishings retailer.

Thank you all for joining us today, and operator, we are now ready for Q&A.

Questions & Answers

Operator: [Operator Instructions]

Our first question comes from Jeremy Hamblin with Craig Hallum Capital Group.

Jeremy Hamblin: So I wanted to start by asking about the inventory management and so forth. In terms of getting that inventory level down below \$100 million, the first part is understanding the composition of the elevated -- I think by my math, inventory was up about 70% year-over-year. Obviously, seeing sales trends down, high teens in total. In terms of thinking about the component parts of that inventory, how much of that was just the freight impact and, whether it's fuel surcharges, other costs, as opposed to the actual pieces themselves that are kind of stacking up? I wanted to just see if we could get an understanding of the component parts and how much of this is actually just inflationary pressures that are hitting you guys.

Nicole Strain: I think a couple of pieces there. So when we compare to last year, we were really low from an inventory perspective, so we had been operating well under where we wanted to be, so we're definitely seeing freight be a big piece of the growth, and we also have the \$8 million of seasonal that we're carrying over to this holiday season. So I'd say that the right number for us is somewhere in between where we were a year ago and where we ended the quarter. So -- if that helps.

Jeremy Hamblin: That is helpful. And then in terms of what you're seeing in the industry, because I think your observation is right that consumer is shifting where they're spending dollars, maybe perhaps more on experiences, but certainly we've seen the home furnishings category soften as a whole; wanted to get an understanding -- you noted that perhaps you have a less affluent customer, more value-oriented -- wanted to get an understanding of how you're seeing the industry pivot here, as I think even at the high end they've seen kind of a rolling over in sales trends, and whether or not you're getting a whole category that's starting to be a little bit more promotional, and whether or not you see that as potentially impacting your ability to clear through goods here over the next couple of quarters.

Steve Woodward: Jeremy, thanks for the question. It's Woody. Multiple things embedded in that. First of all, let's talk about the industry as a whole. I think that people are -- when times are tough and you're filling up your gas tank at \$120 or \$100, and then you go to the grocery store and it's expensive, they are just being more cautious on those discretionary items like what we sell. We don't sell one thing that a customer has to have; we sell things that are wants and dreams.

In the history of the company, when times have gotten tough and we've gone into a recessionary time period, we were -- we benefitted from some of that as being a value player. So we're anticipating that as people kind of change and refocus back on their homes, which if you look at housing and all the components that make that up, I don't think that we have a disaster on our hands; we just have a shift of focus.

But we are seeing our brethren, both at the high end, medium end, low end, being more promotional right now, and that's because this inventory situation caught a lot of us off guard. We were so low by ending last year that we wanted to be in stock this year for our customers, and it came right at the time that the inflation started, and the war started, so I think everyone is a little bit bloated on inventory and they don't want to be, so we will have to be more promotional, I think, in the coming months to liquidate through and get ourselves right at the right level of inventory, which I think Nicole said is around \$100 million or a little bit less, as we go into the next year.

All that being said, the component of our inventory is fairly good. I mean, we're not bloated in one particular category; we seem to be -- it's just the lack of traffic that's caused this decrease in expectation in sales. And so we don't have a lump problem; we have kind of an overall issue where we're just lowering the inventory. It's good inventory; it just, it didn't sell as fast.

And then one other component of that inventory that I think I should mention is that when you have traffic declines like we've had in the past quarter due to these macroeconomic environments, both the things that we've changed dramatically and the things that we haven't changed dramatically are both experiencing the same kind of downtick. So in areas like our candle assortment where we didn't change that much, they're feeling the decline; in areas where we changed dramatically with our increase in furniture and the quality and all the design aspects declined about the same amount. So we do know that it's an overall macro hit on our sales numbers versus it being in one particular pocket. The one area that we will be a little bit more promotional during the next very short period of time is making sure that we liquidate our outdoor category so that we don't carry that seasonal inventory into the third and fourth quarter.

Jeremy Hamblin: Great, that's helpful color. And taking that a step further, you noted, I think, the cutting of roughly \$50 million or so of inventory receipts in the back half of the year; wanted to get a sense of kind of the component departments or categories where you might be seeing that. Presumably not in holiday or seasonal, but wanted to get an understanding between furniture, wall décor, art, textiles, lamps. Where is kind of the bulk of those reductions being made?

Steve Woodward: Yes, we are definitely trying and making every effort to protect our fall harvest and our holiday assortments, because that's what people come to us every year and they really know us for that, and we have a big opportunity from last year when we just were out of stock on those items. So those are protected and those are actually on the water right now, and so we expect to be fully in stock when we launch. Plus, we have the \$8-million carryover from last year for holiday, so we might come out of the gate a little faster on some of those assortments.

The rest of the reductions of \$50 million come from two points: one, it's pure cancellations. Most of our vendors want us to be in a good inventory position, so they've been very accepting of certain items being cancelled. And the second one is just shifting product out to a later date, and I would say that most of those \$50 million are in core products that just didn't hit their sales plans for the first quarter and are right now missing some of their sales plan for the second quarter, and we're just lowering overall that inventory exposure to make sure that we come in at the right amount for the end of the year. So it's kind of across the board, and I would say because we had grown faster in furniture, it might be a little bit heavier there, but generally it's across all categories, and just trying to get that inventory in the right position.

Jeremy Hamblin: Got it. Last one and then I'll hop out of the queue. In terms of thinking about store closures, right? I think you closed one store in the quarter. I think, obviously, profitability metrics have changed here. And is part of the plan here in kind of right-sizing where the business is, do we need to think about closing more stores? Or I know that Nicole and team have done a lot of hard work on getting the leases kind of shored up here over the last couple of years, but just wanted to understand that component of decision-making on a go-forward basis.

Nicole Strain: Not a significant change at this point, Jeremy. I think that we'll close -- we've got a couple of additional closures that we'll have this year, and then we'll have the normal lease renewals that happen at the end of the year where we will evaluate what sort of rent reductions we can get on those stores that we're keeping open just until it doesn't make money, the handful that we've talked about and getting down closer to 350. But not really changing anything significant otherwise at this point, but we'll continue to watch it.

Operator: [Operator Instructions]

Our next question comes from Anthony Lebieczinski with Sidoti & Company.

Anthony Lebieczinski: So the first, in terms of the quarter to date, the commentary, it looks like you're still down at double digits so far in May. Talked about a little bit of pulling some promotional levers. Could you perhaps expand on that as far as what you're doing there? And also just wanted to kind of tie that in with the marketing tests that are still in their initial stages in Atlanta and Nashville, whether you've seen any incremental improvement from -- in those two markets, or is it just too early to say?

Steve Woodward: I'll start with the marketing tests, and it's really -- thanks for the question, Anthony. The marketing tests are really too early to read. We feel that there is some optimism there, but it's still in the early weeks of that, and so we're going to -- we need to make sure that we give that some time. One market, the Nashville market, is responding slightly better than the Atlanta market, but it's still too early to tell. So those are ongoing, and it's exciting to be driving down the road and hearing one of our commercials on the radio or seeing it on TV. So we will continue those.

And then on the other question, I'm going to let Nicole answer that because it's --

Nicole Strain: Yes, I think it's just generally what we're realizing from a promotional perspective is, it takes more right now to get the customer in the store. And so we've increased the level of our merch promotions and we've also increased the level of our coupons, and at this point, it looks like we'll need to continue that in the near future, but we've seen some success. We just came off of Memorial Day, which obviously was very promotional for everyone, and are seeing, when we're willing to go to a deeper level of discount, we are seeing the customer demand change a little bit.

Anthony Lebie dzinski: Okay, thanks for that. And then, can you give us an update on your direct sourcing initiative?

Steve Woodward: Yes, we're making very good progress. We seem to -- we're making good progress on the things we can control, but then when we come back in, some of the cancellations have to come through that direct sourcing. But our goal still remains this year in the 45% to 50% of our assortment being direct sourced, and we will hit those goals, even despite some of the cancellations and other things. We are finding that our Asia sourcing is coming along just fine, although we are mitigating our exposure to not be so dependent on any one country, and then we are looking at opening up some sourcing out of Mexico, which seems to be promising for the future. But yes, generally, we're in good shape on that initiative. It's still producing very good results, plus giving us the exclusive merchandise that can't be found anywhere else.

Anthony Lebie dzinski: Got you. And in terms of your sourcing, still most of that comes from China; have you guys been impacted materially as far as just the lockdowns there? I know your inventory seems to be, certainly, in pretty good shape based on your comments, but just wondering if you could comment on the situation specifically in China.

Nicole Strain: We haven't, really. We haven't -- the ports that we're shipping a lot of our holiday out of aren't the ones that have been impacted. So to this point, no.

Anthony Lebie dzinski: Got it, okay. And then last question from me: So I think that Nicole, you mentioned that you have some cost-cutting moves. I think you talked about \$12 million to \$15 million of that. Could you perhaps expand on that and give us some more details as to what you're looking to do there?

Nicole Strain: Sure. The biggest categories for us that we can find dollars, in our store labor, advertising and IT spend, so really trying to balance continuing to do the things that we need to move the business forward but take out costs or regulate costs to match the sales levels that we're seeing. So pretty much spread as a percent equally through Q2 through Q4. Obviously must be easier to take dollars out of Q3 and Q4 because we're more variable and less fixed at that point, but.

Operator: Question comes from John Lawrence with Benchmark.

John Lawrence: Just a couple of questions. Nicole, can you talk a little bit about this ongoing freight expense and what we see, and I know it was accelerated in the fourth quarter, and what

have you seen so far this year, and what continue to be the impediments of that higher cost?
Thanks.

Nicole Strain: Sure. We just rolled into our new contract rates, and those were about what we were paying last year if you take out the additional that we had to pay to get Christmas here. We are seeing, right now, spot rates be under our contract rates in some ports, so I do think as people pull back demand and overall there's more supply, then people wanting to ship goods for the rest of the year, that we may see some benefit in inbound freight costs, at least. So -- but for right now, we're paying similar to -- we're paying on average \$10,000 a container, which is similar to what we were paying last year outside of Christmas.

John Lawrence: Yes, and the last question there, can you delve into that a little bit more about the second quarter? And I understood you to say it would be a little worse than the first quarter. Is that what you guided to?

Nicole Strain: It is. From a top line perspective, forecasting something similar to where we are in May with being down low double digits, and then I think the biggest impact is what we're expecting from a margin perspective, and that is just being more promotional to move through some of the excess inventory. Outside of that, it is our lowest sales volume quarter, so the P&L really deleverages pretty quickly, especially gross profit. So again, just -- it's always been our toughest quarter, and I think we'll see the same thing this year.

John Lawrence: Yes, and just -- I'm sorry, one more word is that when you look to that second half of the year, and especially the fourth quarter, that advertising that you've tested, will you make a decision, say, August, September, of how much to play into that, say, in the holiday time frame?

Nicole Strain: I think so. We'll continue to watch it and make decisions as it makes sense. I think for us, trying to get new customers, we really realized last year in the back half, better to do that in the first half. We really are strong, and a lot of people come to us for holiday, so really trying to make sure we have the holiday inventory set on our set dates, and I think if we message that to our existing customers, that there will be demand for the holiday product. It is the time period that a lot of people come to us. But we'll continue to watch the advertising and move forward or slow down as makes sense based on results.

Operator: [Operator Instructions]

Our next question comes from Barry Haimen with Sage Asset Management.

Barry Haimen: I had a couple of questions. Just trying to understand the inventory situation a little bit better. So the roughly \$100 million that would be the right-sized inventory, is that assuming that the lower level of sales that you experienced in the first quarter continues? Or does that assume some rebound? And second is, in terms of the -- and granted, last year was too low, but if we just look at the difference, how much of it -- the inventory increase is just price versus units? And then how much of that inventory, the difference between, let's say, \$100 million and where you are now, are in sort of spring seasonal goods like the outdoors that you really want to

sort of move before you get to the holiday, versus inventory that's everyday kinds of things that you would normally carry all year around? Thanks so much.

Nicole Strain: Sure. So let me know if I miss any of those, but starting with the first one, we aren't factoring in a significant rebound, as looking at receipt cuts that made sense to assume, at least relative to 2019, which will look a bit different versus last year, that we would make some improvement just by being more promotional, but not an overall change in the macroeconomic environment or anything significant. So there could be some upside there from a sales perspective.

Going back to the second one, which I believe was freight, so freight right now is running about 35% of our cost of goods sold, so that has been a significant piece. We also have seen materials increases and price increases from vendors. Pretty tough for us to quantify that, because we don't reorder a lot of SKUs, so we're not ordering like items on like items, so it's somewhat difficult to quantify that piece. What was the other --

Steve Woodward: Units. Yeah.

Nicole Strain: Units. So the unit one is also a bit interesting. As we've moved our mix of what we sell more toward furniture, the units are actually not increasing at the same pace as the rest. We're basically getting higher-cost units and bigger and bulkier units. So the whole composition of our inventory has changed. We're looking at the back half of this year a little bit differently in trying to make sure that we have some of the more -- the lower-ticket items that people, if the economy is flowing, that are easier for people to come in and make the decision to purchase. Did I miss anything?

Barry Haimes: And then the seasonal -- yes, the seasonal component of the overage?

Nicole Strain: Yes. Right now, I would say, we don't have significant risk. We obviously, as Woody mentioned, will need to move through outdoor in the next month and a half. There's a portion of outdoor -- it's not significant -- that will carry over in our DC, again, just because it doesn't make sense to ship it out to the stores and discount it significantly, but I think that will impact our margins in Q2. I don't expect us to have a significant amount of inventory at the end that we're trying to burn through at really high discount rates.

Barry Haimes: Great, thanks so much. And I just missed when you said freight as a percent of cost of goods sold; could you just repeat that number?

Nicole Strain: Yes, it's about 35%.

Operator: Our next question comes from John Lewis with Osmium Partners.

John Lewis: Yes, just a couple quick ones. I guess just to start out, on accounts payable, you're at \$47 million; last year, you were at -- you closed the year at \$62 million. Where do you see your accounts payable -- I saw there was a huge drag in cash flow this quarter. What does that look like?

Nicole Strain: In a normal time period, AP is about 60% of our inventory, and that holds in most cases. What's different right now is, we brought the inventory in early, so we're paying for it before we sell it, and that's flip-flopped that ratio to roughly 38%, I think. And that does equate to about \$30 million. So we knew that that would be a working capital hit, but by the end of the year, we should be back to AP being close to 60% of that \$100-million inventory number.

John Lewis: So if I'm doing this right, your inventory will go from now, \$130 million, to, let's say, \$100 million. So you should squeeze \$30 million in cash out of inventories, and if you take 60% of \$100 million, your payables should be at \$60 million, so you should really be closer, just on those two components, to putting \$45 million in cash on your balance sheet. Is that roughly right?

Nicole Strain: From where we are right now, yes.

John Lewis: Right. Okay. Okay, that's -- I guess that was one of my main questions. And then I guess, can you get into -- you talk a little bit about cost reductions. I think you said \$12 million to \$17 million. Can you unpack that a little bit?

Nicole Strain: \$12 million to \$15 million, and you're right, we went through really everything, and we've taken \$45 million of costs out a couple of years ago, so we are relatively lean, but really trying to right-size for the sales levels that we're seeing. I'd say a third of that is coming out of store labor, and that, in some cases, we had added open hours back to stores, going back at the stores that are low sales volume and taking that last hour of the day back off. Marketing also is probably about a third of that, and that is looking at where we're spending marketing that we may not be getting the benefit, and holding that to a time when we are getting the demand from that. And the rest comes from here and there, like every available place that we could come up with dollars that weren't necessary. IT projects that we had planned but weren't essential and weren't sales-driving is the biggest part of that other third.

John Lewis: Got it. I guess the other thing I was going to ask is, given your historic ratio between inventory and access to your credit facility, given that your inventories are where they are, have you thought about expanding that line?

Nicole Strain: We do have -- and one thing to keep in mind, at the \$130-million inventory number, it's a GAAP number, which is a bit different than what we get credit for with the bank. That number compared to the \$130-million GAAP was about \$83 million. So there's obviously valuations that are applied against that, and there are our warehouse cap and other things that are in our GAAP number. We do have the accordion feature, which is \$25 million on top of the \$75 million, that if we needed, we could go to the bank and request that, but beyond that, haven't really gotten any further. We don't think that we'll need it, but I do think it's an option for us if we did.

John Lewis: Got it, yes. I mean, I look at it as you've got \$10 in inventory per share. You'll -- even by your numbers here, you'll put a net cash balance on the balance sheet, and I guess the way I was looking at it is, even if your EBITDA is \$20 million to \$25 million, if you were to cut

your shares in half, you'd have over \$3 a share in EBITDA on a \$5.50 stock. It seems like kind of a no-brainer. And if you go back to -- if you ever get back to \$47 million, \$50 million, you're looking at \$8 a share if you had a \$6-million share count.

So I think the opportunity to repurchase equity at these prices, given enormous -- you have fairly high inventory turns, there's -- for structural, seasonal reasons, there's always a Thanksgiving, there's always a Christmas, so it just seems to me that with buying your equity, your market -- if you look at your market cap to inventory, it's \$0.50 on the dollar. So yes, it's -- I guess we also look -- today, even at the current market, the peers are trading at almost 3x inventory, and we're at 0.5x market cap to inventory, so we think the stock is absolutely undervalued, and get the tough macro headwinds, but we'll catch up, and I appreciate all your efforts.

Steve Woodward: Thanks, John.

Nicole Strain: Yes, I think, John, my thoughts on that is, we'd love to be buying back our stock at \$6 a share and would love to have had back what we've already done and be buying at this level, and we do believe that we are -- continue to be undervalued. I think the balance is, our credit agreement does have some restrictions on how much availability we have to have in order to make share repurchases at any point in time that we're borrowing, so we're just balancing a lot of things in the near term and making sure that we maintain the right liquidity to support the business. But I agree, and we agree with all the things that you said.

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

Steve Woodward: Yes, thank you, operator, Dave. We'd like to thank everyone for listening to today's call, and we look forward to speaking to you when the report of our second quarter 2022 results come out. And again, thanks for joining us.

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