

Retail Geeks – Weekly Spin Cycle

December 19, 2011

Welcome to the *Weekly Spin Cycle*. Each week, we'll deliver some news and commentary about the retail industry. Whether you're an industry insider, investor, or outside observer, the articles/commentary you read here are designed to enhance your understanding of the retail sector and the issues facing it.

In addition, we'll pay close attention to the "managerial spin" and will on occasion offer a contrarian view. You are encouraged to provide any feedback to info@RetailGeeks.com.

Deferred Gains/Revenue at PIR – Where is the Missing \$17.0M?

Pier 1 (PIR - \$13.65) reported its Q3 2011 results this week. While the results were generally stellar, in Q3 2011, PIR recognized \$3.2M "Interest and Investment Income and Other" versus only \$1.0M last year. For the year-to-date period, PIR has recognized \$8.4M "Interest and Investment Income and Other" versus only \$3.1M last year.

Here's where it gets interesting. The company's Cash Flow Statement shows "Amortization of Credit Card Deferred Revenue" of \$15.6M thus far in FY 2011. In addition, the company's Cash Flow Statement shows "Amortization of Deferred Gains" of \$9.8M thus far in FY 2011.

The two amounts were broken-out in this quarter's Cash Flow Statement for the first time (historically, it appears that these two amounts were included in the more generic "Amortization of Deferred Gains").

Per 10-K filing, it appears that the two primary deferred gain items relate to the company's new credit card agreement with Chase on December 30, 2010 (PIR was paid to tear-up a previous agreement) and the company's HQ sale in calendar 2008.

The HQ sale gain of \$23.3 million is being amortized over 7 years (or, we estimate \$3.3M per year / \$830K per quarter). This amount is being amortized into Non-Operating Income.

The credit card sale gain of \$28.3 million is being amortized over a short 18-month period beginning December 2010 (or, we estimate \$4.7M per quarter).

Below is the company's 10-K note disclosure re: the credit card gain:

The net deferred gain associated with the original program agreement will continue to be recognized in nonoperating income over the term of the new program agreement. The Company recognized \$3,535,000, \$2,052,000 and \$2,164,000 related to this deferred gain in fiscal 2011, 2010 and 2009, respectively. The \$28,326,000 in consideration received from Chase was also deferred and is being recognized over the new term of the agreement as a component of revenue consistent with the treatment of amounts received under the original program agreement.

While the company felt compelled to break-out the credit card deferred gain this quarter on its Cash Flow Statement, PIR management again made no mention of the deferred gains and/or non-operating income on its quarterly conference call. And, none of the participating sell-side analysts inquired as to the deferred gains during the conference call's Q&A session (we were precluded from asking this question on the call).

So, the question is... where is the \$25.4M (YTD) being amortized on the Income Statement? Analysts can find \$8.4M in "Interest and Investment Income and Other." But, where's the remaining \$17.0M? Is it a part of Revenue? Is it helping to offset SG&A expenses?

Only the company knows and they're clearly not volunteering the information.

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Chinese Labor Costs Continue to Move Higher

Labor costs in China continue to rise. According to a **WSJ** article this week, **Michael's (ex-MIK)** CEO John Menzer suggested that labor costs increased +15% to +20% at the company's suppliers in calendar 2011.

Ok, we get that. But, what's interesting is that Mr. Menzer expects to "have the same pressures next year." Simply, a smaller supply of young migrant workers and a strengthening currency are expected to continue to pressure sourcing costs into the new year.

Labor intensive industries (e.g. furniture and shoes) are being hit the hardest. **Hooker Furniture Corporation** CEO Paul Toms commented that "We think our suppliers are seeing labor cost increases in the 20% to 30% range."

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