



Kirkland's®

2005 ANNUAL REPORT



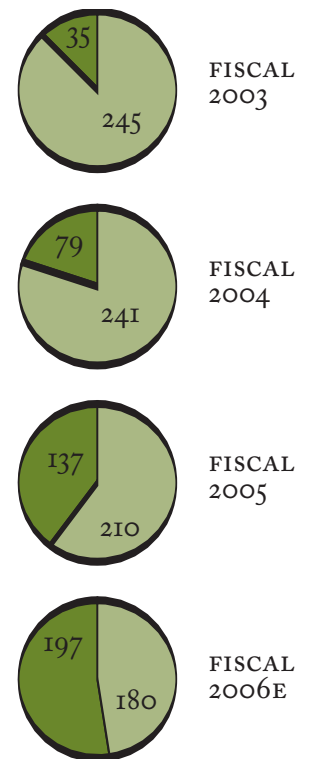
● Corporate Headquarters
& Central Distribution Center



TRANSITIONING THE STORE BASE TO OFF-MALL VENUES

Kirkland's stores are destination locations for shoppers interested in stylish home décor at great prices. Founded in 1966, the company has evolved through the years to meet the changing needs and preferences of customers in many different markets and regions of the United States. During the past seven fiscal

years, we have more than doubled our store base, principally through new store openings. We opened 59 new stores in fiscal 2005, all of which were located in off-mall venues that have become the destinations of choice for our customers. We ended the year with 347 stores operating in 37 states.



● OFF-MALL STORES
● MALL LOCATIONS

DEAR FELLOW SHAREHOLDERS, CUSTOMERS, AND ASSOCIATES:

Fiscal 2005 was another challenging year for Kirkland's. Our financial results suffered as we continued to encounter a difficult sales environment in the home décor sector resulting in customer traffic declines and lower comparable store sales. We also struggled with key elements of our merchandise assortment which attracted our core customer and made us successful in the past. Yet, we made significant strides in key areas of the business to position us for financial turnaround. In logistics and distribution, we built upon the successful opening of our distribution center in fiscal 2004 by increasing efficiency and realizing significant cost reductions in the supply chain. In real estate, we met our growth plan and advanced the transformation of our real estate base to off-mall venues. In store operations, we controlled store-level costs and improved store conversion rates and customer service. However, the lack of top line momentum caused earnings to fall short of our goals.

During fiscal 2005, we achieved our store growth plan by opening 59 stores which, net of closings, represented an 8.4% increase in the store base and a 16.6% increase in gross square footage. Overall sales increased 5.2%, while comparable store sales declined 6.9%. The comparable store sales performance resulted from a decline in customer traffic, particularly in mall stores, and a merchandise offering that did not sufficiently resonate with customers. Markdowns were heavier as we attempted to drive sales and clear unproductive merchandise, leading to a lower merchandise margin. Overall, expense control was good as we achieved reductions in freight and

distribution costs, benefited from lower occupancy costs in off-mall stores and controlled store-level payroll. For the year, we reported earnings of \$0.01 per share compared with \$0.34 per share in fiscal 2004.

As a fellow shareholder, I am acutely disappointed with the earnings results, but I believe we have a significant opportunity to improve and return to the profitability levels that we enjoyed as recently as two years ago. To appreciate the opportunities ahead of us, as investors we must understand where the Kirkland's concept stands today. Kirkland's has long been known for stylish key items and great value. Our customers are loyal, love visiting the stores and expect the right combination of style, quality and value. We are committed to return to those fundamentals. Today's home décor shopper has many choices. We must continually differentiate ourselves by offering an exciting, value-priced merchandise assortment reflecting the latest in style and trend. In 2005, our merchandise assortment was narrowly focused in style, color and adornment. We will redefine "style," incorporating a more appealing and diverse merchandise mix that will reinvigorate current customers, re-engage any that have left us, and introduce new customers to Kirkland's.

Improved merchandising direction is clearly our most important priority for fiscal 2006. We have assembled a talented group of merchants, but we have struggled with vision and leadership in this area over the last two years. On March 22, 2006, we named Catherine David as President and Chief Operating Officer. A 20-year retail veteran, Cathy brings

Kirkland's a proven ability to set a merchandising vision and attract top merchandising talent. Her diverse experience in retail, enthusiasm and passion for our product make her uniquely qualified to lead this effort. We are very excited about having Cathy on our team. We have identified the following areas of focus in implementing this vision: 1) clearly defining and understanding our customer; 2) adjusting the merchandising mix to broaden our appeal; 3) better coordinating the merchandising and marketing process; and 4) continuing the improvement in operational execution and customer service. We are underway, and we look forward to making significant progress during fiscal 2006.

A second priority is to continue the shift to off-mall real estate. Our research has shown that Kirkland's customers clearly prefer to shop off-mall. As of January 28, 2006, we operated 347 stores, 137 of which were located off-mall. Our new, off-mall stores average about 6,500 square feet in size, larger than our historical model. When compared to mall locations, they are easier to operate and shop and provide additional merchandising opportunities. Our off-mall stores are generating better sales volumes and have lower occupancy costs, resulting in better store-level profits. Above all, these stores are more convenient and pleasing for our customer, resulting in higher conversion rates and reinforcing our belief that we are a destination store. Our real estate direction is clear, and our growth plans are focused exclusively on off-mall locations, typically in high-growth, suburban markets. For fiscal 2006, we will open approximately 60 off-mall



stores and close approximately 30 mall stores, an 8.6% growth rate.

There are many initiatives, projects and day-to-day efforts that go into running a business like Kirkland's and making it successful, but merchandise is and always has been the key to our success. We have taken many important steps over the last two years in key areas of the business to provide a solid foundation for growth and profitability to make us a better company. However, the new merchandising efforts will be the most important factor in returning positive comparable store sales, increasing customer traffic and improving our operating margins.

We clearly have challenges ahead of us, but we view these challenges as major opportunities to make Kirkland's again a leading performer in the sector. We are blessed with a

talented and experienced management team, now bolstered by the addition of Cathy David, that is working diligently and is committed to deliver a meaningful earnings recovery.

We look forward to reporting back to you throughout fiscal 2006 on our progress. Thank you for your continued support and investment in Kirkland's, and I hope to see you soon in our stores!

Sincerely,

Robert E. Alderson
Chief Executive Officer

**WE WILL
REDEFINE "STYLE"
INCORPORATING A
MORE APPEALING
AND DIVERSE
MERCHANDISE
MIX THAT WILL
REINVIGORATE
OUR CUSTOMERS.**

DIRECTORS AND OFFICERS

Directors

R. Wilson Orr, III
Chairman of the Board of Directors
General Partner, SSM Partners

Carl Kirkland
Founder
Kirkland's, Inc.

Robert E. Alderson
Chief Executive Officer
Kirkland's, Inc.

Steven J. Collins
Principal
Advent International Corporation

David M. Mussafer
Managing Director
Advent International Corporation

Ralph T. Parks
President
RT Parks, Inc.

Murray M. Spain
President
World Wide Basics, LLC

Officers

Robert E. Alderson
Chief Executive Officer

Catherine A. David
President and Chief Operating Officer

Dwayne F. Cochran
Executive Vice President and
Director of Stores

Andrew P. Gallina
Vice President of Marketing

Michelle R. Graul
Vice President of Human Resources

James W. Harris
Vice President of Store Operations

Rob Janes
Vice President of Information Services
and Chief Information Officer

Roland L. Mackie
Vice President of Real Estate

W. Michael Madden
Vice President of Finance and
Chief Financial Officer

Deborah A. McDonald
Vice President of Visual Merchandising

Tracy Parker
Vice President of Store Operations

Lowell E. Pugh II
Vice President, General Counsel
and Secretary

Grey W. Satterfield
Vice President of Merchandising –
Planning

Connie L. Scoggins
Vice President of Finance and
Treasurer/Controller

Toni F. Warren
Vice President of Merchandising –
Replenishment

Todd A. Weier
Vice President of Logistics

CORPORATE DATA

Corporate Headquarters

Kirkland's, Inc.
805 North Parkway
Jackson, Tennessee 38305
731/668-2444
www.kirklands.com

Transfer Agent and Registrar

StockTrans, Inc.
44 West Lancaster Avenue
Ardmore, Pennsylvania 19003
610/649-7300
Shareholders seeking information concerning stock transfers, change of address, and lost certificates should contact StockTrans directly.

Independent Auditors

Ernst & Young LLP
Memphis, Tennessee

Corporate Counsel

Pepper Hamilton LLP
Philadelphia, Pennsylvania

Annual Report on Form 10-K

A copy of the Company's fiscal 2005 Annual Report on Form 10-K as filed with the Securities and Exchange Commission is available to shareholders by contacting the Investor Relations Department at the Company's address above.

Annual Meeting

The Annual Meeting of Shareholders will be held at 1:00 p.m. Central Daylight Time on June 5, 2006 at the Crescent Club, 6075 Poplar Avenue, 9th Floor, Memphis, Tennessee.

Safe Harbor

Except for historical information contained herein, the statements in this release are forward-looking and made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements involve known and unknown risks and uncertainties, which may cause Kirkland's actual results to differ materially from forecasted results. Those risks and uncertainties include, among other things, the competitive environment in the home décor industry in general and in Kirkland's specific market areas, inflation, product availability and growth opportunities, seasonal fluctuations, and economic conditions in general. Those and other risks are more fully described in Kirkland's filings with the Securities and Exchange Commission, including the Company's Annual Report on Form 10-K filed on April 12, 2006. Kirkland's disclaims any obligation to update any such factors or to publicly announce results of any revisions to any of the forward-looking statements contained herein to reflect future events or developments.

Stock Market Information

The Company's common stock is traded on the NASDAQ National Market under the symbol KIRK. On April 10, 2006, there were approximately 88 holders of record and 1,750 beneficial owners of the Company's common stock. The following table sets forth, for the periods indicated, the high and low last sale prices of shares of the common stock as reported by NASDAQ:

	High	Low
Fiscal 2004:		
Quarter ended May 1, 2004	\$ 18.05	\$ 13.88
Quarter ended July 31, 2004	\$ 18.57	\$ 10.20
Quarter ended October 30, 2004	\$ 10.50	\$ 7.55
Quarter ended January 29, 2005	\$ 12.56	\$ 8.69
Fiscal 2005:		
Quarter ended April 30, 2005	\$ 11.28	\$ 9.18
Quarter ended July 30, 2005	\$ 9.42	\$ 8.17
Quarter ended October 29, 2005	\$ 9.93	\$ 7.05
Quarter ended January 28, 2006	\$ 7.22	\$ 5.73

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