

KIRKLAND'S, INC
Form 10-Q
December 10, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended October 31, 2015,

or

.. **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from _____ to _____.

Commission file number: 000-49885

KIRKLAND S, INC.

(Exact name of registrant as specified in its charter)

Tennessee (State or other jurisdiction of	62-1287151 (IRS Employer
incorporation or organization)	Identification No.)
5310 Maryland Way Brentwood, Tennessee (Address of principal executive offices)	37027 (Zip Code)
Registrant's telephone number, including area code: (615) 872-4800	

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input checked="" type="checkbox"/>
Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input type="checkbox"/>

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES NO

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, no par value 17,024,597 shares outstanding as of December 3, 2015.

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KIRKLAND S, INC.

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(in thousands, except share data)

	October 31, 2015 (Unaudited)	January 31, 2015	November 1, 2014 (Unaudited)
ASSETS			
Current assets:			
Cash and cash equivalents	\$ 32,358	\$ 99,138	\$ 56,642
Inventories, net	95,460	55,775	77,456
Deferred income taxes	3,522	3,538	2,969
Prepaid expenses and other current assets	18,056	8,878	12,549
Total current assets	149,396	167,329	149,616
Property and equipment, net	107,000	90,992	90,683
Other assets	2,107	2,166	2,125
Total assets	\$ 258,503	\$ 260,487	\$ 242,424
LIABILITIES AND SHAREHOLDERS EQUITY			
Current liabilities:			
Accounts payable	\$ 53,962	\$ 24,705	\$ 32,049
Income taxes payable		5,648	
Accrued expenses	26,927	27,027	25,296
Total current liabilities	80,889	57,380	57,345
Deferred rent	45,962	41,995	40,831
Non-current deferred income taxes	4,279	4,138	3,116
Other liabilities	5,934	5,912	5,474
Total liabilities	137,064	109,425	106,766
Shareholders' equity:			
Preferred stock, no par value, 10,000,000 shares authorized; no shares issued or outstanding at October 31, 2015, January 31, 2015, or November 1, 2014, respectively			
Common stock, no par value; 100,000,000 shares authorized; 17,166,491; 17,127,875; and 17,162,929 shares issued and outstanding at October 31, 2015, January 31, 2015, and November 1, 2014, respectively			
	161,253	159,015	158,295
Accumulated deficit	(39,814)	(7,953)	(22,637)
Total shareholders' equity	121,439	151,062	135,658

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Total liabilities and shareholders' equity	\$ 258,503	\$ 260,487	\$ 242,424
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The accompanying notes are an integral part of these financial statements.

Table of Contents**KIRKLAND S, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)****(in thousands, except per share data)**

	13-Week Period Ended		39-Week Period Ended	
	October 31,	November 1,	October 31,	November 1,
	2015	2014	2015	2014
Net sales	\$ 129,238	\$ 117,198	\$ 362,837	\$ 328,938
Cost of sales (exclusive of depreciation as shown below)	81,137	71,446	224,561	202,711
Gross profit	48,101	45,752	138,276	126,227
Operating expenses:				
Compensation and benefits	25,514	23,021	73,116	65,387
Other operating expenses	17,962	16,090	49,601	43,980
Depreciation	5,557	4,670	16,096	13,401
Total operating expenses	49,033	43,781	138,813	122,768
Operating income (loss)	(932)	1,971	(537)	3,459
Interest expense, net	70	70	210	206
Other income, net	(58)	(69)	(169)	(377)
Income (loss) before income taxes	(944)	1,970	(578)	3,630
Income tax expense (benefit)	(674)	710	(549)	1,370
Net income (loss)	\$ (270)	\$ 1,260	\$ (29)	\$ 2,260
Earnings (loss) per share:				
Basic	\$ (0.02)	\$ 0.07	\$ (0.00)	\$ 0.13
Diluted	\$ (0.02)	\$ 0.07	\$ (0.00)	\$ 0.13
Weighted average shares for basic earnings (loss) per share	17,243	17,258	17,252	17,300
Effect of dilutive stock equivalents		476		499
Adjusted weighted average shares for diluted earnings (loss) per share	17,243	17,734	17,252	17,799
Dividends declared per common share outstanding	\$	\$	\$ 1.50	\$

The accompanying notes are an integral part of these financial statements.

Table of Contents**KIRKLAND S, INC.****CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY (UNAUDITED)****(in thousands, except share data)**

	Common Stock		Accumulated	Total
	Shares	Amount	Deficit	Shareholders
				Equity
Balance at January 31, 2015	17,127,875	\$ 159,015	\$ (7,953)	\$ 151,062
Exercise of employee stock options and employee stock purchases	484,347	278		278
Tax benefit from exercise of stock options		1,103		1,103
Net share settlement of stock options and restricted stock units	(297,584)	(2,024)		(2,024)
Issuance of restricted stock	105,864			
Stock-based compensation expense		2,881		2,881
Repurchase and retirement of common stock	(254,011)		(5,881)	(5,881)
Dividends paid			(25,951)	(25,951)
Net loss			(29)	(29)
Balance at October 31, 2015	17,166,491	\$ 161,253	\$ (39,814)	\$ 121,439

The accompanying notes are an integral part of these financial statements.

Table of Contents**KIRKLAND S, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

(in thousands)

	39-Week Period Ended	
	October 31,	November 1,
	2015	2014
Cash flows from operating activities:		
Net income (loss)	\$ (29)	\$ 2,260
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation of property and equipment	16,096	13,401
Amortization of landlord construction allowances	(3,856)	(4,065)
Amortization of debt issue costs	58	58
Loss on disposal of property and equipment	77	294
Cash received for landlord construction allowances	6,308	6,099
Stock-based compensation expense	2,881	2,055
Excess tax benefits from exercise of stock options and vesting of restricted stock	(1,103)	(123)
Deferred income taxes	157	(413)
Changes in assets and liabilities:		
Inventories, net	(39,685)	(24,819)
Prepaid expenses and other current assets	(2,451)	(832)
Other noncurrent assets	1	(345)
Accounts payable	22,797	8,947
Income taxes refundable	(9,172)	(8,803)
Accrued expenses and other current and noncurrent liabilities	(663)	1,813
Net cash used in operating activities	(8,584)	(4,473)
Cash flows from investing activities:		
Capital expenditures	(25,721)	(24,049)
Net cash used in investing activities	(25,721)	(24,049)
Cash flows from financing activities:		
Excess tax benefits from exercise of stock options and restricted stock	1,103	123
Cash used in net share settlement of stock options and restricted stock	(2,024)	(318)
Employee stock purchases	278	242
Cash dividends paid to stockholders	(25,951)	(3,933)
Repurchase and retirement of common stock	(5,881)	(3,933)
Net cash used in financing activities	(32,475)	(3,886)
Cash and cash equivalents:		
Net decrease	(66,780)	(32,408)

Beginning of the period	99,138	89,050
End of the period	\$ 32,358	\$ 56,642

The accompanying notes are an integral part of these financial statements.

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KIRKLAND'S, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1 Basis of Presentation

Kirkland's, Inc. (the Company) is a specialty retailer of home décor and gifts with 370 stores in 35 states as of October 31, 2015. The condensed consolidated financial statements of the Company include the accounts of Kirkland's, Inc. and its wholly-owned subsidiaries, Kirkland's Stores, Inc., Kirkland's DC, Inc., Kirkland's Texas, LLC, and Kirklands.com, LLC. All intercompany accounts and transactions have been eliminated.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required for complete financial statements. In the opinion of management, all adjustments, including normal recurring accruals, considered necessary for a fair presentation have been included. These financial statements should be read in conjunction with the audited financial statements included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on April 14, 2015.

It should be understood that accounting measurements at interim dates inherently involve greater reliance on estimates than those at fiscal year-end. In addition, because of seasonality factors, the results of the Company's operations for the 13-week and 39-week periods ended October 31, 2015 are not indicative of the results to be expected for any other interim period or for the entire fiscal year. The Company's fiscal year ends on the Saturday closest to January 31, resulting in years of either 52 or 53 weeks. All references to a fiscal year refer to the fiscal year ending on the Saturday closest to January 31 of the following year.

The preparation of the condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could differ from the estimates and assumptions used.

Changes in estimates are recognized in the period when new information becomes available to management. Areas where the nature of the estimate makes it reasonably possible that actual results could materially differ from amounts estimated include, but are not limited to impairment assessments on long-lived assets, asset retirement obligations, inventory reserves, self-insurance reserves, income tax liabilities, stock-based compensation, employee bonus accruals, gift card breakage, sales return reserves, customer loyalty program accruals and contingent liabilities.

For the 39-week period ended October 31, 2015, the Company incurred approximately \$7.3 million of non-cash investing activities, due to purchases of property and equipment awaiting processing for payment. This amount was included in accounts payable at October 31, 2015, and was not material for the 39-week period ended November 1, 2014.

Note 2 Income Taxes

An estimate of the annual effective tax rate is used at each interim period based on the facts and circumstances available at that time, while the actual effective tax rate is calculated at year-end. For the 13-week periods ended October 31, 2015 and November 1, 2014, the Company recorded an income tax benefit of 71.4% of the loss before income taxes and an income tax expense of 36.0% of pre-tax income, respectively. For the 39-week periods ended

October 31, 2015 and November 1, 2014, the Company recorded an income tax benefit of 95.0% of the loss before income taxes and an income tax expense of 37.7% of pre-tax income, respectively. The tax benefit for the 13-week and 39-week periods ended October 31, 2015 reflects state employment and investment credits realized during the period.

Note 3 Earnings Per Share

Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding during each period presented, which excludes non-vested restricted stock units. Diluted earnings per share is computed by dividing net income by the weighted average number of shares outstanding plus the dilutive effect of stock equivalents outstanding during the applicable periods using the treasury stock method. Diluted earnings per share reflects the potential dilution that could occur if options to purchase stock were exercised into common stock and if outstanding grants of restricted stock were vested. Stock options and restricted stock units that were not included in the computation of diluted

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earnings per share, because to do so would have been antidilutive, were 1.3 million and 556,000 shares for the 13-week periods ended October 31, 2015 and November 1, 2014, respectively, and 1.3 million and 510,000 shares for the 39-week periods ended October 31, 2015 and November 1, 2014, respectively.

Note 4 Commitments and Contingencies

The Company is party to pending legal proceedings and claims. Although the outcome of such proceedings and claims cannot be determined with certainty, the Company's management is of the opinion that it is unlikely that these proceedings and any claims in excess of insurance coverage will have a material effect on the financial condition, operating results or cash flows of the Company.

Note 5 Stock-Based Compensation

The Company maintains equity incentive plans under which it may grant non-qualified stock options, incentive stock options, restricted stock, restricted stock units, or stock appreciation rights to employees, non-employee directors and consultants.

The Company granted 187,500 stock options and 107,000 restricted stock units during the 39-week period ended October 31, 2015. This compares to 182,500 stock options and 97,000 restricted stock units granted during the 39-week period ended November 1, 2014. Total stock-based compensation expense (a component of compensation and benefits) was \$830,000 for the 13-week period ended October 31, 2015, and \$2.9 million for the 39-week period ended October 31, 2015 compared to \$670,000 and \$2.1 million, respectively, for the comparable prior year periods. Included in the 39-week period ended October 31, 2015 is \$600,000 of stock-based compensation expense that resulted from the accelerated vesting of stock options and restricted stock units upon the retirement of the Company's former Chief Executive Officer. Compensation expense is recognized on a straight-line basis over the vesting periods of each grant. There have been no other material changes in the assumptions used to compute compensation expense during the current quarter.

Note 6 Related Party Transactions

In July 2009, the Company entered into an agreement with a related party vendor to purchase merchandise inventory. The vendor is considered a related party for financial reporting purposes because its principal is the spouse of the Company's Vice President of Merchandising. During the 13-week periods ended October 31, 2015 and November 1, 2014, purchases from this vendor totaled approximately \$13.2 million, or 15.6% of total merchandise purchases, and \$9.4 million, or 13.0% of merchandise purchases, respectively. During the 39-week periods ended October 31, 2015 and November 1, 2014, purchases from this vendor totaled approximately \$28.4 million, or 14.2% of total merchandise purchases, and \$21.4 million, or 12.3% of merchandise purchases, respectively. Included in cost of sales for the 13-week periods ended October 31, 2015 and November 1, 2014 were \$7.7 million and \$5.8 million, respectively, related to this vendor. Included in cost of sales for the 39-week periods ended October 31, 2015 and November 1, 2014 were \$20.8 million and \$17.4 million, respectively, related to this vendor. Payable amounts outstanding to this vendor were approximately \$7.2 million and \$3.8 million as of October 31, 2015 and November 1, 2014, respectively. The Company's payable terms with this vendor are consistent with the terms offered by other vendors in the ordinary course of business.

Note 7 Stock Repurchase Program

On May 22, 2014, the Company announced that its Board of Directors authorized a stock repurchase plan providing for the purchase in the aggregate of up to \$30 million of the Company's outstanding common stock from time to time

until May 2016. From the inception of the plan through October 31, 2015, the Company repurchased and retired approximately 523,000 shares of common stock at an aggregate cost of approximately \$10.7 million under this repurchase plan. As of October 31, 2015, the Company had \$19.3 million remaining under the Board of Directors current authorization to repurchase its common stock. Subsequent to October 31, 2015, the Company has repurchased and retired approximately 142,000 shares of common stock at an aggregate cost of \$2.4 million.

Note 8 Dividend

On May 21, 2015, the Company announced that its Board of Directors authorized a special cash dividend of \$1.50 per share on its common stock. The special dividend of \$26.0 million was paid on June 19, 2015 to stockholders of record as of the close of business on June 5, 2015.

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Note 9 New Accounting Pronouncement

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers. Under ASU 2014-09, an entity will recognize revenue when it transfers promised goods or services to customers in an amount that reflects what it expects in exchange for the goods or services. ASU 2014-09 also requires more detailed disclosures to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. In July 2015, the FASB approved a one-year deferral of ASU 2014-09. As a result of the deferral, the amendments in ASU 2014-09 will be effective for the Company at the beginning of its fiscal 2018 year. The Company is still evaluating the impact the adoption of ASU 2014-09 will have on its consolidated financial statements.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward Looking Statements

This Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) is intended to provide an understanding of our financial condition, change in financial condition, cash flow, liquidity and results of operations. The f