

KIRKLAND'S, INC
Form 10-K
April 12, 2012
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934

For the fiscal year ended January 28, 2012

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND 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
(I.R.S. Employer

Edgar Filing: KIRKLAND'S, INC - Form 10-K

incorporation or organization)

Identification No.)

2501 McGavock Pike, Suite 1000, Nashville, TN
(Address of principal executive offices)

37214
(Zip Code)

Registrant's telephone number, including area code:

(615) 872-4800

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of Each Exchange on Which Registered
Common Stock, no par value per share	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:

(None)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Note: Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Exchange Act from their obligations under those Sections.

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input checked="" type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	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 Act). Yes No

The aggregate market value of the common stock held by non-affiliates of the registrant as of July 30, 2011, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$184,420,000 based on the last sale price of the common stock as reported by The Nasdaq Stock Market.

Edgar Filing: KIRKLAND'S, INC - Form 10-K

As of April 2, 2012, there were 18,305,389 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the Annual Meeting of Shareholders of Kirkland's, Inc. to be held May 30, 2012, are incorporated by reference into Part III of this Form 10-K.

Table of Contents**TABLE OF CONTENTS****FORM 10-K**

	Page
<u>Forward-Looking Statements</u>	3
PART I	
Item 1. <u>Business</u>	4
Item 1A. <u>Risk Factors</u>	11
Item 1B. <u>Unresolved Staff Comments</u>	19
Item 2. <u>Properties</u>	19
Item 3. <u>Legal Proceedings</u>	20
Item 4. <u>Mine Safety Disclosures</u>	20
PART II	
Item 5. <u>Market for Registrant's Common Equity and Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	21
Item 6. <u>Selected Financial Data</u>	22
Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	23
Item 7A. <u>Quantitative and Qualitative Disclosure About Market Risk</u>	33
Item 8. <u>Financial Statements and Supplementary Data</u>	33
Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	33
Item 9A. <u>Controls and Procedures</u>	33
Item 9B. <u>Other Information</u>	34
PART III	
Item 10. <u>Directors and Executive Officers of the Registrant and Corporate Governance</u>	35
Item 11. <u>Executive Compensation</u>	35
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	35
Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>	35
Item 14. <u>Principal Accountant Fees and Services</u>	35
PART IV	
Item 15. <u>Exhibits and Financial Statement Schedules</u>	36
<u>Reports of Independent Registered Public Accounting Firm</u>	37
<u>Consolidated Balance Sheets as of January 28, 2012 and January 29, 2011</u>	39
<u>Consolidated Statements of Income for the 52 weeks ended January 28, 2012, January 29, 2011 and January 30, 2010</u>	40
<u>Consolidated Statements of Changes in Shareholders' Equity for the 52 weeks ended January 28, 2012, January 29, 2011 and January 30, 2010</u>	41
<u>Consolidated Statements of Cash Flows for the 52 weeks ended January 28, 2012, January 29, 2011 and January 30, 2010</u>	42
<u>Notes to Consolidated Financial Statements</u>	43
<u>Exhibits</u>	53
<u>Signatures</u>	54
<u>Index of Exhibits Filed with this Annual Report on Form 10-K</u>	55

Table of Contents

FORWARD-LOOKING STATEMENTS

This Form 10-K contains forward-looking statements within the meaning of the federal securities laws and the Private Securities Litigation Reform Act of 1995. These statements may be found throughout this Form 10-K, particularly under the headings Business and Management's Discussion and Analysis of Financial Condition and Results of Operations, among others. Forward-looking statements typically are identified by the use of terms such as may, will, should, expect, anticipate, believe, estimate, intend and similar words, although some forward-looking statements are expressed differently. You should consider statements that contain these words carefully because they describe our expectations, plans, strategies and goals and our beliefs concerning future business conditions, our results of operations, financial position and our business outlook or state other forward-looking information based on currently available information. The factors listed below under the heading Risk Factors and in the other sections of this Form 10-K provide examples of risks, uncertainties and events that could cause our actual results to differ materially from the expectations expressed in our forward-looking statements.

The forward-looking statements made in this Form 10-K relate only to events as of the date on which the statements are made. We undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events.

The terms Kirkland's, we, us, and our as used in this Form 10-K refer to Kirkland's, Inc.

Table of Contents

PART I

**Item 1. Business
General**

We are a specialty retailer of home décor and gifts in the United States, operating 309 stores in 30 states as of January 28, 2012. Our stores present a broad selection of distinctive merchandise, including framed art, mirrors, wall décor, candles and related items, lamps, decorative accessories, accent furniture, textiles, garden-related accessories and artificial floral products. Our stores also offer an extensive assortment of holiday merchandise during seasonal periods as well as items carried throughout the year suitable for gift-giving. In addition, we use innovative design and packaging to market home décor items as gifts. We provide our predominantly female customers an engaging shopping experience characterized by a diverse, ever-changing merchandise selection at prices which provide discernable value to the customer. Our stores offer a unique combination of style and value that has led to our emergence as a leader in home décor and has enabled us to develop a strong customer franchise.

Business Strategy

Our goal is to be one of the leading specialty retailers of home décor in each of our markets. We believe the following elements of our business strategy both differentiate us from our competitors and position us for growth:

Item-focused merchandising. While our stores contain items covering a broad range of complementary product categories, we emphasize traditionally-styled, high quality and fashionable key items within our targeted categories rather than merchandising complete, themed product classifications. Our buyers work closely with our vendors to identify and develop stylish merchandise that appeals to a broad base of customers while reflecting the latest trends. We test-market products where appropriate and monitor individual item sales, which enables us to identify and quickly reorder bestselling items in order to maximize sales. We constantly evaluate market trends and merchandise sales data and work with vendors to develop new products to be sold in our stores, frequently on an exclusive basis. In most cases, this exclusive merchandise is the result of our buying team's experience in interpreting market and merchandise trends in a way that appeals to our customers.

Ever-changing merchandise mix. We believe our ever-changing merchandise mix and method of display create an exciting treasure hunt environment, encouraging strong customer loyalty and frequent return visits to our stores. The merchandise in our stores is traditionally-styled for broad market appeal, yet it reflects an understanding of our customer's desire for fashion and novelty. Our information systems permit close tracking of individual item sales, enabling us to react quickly to both fast-selling and slow-moving items. Accordingly, our inventory turns rapidly and we actively change our merchandise throughout the year in response to market trends, sales results and changes in seasons. We also strategically increase selling space devoted to gifts and seasonal merchandise in advance of holidays.

Stimulating visual presentation. Through our marketing and in-store presentation, we seek to help customers visualize our merchandise in their own homes and inspire decorating and gift-giving ideas. We creatively group complementary merchandise throughout the store. We believe this cross-category merchandising encourages customers to browse for longer periods of time, promoting add-on sales. We adjust our visual presentation frequently to take advantage of sales trends and enhance our ever-changing merchandise mix.

Strong value proposition. Our customers regularly experience the satisfaction of paying noticeably less for items similar to those sold by other retail stores or through other retail channels. This strategy of providing a unique combination of style, quality and value is an important element in making Kirkland's a destination store. While we carry some items in our stores that sell for several hundred dollars, most items sell for under \$20 and are perceived by our customers as very affordable home décor and gifts. Our longstanding relationships with vendors and our ability to place and sell-through large orders of a single item enhance our ability to attain favorable product pricing from vendors.

Broad market appeal. Our stores operate successfully across different geographic regions and market sizes. As of January 28, 2012, we operated stores in 30 states. Although originally focused in the Southeast, over 50% of our stores are now located outside that region. The flexibility of our concept enables us to select the most promising real estate opportunities that meet requisite economic and demographic criteria within the target markets where our customers live and shop. In addition to our stores, we sell direct-to-customer through our website at www.kirklands.com. We view this on-line channel as an important part of our business strategy, allowing us to introduce our concept to new customers and complement our brick-and-mortar business.

Table of Contents

Opening new stores. We experienced net store growth during fiscal 2011, ending the year with 309 stores versus 300 stores at the end of fiscal 2010. Our approach to new store growth in fiscal 2012 will continue to focus on replacements of successful mall and smaller-sized off-mall stores with new, larger off-mall locations that have proved to produce higher sales. We expect to open stores in existing, underpenetrated markets as well as selected new geographic markets within the continental United States. During fiscal 2012, we expect to open a total of 35 to 45 stores, and expect to close approximately 25 stores. Many of these expected closings are currently in markets where we are pursuing or have identified a relocation opportunity. Fiscal 2012 new store openings will be weighted toward the back half of the year while store closings for fiscal 2012 are expected to be weighted toward the first half of the year.

Merchandising

Merchandising strategy. Our merchandising strategy is to (i) offer unique, distinctive and often exclusive, high quality home décor products and gifts at affordable prices representing great value to our customers, (ii) maintain a breadth of productive merchandise categories, (iii) provide a carefully edited selection of key items within targeted categories, rather than merchandising complete, themed product classifications, (iv) emphasize new and fresh-to-market merchandise by continually updating our merchandise mix, and (v) present merchandise in a visually appealing manner to create an inviting atmosphere which inspires decorating and gift-giving ideas and encourages frequent store visits.

Our information systems permit close tracking of individual item sales, which enables us to react quickly to market trends and best or slow sellers. This daily sales and gross margin information helps us to maximize the productivity of successful products and categories, and minimize the accumulation of slow-moving inventory. Our core merchandise assortment is relatively consistent across the chain. We address regional differences where applicable by tailoring inventories to geographic considerations and specific store sales results in selected categories and classes of product.

We continuously introduce new and often exclusive products to our merchandise assortment in order to (i) maintain customer interest by providing freshness in our product selections, encouraging frequent return visits to our stores, (ii) enhance our reputation as a source for identifying and developing high quality, fashionable products, and (iii) allow merchandise which has peaked in sales to be quickly discontinued and replaced by new items. In addition, we strategically manage the selling space devoted to gifts and holiday merchandise throughout the year. Our flexible store design and display fixtures allow us to adjust our selling space as needed to capitalize on sales trends.

Our average store generally carries approximately 4,000-5,000 Stock Keeping Units (SKUs). We regularly monitor the sell-through on each item, and therefore, the number and make-up of our active SKUs is continuously changing based on changes in selling trends. New and different SKUs are introduced to our stores constantly.

We purchase merchandise from approximately 240 vendors, and our buying team works closely with vendors to differentiate Kirkland's merchandise from that of our competitors. For products that are not manufactured specifically for Kirkland's, we may create custom packaging as a way to differentiate our merchandise offering and reinforce our brand. Exclusive or proprietary products distinguish us from our competition, enhance the value of our merchandise and provide the opportunity to improve our net sales and gross margin. Our strategy is to continue to increase the amount of exclusive and proprietary products within our merchandise mix.

Product assortment. Our major merchandise categories include wall décor (framed art, mirrors, metal and other wall ornaments), lamps, decorative accessories, accent furniture, candles and related items, textiles, garden-related accessories, and artificial floral products. Our stores also offer an extensive assortment of holiday merchandise, as well as items carried throughout the year suitable for gift-giving. Consistent with our item-focused strategy, a vital part of the product mix is a variety of home décor and other assorted merchandise that does not necessarily fit into a specific product category. Decorative accessories consist of such varied products as vases and clocks. Throughout the year and especially during the fourth quarter of the calendar year, our buying team uses its experience in home décor to develop products that are equally appropriate for gift-giving.

Table of Contents

The following table presents the percentage of net sales contributed by our major merchandise categories over the last three fiscal years:

Merchandise Category	% of Net Sales		
	Fiscal 2011	Fiscal 2010	Fiscal 2009
Wall Décor (including framed art, mirrors, metal and other wall ornaments)	29%	30%	31%
Decorative Accessories	12	13	14
Accent Furniture	10	9	9
Candles and Accessories	9	9	9
Holiday, Seasonal	8	7	7
Lamps	7	7	7
Gifts	7	7	6
Textiles	6	5	5
Floral	6	4	4
Frames	4	6	6
Garden	2	3	2
Total	100%	100%	100%

Value to customer. We continually strive to increase the perceived value of Kirkland's products to our customers through our distinctive merchandising, carefully coordinated in-store signage, visual presentation and product packaging. Our shoppers regularly experience the satisfaction of paying noticeably less for items similar to those sold by other retail stores, through catalogs, or on the Internet. Our stores typically have two major semi-annual sale events, one in January and one in July. We also use temporary promotions throughout the year featuring specific items or categories of merchandise. We believe our value-oriented pricing strategy, coupled with an adherence to high quality standards, is an important element in establishing our distinct brand identity and solidifying our connection with our customers.

Buying and Inventory Management

Merchandise sourcing and product development. Our merchandise team purchases inventory on a centralized basis to take advantage of our consolidated buying power and our technology to closely control the merchandise mix in our stores. Our buying team selects all of our products, negotiates with vendors and works closely with our planning and allocation team to optimize store-level merchandise quantity and mix by category, classification and item.

We purchase merchandise from approximately 240 vendors. Approximately 95% of our total purchases are from importers of merchandise manufactured primarily in China, with the balance purchased from domestic manufacturers and wholesalers. For our purchases of merchandise manufactured abroad, we have historically bought from importers or U.S.-based representatives of foreign manufacturers rather than dealing directly with foreign manufacturers. This process has enabled us to maximize flexibility and minimize product liability and credit risks. We continually evaluate the best ways to source and differentiate our merchandise while attaining our sales and gross margin objectives. For certain categories and items, the strategic use of domestic manufacturers and wholesalers enables us to reduce the lead times between ordering products and presenting them for sale in our stores.

Planning and allocation. Our merchandise planning and allocation team works closely with our buying team, field management and store personnel to meet the requirements of individual stores for appropriate merchandise in sufficient quantities. This team also manages inventory levels, allocates merchandise to stores and replenishes inventory based upon information generated by our information systems. Our inventory control systems monitor current inventory levels at each store, by operating district, and for the total company. We also continually monitor recent selling history within each store by category, classification and item to properly allocate future purchases to maximize sales and gross margin.

Each of our stores is internally classified for merchandising purposes based on certain criteria including sales volume, size, location and historical performance. Although all of our stores carry similar merchandise, the variety and depth of products in a given store may vary depending on the store's rank and classification. Where applicable, inventory purchases and allocation are also tailored based on regional or demographic differences between stores in selected categories.

Store Operations

Edgar Filing: KIRKLAND'S, INC - Form 10-K

General. As of January 28, 2012, we operated 309 stores in 30 states, with stores operating seven days a week. In addition to corporate management and three Regional Directors, approximately 23 Multi-Unit Managers (who generally have responsibility for approximately 10-18 stores within a geographic district) manage store operations. A Store Manager and one to three Assistant Managers manage individual stores. The Store Manager is responsible for the day-to-day operation of the store, including sales, customer service, merchandise display, human resource functions and store security. A typical store operates with an average of eight to 10 employees including a combination of full and part-time employees, depending on the volume of the store and the season. Additional part-time employees are typically hired to assist with increased traffic and sales volume in the fourth quarter of the calendar year.

Table of Contents

Formats. We operate stores in enclosed malls and a variety of off-mall venues. As of January 28, 2012, we operated 50 stores in enclosed malls, of which seven were outward-facing, and 259 stores in off-mall venues. Off-mall stores included 236 in lifestyle centers and power strip centers, 9 in outlet centers and 14 freestanding locations. Off-mall stores are generally larger than mall stores and tend to have a lower occupancy cost per square foot. The average size of our mall stores was approximately 5,000 square feet, and the average size of our off-mall stores was approximately 7,200 square feet. The average size of the new stores we opened in fiscal 2011 was approximately 9,300 square feet, and we currently expect our fiscal 2012 new stores to be of similar average size.

Merchandise Presentation. Merchandise is generally displayed according to guidelines and directives given to each store from the Merchandise Presentation team with input from Store Operations. This procedure promotes somewhat uniform display standards throughout the chain depending upon store configuration. Using multiple types of fixtures, we group complementary merchandise creatively throughout the store, and also display certain products strictly by category or product type.

Because of the nature of our merchandise and our focus on identifying and developing best-selling items, we emphasize our merchandise presentation standards. Our Merchandise Presentation team provides Store Managers with recommended directives such as photographs, diagrams and placement guides. Augmenting this centralized approach, each Store Manager has flexibility to creatively highlight those products that are expected to have the greatest appeal to local shoppers. Effective and consistent visual merchandising enhances a store's ability to reach its full sales potential.

Personnel recruitment and training. We believe our continued success is dependent in part on our ability to attract, retain and motivate quality employees. In particular, the success of our growth strategy depends on our ability to promote and/or recruit qualified Multi-Unit and Store Managers and maintain quality full- and part-time sales associates. A training program is provided for new Multi-Unit Managers and Store Managers. Many Store Managers begin their Kirkland's career as sales associates, but complete a formal training program before taking responsibility for a store. This training program includes three to 10 days in a designated training store, working directly with a qualified Training Store Manager. Multi-Unit Managers are primarily responsible for recruiting new Store Managers. Store Managers are responsible for the hiring and training of new associates, assisted where appropriate by a Human Resources Manager. We constantly look for motivated and talented people to promote from within Kirkland's, in addition to recruiting outside Kirkland's.

Compensation and incentives. Multi-Unit and Store Managers are compensated with a base salary or on an hourly basis, plus a monthly sales bonus combined with a quarterly performance bonus based on store-level profit contribution. Sales associates are compensated on an hourly basis. In addition, we periodically run a variety of contests that reward associates for outstanding achievement in sales and other corporate initiatives.

Real Estate

Strategy. Our real estate strategy is to identify dominant retail properties that are convenient and attractive to our target female customer. The flexibility and broad appeal of our stores and our merchandise allow us to operate successfully in major metropolitan markets such as Houston, Texas and Atlanta, Georgia; middle markets such as Birmingham, Alabama, Nashville, Tennessee, and Fresno, California; and smaller markets such as Lafayette, Louisiana, and Amarillo, Texas. As we execute our store growth strategy, we are increasingly focused on under-penetrated markets in the United States such as the Mid-Atlantic states, California and the Midwest to provide us with the unit growth to achieve our goals.

Site selection. Our current strategy is to locate our stores in venues which are destinations for large numbers of shoppers and which reinforce our quality image and brand. To assess potential new locations, we review financial and demographic criteria and infrastructure for access. We also analyze the quality and relative location of co-tenants and competitive factors, square footage availability, frontage space and other relevant criteria to determine the overall acceptability of a property and the optimal locations within it.

As of January 28, 2012, of our 309 stores, 259 were in a variety of off-mall venues including 236 in lifestyle centers and power strip centers, 9 in outlet centers and 14 freestanding locations. We currently anticipate that most of the new stores opening in fiscal 2012 and beyond will be located in off-mall venues, where we have generally experienced better financial results, primarily due to higher sales volumes. We also believe that our target shopper prefers the off-mall location for convenience in her shopping experience.

Table of Contents

We believe we are a desirable tenant to developers because of our long and successful operating history, sales productivity, ability to attract customers, financial strength and our strong position with co-tenants in the home décor category. The following table provides a history of our store openings and closings by venue for the last five fiscal years.

	Fiscal 2007	Fiscal 2008	Fiscal 2009	Fiscal 2010	Fiscal 2011
Mall					
Stores open at beginning of period	168	121	91	66	59
Store openings				2	3
Store closings	(47)	(30)	(25)	(9)	(12)
Stores open at end of period	121	91	66	59	50
Off-Mall					
Stores open at beginning of period	181	214	208	213	241
Store openings	35	3	18	36	31
Store closings	(2)	(9)	(13)	(8)	(13)
Stores open at end of period	214	208	213	241	259
Total					
Stores open at beginning of period	349	335	299	279	300
Store openings	35	3	18	38	34
Store closings	(49)	(39)	(38)	(17)	(25)
Stores open at end of period	335	299	279	300	309

Distribution and Logistics

We have implemented a comprehensive approach to the management of our merchandise supply chain. This approach encompasses all parts of the supply chain, from the manufacturer overseas to the store selling floor. Our 771,000-square-foot distribution center in Jackson, Tennessee was built to our specifications in May 2004 and provides a scalable infrastructure for our supply chain. Our custom warehouse management system and improved material handling equipment streamline the flow of goods within the distribution center.

In addition to making improvements to our distribution center operation, we have taken important steps to improve our efficiency in transporting merchandise to stores. We currently utilize third-party carriers to transport merchandise from our Jackson distribution center to our stores. Prior to fiscal 2006, the majority of our merchandise deliveries were handled by either less-than-truckload (LTL) carriers or full truckload deliveries to regional pool points, with local delivery agents handling the actual store delivery function. By the end of fiscal 2011, we had migrated 94% of our stores to less-frequent, full truckload deliveries. This alternative results in lower distribution costs and allows our field personnel to better schedule our store staff for the receiving process. The optimal delivery method for a given store depends on the store's sales volume, square footage, geographic location and other factors. This shift to direct store delivery methods has resulted in lower annual outbound freight costs both on a dollar basis and as a percentage of sales compared to the LTL and pool point delivery methods used in the past.

An important part of our efforts to achieve efficiencies, cost reductions and net sales growth is the continued identification and implementation of improvements to our planning, logistical and distribution infrastructure and our supply chain, including merchandise ordering, transportation and receipt processing. We seek to ensure that our distribution infrastructure and supply chain are kept in sync with our anticipated growth and increased number of stores. For the foreseeable future, we believe our current distribution infrastructure is adequate to support our operational needs.

Table of Contents

Our distribution facility is also used for e-commerce fulfillment for sales made through our website. We currently use approximately 55,000 square feet of the building to support the pick-and-pack operation used in e-commerce fulfillment. Due to the anticipated growth in the e-commerce business, we are planning to spend approximately \$2 million in capital improvements during fiscal 2012 to allow the e-commerce space to grow, as well as support the increase in store count. These improvements will primarily consist of the reconfiguration of certain areas of the distribution center to generate additional space for e-commerce, streamline the sorting systems for the brick-and-mortar business, and offload other processes such as new store staging and data storage to other, more cost-effective solutions.

Information Systems

Our store information systems include a server in each store that runs our automated point-of-sale (POS) application on multiple POS registers. The server provides Store Managers with convenient access to detailed sales and inventory information for the store. Our POS registers provide a price look-up function (all merchandise is bar-coded), time and attendance, and automated check, credit card, debit card and gift card processing. Through nightly two-way electronic communication with each store, we upload SKU-level sales, gross margin information and payroll hours to our home office system and download new merchandise pricing, price changes for existing merchandise, purchase orders and system maintenance tasks to the store server. Based upon the evaluation of information obtained through this daily information exchange, our planning and allocation team implements merchandising decisions regarding inventory levels, reorders, price changes and allocation of merchandise to our stores. During the second half of 2011, we implemented a new point-of-sale software package. This new software provides us with new tools to better control store-level labor and implement additional scheduling capabilities. It also allowed us to move away from a highly-customized, more expensive solution to a more scalable and flexible solution as we seek to take quick advantage of the rapidly-changing technology landscape in the retail market.

Our current merchandise management system integrates all merchandising and inventory management applications, including category, classification and SKU inventory tracking, purchase order management, automated ticket making, and sales audit. We completed a vendor selection process for this foundational merchandising system and are in the development phase of the new system implementation. Testing of the new system will occur throughout 2012 with an implementation targeted for late fiscal 2012. Our financial system applications, including general ledger and accounts payable, were upgraded to new software in February 2011.

We moved into our distribution center during the second quarter of 2004. Concurrent with this move, we implemented a new warehouse management system (WMS). The WMS was tailored to our specifications and provides us with a fully automated solution for all operations within the distribution center.

Marketing

Although our overall marketing efforts encompass various techniques, in recent years, we have had a specific focus on e-mail communication. We now manage a database of approximately 3.5 million e-mail addresses that have been provided by our customers, primarily through in-store collection processes and various contests and initiatives designed to drive e-mail sign-ups. We use this database to communicate frequently with our loyal customer base about new products, in-store events and special offers. We are beginning to utilize other means of media advertising to enhance the visibility of our products and our brand. During the first quarter of 2012, we developed a catalog of current merchandise offerings that was distributed to one million addresses within our demographic criteria and provided to our stores to facilitate customer interaction. We additionally devoted presence on the internet and with our email database for these merchandise offerings. Additional mailings are planned for 2012. We are actively evaluating other forms of advertising to test during 2012, as we seek to build the brand of the company as we execute our growth strategy.

We utilize marketing efforts and other in-store activity to promote specific events in our stores, including our major semi-annual sale events. Our marketing efforts emphasize in-store signage, store and window banners, displays and other techniques to attract customers and provide an exciting shopping experience. Historically, we have not engaged in extensive media advertising because we believe that we have benefited from our strategic locations in high-traffic shopping centers and valuable word-of-mouth advertising by our customers.

To drive customer loyalty, we provide our customers with the option to utilize Kirkland's private-label credit card. This program is administered by a third-party, who bears the credit risk associated with the card program without recourse to us. As cardholders, customers are automatically enrolled in a loyalty program whereby they earn loyalty points for their purchases. Customers attaining specified levels of loyalty points are eligible for special discounts on future purchases. We believe that customers using the card visit our stores and purchase merchandise more frequently as well as spend more per visit than our customers not using the card. During December of 2011, we terminated the agreement with our prior service provider. We launched a new program with a new provider during the first quarter of 2012.

Table of Contents

Internet and Social Media

We believe the Internet offers opportunities to complement our brick-and-mortar stores, increase sales and increase consumer brand awareness of our products. Our website at www.kirklands.com, provides our customers with the ability to purchase Kirkland's merchandise online and have it delivered directly to their homes or their nearest Kirkland's store. Customers may also use the website as a resource to locate a store, preview our merchandise, apply for a Kirkland's credit card, and purchase gift cards online. We are also very active in social media and have developed a social community website at www.mykirklands.com for home décor discussions, photographs, and reviews of Kirkland's product. Over 160,000 customers have joined the site and regularly interact with each other and with professional designers with whom we have partnered to contribute content to the site. In addition, we maintain a presence on Facebook, where we have a growing fan base of over 340,000. We launched a Twitter initiative in 2011, and are actively pursuing oppo