KIRKLAND'S, INC
Form 10-Q
September 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 August 1, 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	**62-1287151**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**

5310 Maryland Way	
Brentwood, Tennessee	**37027**
(Address of principal executive offices)	**(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 x 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 x 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	¨	Accelerated filer	x
Non-accelerated filer	¨	Smaller reporting company	¨

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

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 17,292,899 shares outstanding as of September 3, 2015.

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KIRKLAND S, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	August 1, 2015 (Unaudited)	January 31, 2015	August 2, 2014 (Unaudited)
ASSETS			
Current assets:			
Cash and cash equivalents	$ 49,126	$ 99,138	$ 68,468
Inventories, net	65,895	55,775	57,364
Deferred income taxes	3,548	3,538	2,828
Prepaid expenses and other current assets	14,501	8,878	12,534
Total current assets	133,070	167,329	141,194
Property and equipment, net	94,904	90,992	86,201
Other assets	2,565	2,166	2,065
Total assets	$ 230,539	$ 260,487	$ 229,460
LIABILITIES AND SHAREHOLDERS EQUITY			
Current liabilities:			
Accounts payable	$ 27,951	$ 24,705	$ 22,434
Income taxes payable		5,648	
Accrued expenses	25,319	27,027	22,440
Total current liabilities	53,270	57,380	44,874
Deferred rent	42,695	41,995	39,519
Non-current deferred income taxes	4,126	4,138	3,274
Other liabilities	6,156	5,912	5,416
Total liabilities	106,247	109,425	93,083
Shareholders equity:			
Preferred stock, no par value, 10,000,000 shares authorized; no shares issued or outstanding at August 1, 2015, January 31, 2015, or August 2, 2014, respectively			
Common stock, no par value; 100,000,000 shares authorized; 17,294,057; 17,127,875; and 17,317,777 shares issued and outstanding at August 1, 2015, January 31, 2015, and August 2, 2014, respectively	160,469	159,015	157,576
Accumulated deficit	(36,177)	(7,953)	(21,199)
Total shareholders equity	124,292	151,062	136,377

Total liabilities and shareholders equity	$ 230,539	$ 260,487	$ 229,460

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

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KIRKLAND S, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(in thousands, except per share data)

	13-Week Period Ended		26-Week Period Ended	
	August 1, 2015	August 2, 2014	August 1, 2015	August 2, 2014
Net sales	$ 115,289	$ 103,485	$ 233,599	$ 211,740
Cost of sales (exclusive of depreciation as shown below)	72,777	65,612	143,424	131,265
Gross profit	42,512	37,873	90,175	80,475
Operating expenses:				
Compensation and benefits	24,389	21,087	47,602	42,366
Other operating expenses	16,515	14,226	31,639	27,890
Depreciation	5,310	4,431	10,539	8,731
Total operating expenses	46,214	39,744	89,780	78,987
Operating income (loss)	(3,702)	(1,871)	395	1,488
Interest expense, net	70	67	140	136
Other income, net	(56)	(226)	(111)	(308)
Income (loss) before income taxes	(3,716)	(1,712)	366	1,660
Income tax expense (benefit)	(1,428)	(657)	125	660
Net income (loss)	$ (2,288)	$ (1,055)	$ 241	$ 1,000
Earnings (loss) per share:				
Basic	$ (0.13)	$ (0.06)	$ 0.01	$ 0.06
Diluted	$ (0.13)	$ (0.06)	$ 0.01	$ 0.06
Weighted average shares for basic earnings (loss) per share:	17,277	17,335	17,257	17,321
Effect of dilutive stock equivalents			498	510
Adjusted weighted average shares for diluted earnings (loss) per share	17,277	17,335	17,755	17,831
Dividends declared per common share outstanding	$ 1.50	$	$ 1.50	$

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

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KIRKLAND S, INC.

CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY (UNAUDITED)

(in thousands, except share data)

	Common Stock		Accumulated	Total Shareholders
	Shares	**Amount**	**Deficit**	**Equity**
Balance at January 31, 2015	17,127,875	$ 159,015	$ (7,953)	$ 151,062
Exercise of employee stock options and employee stock purchases	445,673	203		203
Tax benefit from exercise of stock options		1,192		1,192
Net share settlement of stock options and restricted stock units	(279,851)	(1,992)		(1,992)
Issuance of restricted stock	105,864			
Stock-based compensation expense		2,051		2,051
Repurchase and retirement of common stock	(105,504)		(2,514)	(2,514)
Dividends paid			(25,951)	(25,951)
Net income			241	241
Balance at August 1, 2015	17,294,057	$ 160,469	$ (36,177)	$ 124,292

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

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KIRKLAND S, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(in thousands)

	26-Week Period Ended	
	August 1, 2015	August 2, 2014
Cash flows from operating activities:		
Net income	$ 241	$ 1,000
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation of property and equipment	10,539	8,731
Amortization of landlord construction allowances	(2,716)	(3,038)
Amortization of debt issue costs	38	38
Loss on disposal of property and equipment	5	224
Cash received for landlord construction allowances	3,519	4,354
Stock-based compensation expense	2,051	1,385
Excess tax benefits from exercise of stock options and vesting of restricted stock	(1,192)	(130)
Deferred income taxes	(22)	(114)
Changes in assets and liabilities:		
Inventories, net	(10,120)	(4,727)
Prepaid expenses and other current assets	(2,201)	(608)
Other noncurrent assets	(437)	(265)
Accounts payable	(455)	(668)
Income taxes refundable	(8,052)	(9,635)
Accrued expenses and other current and noncurrent liabilities	(1,393)	(1,065)
Net cash used in operating activities	(10,195)	(4,518)
Cash flows from investing activities:		
Capital expenditures	(10,755)	(14,827)
Net cash used in investing activities	(10,755)	(14,827)
Cash flows from financing activities:		
Excess tax benefits from exercise of stock options and restricted stock	1,192	130
Cash used in net share settlement of stock options and restricted stock	(1,992)	(315)
Employee stock purchases	203	183
Cash dividends paid to stockholders	(25,951)	
Repurchase and retirement of common stock	(2,514)	(1,235)
Net cash used in financing activities	(29,062)	(1,237)
Cash and cash equivalents:		

Net decrease	(50,012)	(20,582)
Beginning of the period	99,138	89,050
End of the period	$ 49,126	$ 68,468

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

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 351 stores in 35 states as of August 1, 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 26-week periods ended August 1, 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 26-week period ended August 1, 2015, the Company incurred approximately $4.5 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 August 1, 2015, and was not material for the 26-week period ended August 2, 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 each of the 13-week periods ended August 1, 2015 and August 2, 2014, the Company recorded an income tax benefit of 38.4% of the loss before income taxes. For the 26-week periods ended August 1, 2015 and August 2, 2014, the Company recorded an income tax expense of 34.2% and 39.8% of pre-tax income, respectively.

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 earnings per share, because to do so would have been antidilutive, were 1.3 million and 1.6 million shares for the 13-week periods ended August 1, 2015 and August 2, 2014, respectively and 171,000 and 487,000 shares for the 26-week periods ended August 1, 2015 and August 2, 2014, respectively.

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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 13-week and 26-week periods ended August 1, 2015. This compares to 182,500 stock options and 97,000 restricted stock units granted during the 13-week and 26-week periods ended August 2, 2014. Total stock-based compensation expense (a component of compensation and benefits) was $815,000 for the 13-week period ended August 1, 2015, and $2.1 million for the 26-week period ended August 1, 2015 compared to $748,000 and $1.4 million, respectively, for the comparable prior year periods. Included in the 26-week period ended August 1, 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 August 1, 2015 and August 2, 2014, purchases from this vendor totaled approximately $8.2 million, or 13.5% of total merchandise purchases, and $6.3 million, or 11.6% of merchandise purchases, respectively. During the 26-week periods ended August 1, 2015 and August 2, 2014, purchases from this vendor totaled approximately $15.2 million, or 13.2% of total merchandise purchases, and $12.0 million, or 11.8% of merchandise purchases, respectively. Included in cost of sales for the 13-week periods ended August 1, 2015 and August 2, 2014 were $6.8 million and $5.7 million, respectively, related to this vendor. Included in cost of sales for the 26-week periods ended August 1, 2015 and August 2, 2014 were $13.2 million and $11.5 million, respectively, related to this vendor. Payable amounts outstanding to this vendor were approximately $2.2 million and $1.7 million as of August 1, 2015 and August 2, 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 August 1, 2015, the Company repurchased and retired approximately 374,000 shares of common stock at an aggregate cost of approximately $7.3 million under this repurchase plan. As of August 1, 2015, the Company had $22.7 million remaining under the Board of Directors current authorization to repurchase its common stock. Subsequent to August 1, 2015, the Company has repurchased and retired approximately 36,000 shares of common stock at an aggregate cost of $843,000.

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 following MD&A discussion should be read in conjunction with the condensed consolidated financial statements and notes to those statements that appear elsewhere in this Form 10-Q and in our Annual Report on Form 10-K, filed April 14, 2015. The following discussion contains forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could differ materially from those discussed or referred to in the forward-looking statements. Factors that could cause or contribute to any differences include, but are not limited to, those discussed under the caption Cautionary Statement for Purposes of the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995 and under Part II, Item 1A Risk Factors .

General

We are a specialty retailer of home décor and gifts in the United States, operating 351 stores in 35 states as of August 1, 2015, as well as an e-Commerce enabled website, www.kirklands.com. 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 reflecting current styles at prices which provide discernible value. This combination of ever-changing and stylish merchandise, value pricing and a stimulating store experience has led to our emergence as a leader in home décor and enabled us to develop a strong customer franchise.

During the 13-week period ended August 1, 2015, we opened nine new stores and did not close any stores. During the 26-week period ended August 1, 2015 we opened 10 new stores and closed three stores. The following table summarizes our stores and square footage under lease:

	As of August 1, 2015	As of August 2, 2014
Number of stores	351	328
Square footage	2,657,726	2,470,440
Average square footage per store	7,572	7,532

13-Week Period Ended August 1, 2015 Compared to the 13-Week Period Ended August 2, 2014

Results of operations. The table below sets forth selected results of our operations both in dollars (in thousands) and as a percentage of net sales for the periods indicated:

13-Week Period Ended

	August 1, 2015		August 2, 2014		Change	
	$	%	$	%	$	%
Net sales	$ 115,289	100.0%	$ 103,485	100.0%	$ 11,804	11.4%
Cost of sales	72,777	63.1%	65,612	63.4%	7,165	10.9%
Gross profit	42,512	36.9%	37,873	36.6%	4,639	12.2%
Operating expenses:						
Compensation and benefits	24,389	21.2%	21,087	20.4%	3,302	15.7%
Other operating expenses	16,515	14.3%	14,226	13.7%	2,289	16.1%
Depreciation	5,310	4.6%	4,431	4.3%	879	19.8%
Total operating expenses	46,214	40.1%	39,744	38.4%	6,470	16.3%
Operating loss	(3,702)	(3.2%)	(1,871)	(1.8%)	(1,831)	97.9%
Interest expense, net	70	0.1%	67	0.1%	3	4.5%
Other income, net	(56)	(0.1%)	(226)	(0.2%)	170	(75.2%)
Loss before income taxes	(3,716)	(3.2%)	(1,712)	(1.7%)	(2,004)	117.1%
Income tax benefit	(1,428)	(1.2%)	(657)	(0.6%)	(771)	117.4%
Net loss	$ (2,288)	(2.0%)	$ (1,055)	(1.0%)	$ (1,233)	116.9%

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Net sales. Net sales increased 11.4% to $115.3 million for the second fiscal quarter of 2015 compared to $103.5 million for the prior year period. The impact of net new store growth contributed an increase to net sales of $5.2 million. An increase in comparable store sales, including e-Commerce sales, of 6.7%, contributed an increase over the prior year quarter of $6.6 million. Comparable store sales, including e-Commerce sales, increased 3.6% in the prior year period. For the second fiscal quarter of 2015, the e-Commerce business was up 37.7% versus the prior year period, accompanied by an increase in comparable store sales at brick-and-mortar stores of 4.7%. For brick-and-mortar stores, the comparable store sales increase was primarily due to an increase in the number of transactions and a slight increase in the average ticket. The increase in transactions resulted from an increase in conversion, partially offset by a slight decrease in traffic. The increase in average ticket was due to an increase in items sold per transaction. The e-Commerce business benefitted from an increase in website traffic coupled with an increase in conversion, slightly offset by a decrease in average order size. The merchandise categories contributing most to the comparable store sales increase were wall décor and housewares.

Gross profit. Gross profit as a percentage of net sales increased from 36.6% in the second quarter of 2014 to 36.9% in the second quarter of 2015. The overall increase in gross profit margin was primarily due to lower outbound freight costs partially offset by higher central distribution costs and lower merchandise margins. Outbound freight costs decreased as a percentage of sales, primarily due to a shift in our e-Commerce business to more in-store-pickup sales which carry a lower fulfillment cost for the Company. Our central distribution costs increased as a percent of sales due to the addition of a 300,000 square-foot fulfillment facility in Jackson, Tennessee to support our growing e-Commerce business as well as some other ancillary supply chain needs. Store occupancy costs as a percentage of net sales decreased slightly in the second quarter of 2015 as compared to the prior year period. Merchandise margin decreased from 54.2% in the second quarter of fiscal 2014 to 54.0% in the second quarter of fiscal 2015. The decrease in merchandise margin was primarily due to an unfavorable comparison to prior year s shrink results and growth in our loyalty program. Merchandise margin is calculated as net sales minus product cost of sales (including inbound freight), inventory shrinkage, and loyalty reward program charges. Merchandise margin excludes outbound freight, store occupancy and central distribution costs.

Compensation and benefits. Compensation and benefits expenses at the store level decreased as a percentage of net sales for the second quarter of fiscal 2015 as compared to the second quarter of 2014 due to comparable store sales leverage. At the corporate level, the compensation and benefits ratio was higher in the second quarter of 2015 as compared to the prior year period primarily due to increased headcount.

Other operating expenses. Other operating expenses increased as a percentage of sales versus the prior year period. At the store level, advertising expense decreased in dollars and as a percentage of sales compared to the prior year period, but this was largely offset by an isolated data processing issue involving the loss of credit card data preventing us from collecting credit card funds for one specific day during the last week of the quarter. The issue, which has been addressed, did not compromise data integrity or affect any of the Company s other systems. At the corporate level, professional fees and corporate office rent increased in dollars and as a percentage of sales compared to the prior year period.

Depreciation. The increase in depreciation as a percentage of sales reflects an increase in capital expenditures in recent fiscal years and the implementation of major technology upgrades.

Income tax expense. We recorded an income tax benefit of approximately $1.4 million, or 38.4% of the loss before income taxes during the second quarter of fiscal 2015, compared to a tax benefit of approximately $657,000, or 38.4% of the loss before income taxes, in the prior year quarter.

Net income and earnings per share. As a result of the foregoing, we reported a net loss of $2.3 million, or $0.13 per diluted share, for the second quarter of fiscal 2015 as compared to a net loss of $1.1 million, or $0.06 per diluted share, for the second quarter of fiscal 2014.

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26-Week Period Ended August 1, 2015 Compared to the 26-Week Period Ended August 2, 2014

Results of operations. The table below sets forth selected results of our operations both in dollars (in thousands) and as a percentage of net sales for the periods indicated:

	26-Week Period Ended					
	August 1, 2015		August 2, 2014		Change	
	$	%	$	%	$	%
Net sales	$ 233,599	100.0%	$ 211,740	100.0%	$ 21,859	10.3%
Cost of sales	143,424	61.4%	131,265	62.0%	12,159	9.3%
Gross profit	90,175	38.6%	80,475	38.0%	9,700	12.1%
Operating expenses:						
Compensation and benefits	47,602	20.4%	42,366	20.0%	5,236	12.4%
Other operating expenses	31,639	13.5%	27,890	13.2%	3,749	13.4%
Depreciation	10,539	4.5%	8,731	4.1%	1,808	20.7%
Total operating expenses	89,780	38.4%	78,987	37.3%	10,793	13.7%
Operating income	395	0.2%	1,488	0.7%	(1,093)	(73.5%)
Interest expense, net	140	0.1%	136	0.1%	4	2.9%
Other income, net	(111)	(0.1%)	(308)	(0.1%)	197	(64.0%)
Income before income taxes	366	0.2%	1,660	0.8%	(1,294)	(78.0%)
Income tax expense	125	0.1%	660	0.3%	(535)	(81.1%)
Net income	$ 241	0.1%	$ 1,000	0.5%	$ (759)	(75.9%)

Net sales. Net sales increased 10.3% to $233.6 million for the first half of fiscal 2015 compared to $211.7 million for the prior year period. The impact of net new store growth contributed an increase to net sales of $12.2 million. An increase in comparable store sales, including e-commerce sales, of 4.8%, contributed an increase over the prior year period of $9.7 million. Comparable store sales increased 4.3% in the prior year period. For the first half of 2015, the e-Commerce business was up 39.2% versus the prior year period, accompanied by an increase in comparable store sales at brick-and-mortar stores of 2.8%. For brick-and-mortar stores, the comparable store sales increase was primarily due to an increase in the number of transactions, while average ticket remained flat. The increase in transactions resulted from an increase in conversion. The flat average ticket reflected a slight decrease in average retail selling price, offset by a slight increase in items sold per transaction. The e-Commerce business benefitted from an increase in website traffic coupled with an increase in conversion, slightly offset by a decrease in average order size. The merchandise categories contributing most to the comparable store sales increase were housewares, textiles, wall decor, and fragrance and accessories.

Gross profit. Gross profit as a percentage of net sales increased from 38.0% in the first half of 2014 to 38.6% in the first half of 2015. The overall increase in gross profit margin was primarily due to lower outbound freight costs and higher merchandise margins. Outbound freight costs decreased as a percentage of sales, primarily due to a shift in our e-Commerce business to more in-store-pickup sales which carry a lower fulfillment cost for the Company. Merchandise margins increased from 55.1% in the first half of fiscal 2014 to 55.2% in the first half of fiscal 2015 due to a year-over-year reduction in markdowns and promotional activity. Merchandise margin is calculated as net sales minus product cost of sales (including inbound freight), inventory shrinkage, and loyalty reward program charges. Merchandise margin excludes outbound freight, store occupancy and central distribution costs. Store occupancy costs and central distribution costs as a percentage of net sales were essentially flat in the first half of 2015 as compared to the prior year period.

Compensation and benefits. Compensation and benefits expenses for stores increased in dollars as a result of an increase in store count, but slightly decreased as a percent of net sales for the first half of fiscal 2015 as compared to the first half of 2014 due to comparable store sales leverage. At the corporate level, the compensation and benefits ratio was higher in the first half of 2015 as compared to the prior year period primarily due to increased head count and $600,000 of stock-based compensation expense that resulted from the accelerated vesting of stock options and restricted stock units upon the retirement of our former Chief Executive Officer.

Other operating expenses. Other operating expenses increased in dollars and as a percentage of net sales versus the prior year period. At the store level, advertising expense decreased in dollars and as a percent of sales compared to the prior year period which was partially offset by an isolated data processing issue involving the loss of credit card data preventing us from collecting credit card funds for one specific day during the last week of the period. At the corporate level, professional fees and corporate office rent increased in dollars and as a percent of sales compared to the prior year period.

Depreciation. The increase in depreciation as a percentage of sales reflects an increase in capital expenditures in recent fiscal years and the implementation of major technology upgrades.

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Income tax expense. We recorded income tax expense of approximately $125,000, or 34.2% of pre-tax income during the first half of fiscal 2015, versus approximately $660,000, or 39.8% of pre-tax income, in the prior year period.

Net income and earnings per share. As a result of the foregoing, we reported net income of $241,000, or $0.01 per diluted share, for the first half of fiscal 2015 as compared to net income of $1.0 million, or $0.06 per diluted share, for the first half of fiscal 2014.

Liquidity and Capital Resources

Our principal capital requirements are for working capital and capital expenditures. Working capital consists mainly of merchandise inventories offset by accounts payable, which typically reach their peak by the early portion of the fourth quarter of each fiscal year. Capital expenditures primarily relate to new store openings; existing store expansions, remodels or relocations; and purchases of equipment or information technology assets for our stores, distribution facilities and corporate headquarters. Historically, we have funded our working capital and capital expenditure requirements with internally generated cash and borrowings under our credit facility.

Cash flows from operating activities. Net cash used in operating activities was approximately $10.2 million for the first half of fiscal 2015, compared to net cash used in operating activities of approximately $4.5 million for the first half of 2014. Cash flows from operating activities depend heavily on operating performance, changes in working capital and the timing and amount of payments for income taxes. The change in the amount of cash used in operations as compared to the prior year period was primarily the result of increased inventory levels to support our expected sales increase for the third quarter combined with an increased in new store opening activity.

Cash flows from investing activities. Net cash used in investing activities for the first half of fiscal 2015 consisted of $10.8 million in capital expenditures as compared to $14.8 million in capital expenditures for the prior year period. The capital expenditures in the current year period related to technology investments in our stores and e-Commerce site, improvements to our supply chain, investments in existing stores, as well as the opening of nine new stores during the period. Capital expenditures in the prior year period related primarily to the opening of thirteen new stores and information technology assets. We expect that capital expenditures for all of fiscal 2015 will be approximately $29 to $31 million, primarily to fund the leasehold improvements of new stores, supply chain investments, improvements in our information technology infrastructure and multi-channel capabilities, and maintain our investments in existing stores.

Cash flows from financing activities. Net cash used in financing activities was approximately $29.1 million for the first half of fiscal 2015, and was primarily related to a special cash dividend of $26.0 million and the repurchase and retirement of common stock. Net cash used in financing activities was approximately $1.2 million for the first half of fiscal 2014, and was related to the repurchase and retirement of common stock, partially offset by employee stock purchases and the related tax benefits.

Revolving credit facility. On August 19, 2011, we entered into an Amended and Restated Credit Agreement (the Credit Agreement) with Bank of America, N.A. as administrative agent and collateral agent, and the lenders named therein (the Lenders), replacing our prior credit agreement entered into in 2004. The Credit Agreement increased our senior secured revolving credit facility from $45 million to $50 million and extended the maturity date to August 2016. Borrowings under the facility bear interest at an annual rate equal to LIBOR plus a margin ranging from 175 to 225 basis points with no LIBOR floor. Additionally, a fee of 0.375% per annum is assessed on the unused portion of the facility.

Pursuant to the Credit Agreement, borrowings are subject to certain customary conditions and contain customary events of default, including, without limitation, failure to make payments, a cross-default to certain other debt, breaches of covenants, breaches of representations and warranties, a change in control, certain monetary judgments and bankruptcy and ERISA events. Upon any such event of default, the principal amount of any unpaid loans and all other obligations under the Credit Agreement may be declared immediately due and payable. The maximum availability under the facility is limited by a borrowing base formula which consists of a percentage of eligible inventory and eligible credit card receivables, less reserves.

Also on August 19, 2011, we entered into an Amended and Restated Security Agreement with our Lenders. Pursuant to the Security Agreement, we pledged and granted to the administrative agent, for the benefit of itself and the secured parties specified therein, a lien on and security interest in all of the rights, title and interest in substantially all of our assets to secure the payment and performance of the obligations under the Credit Agreement.

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As of August 1, 2015, we were in compliance with the covenants in the facility and there were no outstanding borrowings under the credit facility, with approximately $42.3 million available for borrowing.

At August 1, 2015, our balance of cash and cash equivalents was approximately $49.1 million. We do not anticipate any borrowings under the credit facility during fiscal 2015. We believe that the combination of our cash balances and cash flow from operations will be sufficient to fund our planned capital expenditures and working capital requirements for at least the next twelve months.

Share Repurchase Authorization. On May 22, 2014, we announced that our Board of Directors authorized a stock repurchase plan providing for the purchase in the aggregate of up to $30 million of our outstanding common stock until May 2016. From inception of the plan through August 1, 2015, we repurchased and retired approximately 374,000 shares of common stock at an aggregate cost of approximately $7.3 million under this repurchase plan. As of August 1, 2015, we had $22.7 million remaining under our Board of Directors current authorization to repurchase our common stock. Subsequent to August 1, 2015, we have repurchased and retired approximately 36,000 shares of common stock at an aggregate cost of $843,000.

Special Cash 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.

Related Party Transactions

In July 2009, we 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 our Vice President of Merchandising. During the 13-week periods ended August 1, 2015 and August 2, 2014, purchases from this vendor totaled approximately $8.2 million, or 13.5% of total merchandise purchases, and $6.3 million, or 11.6% of merchandise purchases, respectively. During the 26-week periods ended August 1, 2015 and August 2, 2014, purchases from this vendor totaled approximately $15.2 million, or 13.2% of total merchandise purchases, and $12.0 million, or 11.8% of merchandise purchases, respectively. Included in cost of sales for the 13-week periods ended August 1, 2015 and August 2, 2014 were $6.8 million and $5.7 million, respectively, related to this vendor. Included in cost of sales for the 26-week periods ended August 1, 2015 and August 2, 2014 were $13.2 million and $11.5 million, respectively, related to this vendor. Payable amounts outstanding to this vendor were approximately $2.2 million and $1.7 million as of August 1, 2015 and August 2, 2014, respectively. Our payable terms with this vendor are consistent with the terms offered by other vendors in the ordinary course of business.

Significant Contractual Obligations and Commercial Commitments

Construction commitments

The Company had commitments for new store construction projects totaling approximately $3.1 million at August 1, 2015.

Critical Accounting Policies and Estimates

There have been no significant changes to our critical accounting policies during fiscal 2015. Refer to our Annual Report on Form 10-K for the fiscal year ended January 31, 2015, for a summary of our critical accounting policies.

Cautionary Statement for Purposes of the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995

The following information is provided pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. Certain statements under the heading Management s Discussion and Analysis of Financial Condition and Results of Operations in this Form 10-Q are forward-looking statements made pursuant to these provisions. Forward-looking statements provide current expectations of future events based on certain assumptions and include any statement that does not directly relate to any historical or current fact. Words such as should, likely to, forecasts, strategy, goal, anticipates, believes, expects, estimates, intends, plans, projects, and sim identify such forward-looking statements. Such statements are subject to certain risks and uncertainties which could cause actual results to differ materially from the results projected in such statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof.

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The factors listed below under the heading Risk Factors and in the other sections of this Form 10-Q 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.

These forward-looking statements speak only as of the date of this report and, except as required by law, we undertake no obligation to update forward-looking statements to reflect events or circumstances occurring after the date of this report.

We caution readers that the following important factors, among others, have in the past, in some cases, affected and could in the future affect our actual results of operations and cause our actual results to differ materially from the results expressed in any forward-looking statements made by us or on our behalf.

If We Do Not Generate Sufficient Cash Flow, We May Not Be Able to Implement Our Growth Strategy.

If We Are Unable to Profitably Open and Operate New Stores at a Rate that Exceeds Planned Store Closings, We May Not Be Able to Adequately Execute Our Growth Strategy, Resulting in a Decrease in Net Sales and Net Income.

Our Success Depends Upon our Marketing, Advertising and Promotional Efforts. If We are Unable to Implement them Successfully, or if Our Competitors Market, Advertise or Promote More Effectively than We Do, Our Revenue May Be Adversely Affected.

We May Not Be Able to Successfully Anticipate Consumer Trends and Our Failure to Do So May Lead to Loss of Consumer Acceptance of Our Products Resulting in Reduced Net Sales.

We May Not Be Able to Successfully Respond to Technological Change, Our Website Could Become Obsolete and Our Financial Results and Conditions Could be Adversely Affected.

Inventory Loss and Theft and the Inability to Anticipate Inventory Needs may Result in Reduced Net Sales.

Inability to Successfully Develop and Maintain a Relevant and Reliable Multichannel Experience for Our Customers Could Adversely Affect Our Sales, Results of Operations and Reputation.

Our Results Could be Negatively Impacted if our Merchandise Offering Suffers a Substantial Impediment to its Reputation Due to Real or Perceived Quality Issues.

We Face an Extremely Competitive Specialty Retail Business Market, and Such Competition Could Result in a Reduction of Our Prices and a Loss of Our Market Share.

Weather Conditions Could Adversely Affect Our Sales and/or Profitability by Affecting Consumer Shopping Patterns.

We are Exposed to the Risk of Natural Disasters, Pandemic Outbreaks, Global Political Events, War and Terrorism That Could Disrupt Our Business and Result in Lower Sales, Increased Operating Costs and Capital Expenditures.

Our Performance May be Affected by General Economic Conditions.

Our Profitability is Vulnerable to Inflation and Cost Increases.

Our Business Is Highly Seasonal and Our Fourth Quarter Contributes a Disproportionate Amount of Our Net Sales, Net Income and Cash Flow, and Any Factors Negatively Impacting Us During Our Fourth Quarter Could Reduce Our Net Sales, Net Income and Cash Flow, Leaving Us with Excess Inventory and Making It More Difficult for Us to Finance Our Capital Requirements.

Failure to Control Merchandise Returns Could Negatively Impact the Business.

We May Experience Significant Variations in Our Quarterly Results.

Our Comparable Store Net Sales Fluctuate Due to a Variety of Factors.

Our Freight Costs and thus Our Cost of Goods Sold are Impacted by Changes in Fuel Prices.

New Legal Requirements Could Adversely Affect Our Operating Results.

Litigation May Adversely Affect Our Business, Financial Condition, Results of Operations or Liquidity.

Product Liability Claims Could Adversely Affect Our Reputation.

If We Fail to Protect Our Brand Name, Competitors May Adopt Trade Names that Dilute the Value of Our Brand Name.

Failure to Protect the Integrity and Security of Individually Identifiable Data of Our Customers and Employees Could Expose Us to Litigation and Damage Our Reputation; The Expansion of Our e-Commerce Business Has Inherent Cybersecurity Risks That May Result in Business Disruptions.

Our Hardware and Software Systems Are Vulnerable to Damage that Could Harm Our Business.

We Depend on a Number of Vendors to Supply Our Merchandise, and Any Delay in Merchandise Deliveries from Certain Vendors May Lead to a Decline in Inventory Which Could Result in a Loss of Net Sales.

We Are Dependent on Foreign Imports for a Significant Portion of Our Merchandise, and Any Changes in the Trading Relations and Conditions Between the United States and the Relevant Foreign Countries May Lead to a Decline in Inventory Resulting in a Decline in Net Sales, or an Increase in the Cost of Sales Resulting in Reduced Gross Profit.

Our Success Is Highly Dependent on Our Planning and Control Processes and Our Supply Chain, and Any Disruption in or Failure to Continue to Improve These Processes May Result in a Loss of Net Sales and Net Income.

We Depend on Key Personnel, and, if We Lose the Services of Any Member of Our Senior Management Team, We May Not Be Able to Run Our Business Effectively.

Our Charter and Bylaw Provisions and Certain Provisions of Tennessee Law May Make It Difficult in Some Respects to Cause a Change in Control of Kirkland s and Replace Incumbent Management.

Concentration of Ownership among Our Existing Directors, Executive Officers, and Their Affiliates May Prevent New Investors from Influencing Significant Corporate Decisions.

If We Fail to Maintain an Effective System of Internal Control, We May Not be Able to Accurately Report Our Financial Results.

The Market Price for Our Common Stock Might Be Volatile and Could Result in a Decline in the Value of Your Investment.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company does not utilize financial instruments for trading or other speculative purposes, nor does it utilize leveraged financial instruments. There have been no material changes in the market risk factors from those disclosed in the Company s Form 10-K for the year ended January 31, 2015.

ITEM 4. CONTROLS AND PROCEDURES

(a) *Evaluation of disclosure controls and procedures*. Both our President and Chief Executive Officer and Vice President and Chief Financial Officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15(d)-(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act) have concluded that as of August 1, 2015 our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by the Company in reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms and is accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

(b) *Change in internal controls over financial reporting*. There have been no changes in internal controls over financial reporting identified in connection with the foregoing evaluation that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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 claims in excess of insurance coverage will have a material effect on the financial condition, operating results or cash flows of the Company.

ITEM 1A. RISK FACTORS

In addition to factors set forth in Management s Discussion and Analysis of Financial Condition and Results of Operations Cautionary Statement for Purposes of the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995, in Part I Item 2 of this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the fiscal year ended January 31, 2015, which could materially affect our business, financial condition or future results. The risks described in this report and in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Shares of common stock repurchased by the Company during the second quarter of fiscal 2015, ending August 1, 2015, were as follows:

Issuer Repurchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Program (in 000s)
May 3, 2015 to May 30, 2015	17,038	$ 24.13	17,038	$ 23,045
May 31, 2015 to July 4, 2015	10,734	$ 26.11	10,734	$ 22,764
July 5, 2015 to August 1, 2015	2,986	$ 26.90	2,986	$ 22,684
Total	30,758	$ 25.09	30,758	$ 22,684

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. Through August 1, 2015, the Company repurchased and retired a total of approximately 374,000 shares at an aggregate cost of $7.3 million under this repurchase plan. Subsequent to August 1, 2015, the Company has repurchased and retired approximately 36,000 shares of common stock at an aggregate cost of $843,000.

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ITEM 6. EXHIBITS

(a) Exhibits.

Exhibit No.	Description of Document
3.1	Amended and Restated Charter of Kirkland s, Inc.
31.1	Certification of the President and Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a)
31.2	Certification of the Vice President and Chief Financial Officer Pursuant to Rule 13a-14(a) or Rule 15d-14(a)
32.1	Certification of the President and Chief Executive Officer pursuant to 18 U.S.C. Section 1350
32.2	Certification of the Vice President and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350
101	Interactive Data File (Quarterly Report on Form 10-Q, for the quarter ended August 1, 2015, furnished in XBRL (eXtensible Business Reporting Language))

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

	KIRKLAND S, INC.
Date: September 10, 2015	/s/ W. Michael Madden W. Michael Madden President and Chief Executive Officer
Date: September 10, 2015	/s/ Adam C. Holland Adam C. Holland Vice President and Chief Financial Officer

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