

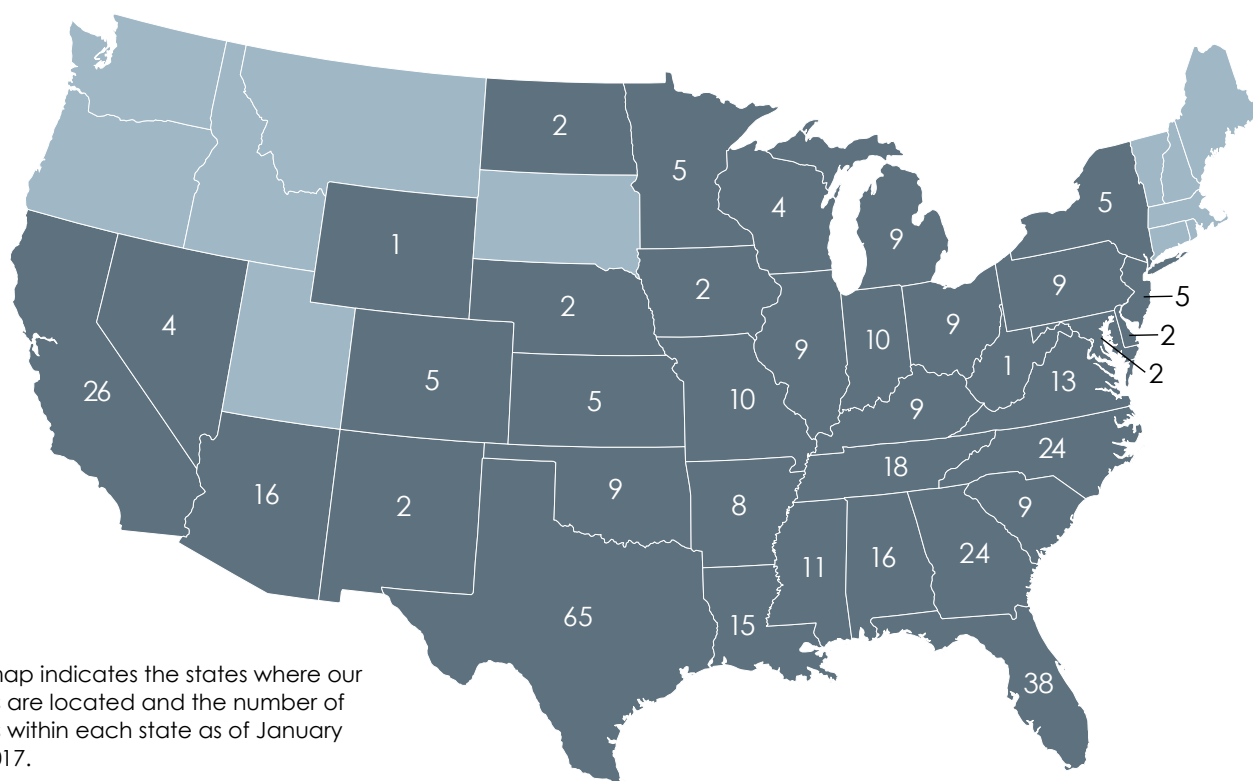
ANNUAL REPORT 2016



KIRKLAND'S®
YOUR DOORWAY TO *Home*

Financial Highlights

<i>(In thousands, except per share data and performance metrics)</i>	Fiscal 2016 (52 Weeks)	Fiscal 2015 (52 Weeks)	Fiscal 2014 (52 Weeks)
STATEMENT OF INCOME DATA			
Total revenue	\$ 594,328	\$ 561,807	\$ 507,621
Gross profit	221,471	218,794	202,897
Operating income	16,999	26,191	28,641
Pretax income	16,975	26,097	28,820
Net income	11,046	16,573	17,814
Diluted earnings per share	\$ 0.68	\$ 0.94	\$ 1.00
Dividends declared per share	—	\$ 1.50	—
BALANCE SHEET DATA			
Cash and cash equivalents	\$ 63,937	\$ 44,352	\$ 99,138
Inventories, net	75,447	68,222	55,775
Total assets	270,146	235,256	256,949
Total shareholders' equity	133,813	119,695	151,062
OTHER FINANCIAL DATA			
Comparable store sales increase (decrease)	(2.9)%	2.9%	6.1%
Number of stores at year end	404	376	344
Gross profit margin	37.3%	38.9%	40.0%
Return on assets	4.4%	6.7%	7.3%
Return on equity	8.7%	12.2%	12.4%



Dear Shareholder

For over 50 years, Kirkland's has served as your doorway to home, a destination for those special items that make your home uniquely yours, always providing great style at a great price. That's true more than ever today as we serve a growing home furnishings market with a dynamic shopping experience that encompasses stores, kirklands.com and an array of digital and social media.

In today's rapidly evolving retail environment, ensuring Kirkland's "doorway" spans a best-in-class omni-channel platform is just one of the ways we're working toward our goal to transform the company into a high-performing, nationally recognized home décor brand of choice. We believe our strategy can drive significant long-term sales and earnings growth, and we're making important progress to support those plans.

Consider that during 2016, Kirkland's:

- **Achieved record revenues.** Total sales increased 6% to \$594 million in 2016. E-commerce growth was strong with sales rising 22% to account for 8% of total revenues.
- **Strengthened the management team.** We added, among others, a Chief Operating Officer and Vice President of Planning and Allocation, which are both new positions. We entered 2017 with a talented balance of senior leaders with a deep knowledge of home décor and experience operating in national omni-channel organizations.
- **Improved the supply chain.** We expanded our West Coast supply chain capabilities and added an e-Commerce fulfillment center in Jackson, Tennessee. Both investments are driving better product flow and reducing operating costs. We expect further benefits as we move forward.
- **Geared the assortment to support innovation.** We began a significant refresh of our core assortment during 2016 with a goal to eliminate down-trending products, right-size categories and upgrade our assortments.
- **Positively impacted the communities we serve.** Our team was recognized as the top fundraiser for the Nashville area's Susan G. Komen "Race for the Cure," and we expanded our relationship with Habitat for Humanity.
- **Maintained a strong balance sheet.** We ended the year with no debt and \$64 million in cash. Our solid financial position provides us ample flexibility to support our long-term objectives.

For 2017, our goal is to build upon this foundation and expand our market share. We've begun a broad effort to increase sales and margin productivity by improving the product assortment,

sharpening our pricing and promotional strategies, and enhancing the brand experience. Tactical initiatives support these priorities to improve e-Commerce profitability, enhance marketing to increase traffic and differentiate the brand, and continue our efforts to expand our supply chain capabilities to support future store unit growth, and better, faster e-Commerce fulfillment.

IMPROVING THE PRODUCT ASSORTMENT

We believe we can increase productivity with a more optimal product assortment and use of space in our stores. The work we accomplished to refresh the core assortment in 2016 paved the way for our merchants to introduce newness while eliminating non-productive SKUs. We are also implementing process improvements and taking aggressive action to adjust category penetration. For example, we are replacing impulse product around the registers with key items geared to home décor and home comfort. We are also increasing our relevancy in categories related to entertaining and gifting during the holidays.

The assortment refresh is sharpening our overall shopping experience with a clearer point of view, something we've heard loud and clear from our customers. Over the long term, the effort should reduce out-of-stocks, cut excess inventory, and drive higher customer satisfaction.

ADDRESSING PRICING & PROMOTION

A second area of focus for 2017 is pricing and promotion. Kirkland's has a well-established value message, but we believe we can increase the merchandise margin without compromising that aspect of the brand. We are a high-margin specialty retailer with frequent promotional activity and discounts. That will not



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change. However, we will reduce promotions that have a diminishing return for traffic and an unsatisfactory return on investment.

This effort naturally involves tests around price elasticity. Reducing the overuse and overlapping nature of coupons, instilling a better "clearance" discipline, and taking credit for pricing power are all areas we are addressing.

ENHANCING THE BRAND EXPERIENCE

We're pleased with the continued development of our e-Commerce channel. Revenues from kirklands.com exceeded expectations in 2016 and investments in the supply chain are reducing costs and removing stress on our organization. We made improvements in our online user experience during the second half of 2016 and believe there are near-term opportunities to improve conversion, expand vendor direct shipments, and add specific on-line assortments for our seasonal periods. An upgrade of the fulfillment platform will be in place for the peak seasonal period, and is expected to improve our speed of delivery, order accuracy and labor efficiency.

We also intend to improve our marketing, which included a significant shift to digital spend in the second half of 2016. We've learned a lot about the medium, and our media mix will be much better positioned for the back half of 2017. As shopping behavior continues to evolve, effective marketing is crucial to drive traffic and differentiate the brand. Our objective is to increase our investment in marketing as we determine the appropriate media mix.

We are also establishing test stores to experiment with expanded service offerings; all designed to further differentiate our brand and provide an exceptional customer experience.

PRIORITIZING MARKET EXPANSION

With 404 stores in 36 states at the end of fiscal 2016, Kirkland's is well-positioned to evolve with changes in consumer shopping patterns. We've significantly improved the site selection process over the last two years, and the recent classes of new stores are performing well and generating favorable returns.



Stores are the anchor to our omni-channel experience. Most online sales are picked up in the stores, and customers typically spend time on the site before coming to the store. Our seasonal and inspirational product sets are best experienced up close and personal. While we continue to believe that the Kirkland's concept has growth potential to over 500 stores, we're comfortable with a lower rate of unit expansion in the near-term given the strong rate of growth for kirklands.com and the significant opportunities underway to improve store productivity. For 2017, we're focused on further penetration in high density markets and executing more relocations, which have demonstrated attractive return on investment.

Overall, we're confident about the long-term outlook for the business. We have a more capable team, and I'm pleased with the cohesion we are building. The openness to change and fresh ideas should benefit Kirkland's in 2017 and beyond, and we're shifting investment dollars to customer centric initiatives to support our omni-channel growth. Some of our investments will impact 2017, and all have the potential to drive revenue and earnings growth over the longer term.

Thank you for your support, and we hope to see you in our stores and online.

W. Michael Madden
President and Chief Executive Officer



In Memoriam, Robert E. Alderson

We lost a long-time member of the Kirkland's family with the passing of Robert E. Alderson in November 2016.

Robert had been a director of Kirkland's since 1986 and served as the Company's Chief Executive Officer two separate times

between 2001 and 2015. He also served in numerous roles for Kirkland's since joining the Company in 1986, including President, Chief Operating Officer, Chief Administrative Officer, Senior Vice President and Vice President. He was a driving force behind the Company's transformation from a regional retailer to a national chain and successfully led the Company through an initial public offering in 2002.

Robert was truly one-of-a-kind and leaves an indelible mark on our culture. His determination, spirit, passion and commitment to Kirkland's will inspire and stay with us always. He is greatly missed.



**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, 2017

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
incorporation or organization)

62-1287151

(I.R.S. Employer
Identification No.)

5310 Maryland Way, Brentwood, TN

(Address of principal executive offices)

37027

(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

Common Stock, no par value per share

Name of Each Exchange on Which Registered

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

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

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

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 29, 2016, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$224 million based on the last sale price of the common stock as reported by The Nasdaq Stock Market.

As of March 16, 2017, there were 15,916,563 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 June 2, 2017, are incorporated by reference into Part III of this Form 10-K.

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FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K for the fiscal year ended January 28, 2017 (“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 in Item 1A. 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.

PART I

Item 1. *Business*

General

We are a specialty retailer of home décor and gifts in the United States, operating 404 stores in 36 states as of January 28, 2017, 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 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 online and store experience has led to our emergence as a leader in home décor and enabled us to develop a strong customer base.

Business Strategy

Our goal is to be the leading specialty retailer of home décor and accessories 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:

Product mix differentiation. While our stores contain items covering a broad range of complementary product categories, we emphasize traditionally-styled, quality merchandise within each category, striving to combine steady-selling, everyday “core” items with trend-appropriate fashion and seasonal items. Our buyers work closely with our merchandise vendors to identify and develop stylish products that appeal to a broad base of customers while reflecting the latest trends. These products are often proprietary, the result of the development and collaboration between our buyers and our vendors. 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. For these reasons, we believe our buying process yields a merchandise assortment that is differentiated from our competition. We also 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.

Ever-changing merchandise mix. We believe our ever-changing merchandise mix creates an inviting store 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 assortment 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 store experience. Through our in-store visual presentation, marketing and promotions, and customer service, we seek to make customers feel welcome and “at home.” Our merchandise presentation effort is geared toward helping our customers visualize our products 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, enhance our ever-changing merchandise mix, and support our promotional strategies. Our store associates support this environment through their engagement with our customers, knowledge of our products, and passion for customer service.

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 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, accessories 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. 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 (“DTC”) and facilitate orders for in-store pickup (“ISP”) through our website at www.kirklands.com. We view our e-Commerce channel as a crucial part of our overall business strategy, allowing us to introduce our concept to new customers and complement our “brick-and-mortar” business for a true omni-channel brand experience.

Brick-and-mortar store growth. With only 404 stores in 36 states as of the end of fiscal 2016, we view expansion of our physical store locations as an opportunity for growth. During fiscal 2017, we expect to increase our total retail square footage by approximately 2% to 3%. We will focus on infill opportunities in some of our core markets, as well as expansion opportunities in under-penetrated markets in the United States such as the Mid-Atlantic states, the Midwest, portions of the Northeast, and California. We expect to open 25 to 30 new locations during fiscal 2017, and expect to close approximately 20 locations. The new store openings during fiscal 2017 are expected to be weighted towards the second and third quarters of the year, while closings during fiscal 2017 are expected to be weighted towards the first half of the year. Longer-term, we see an opportunity for meaningful annual square footage growth in both existing and new markets.

e-Commerce growth. As customers increasingly turn to the web for their shopping, we expect our e-Commerce channel to provide another growth opportunity. We are continuing to capture additional market share by attracting new customers via the website. We launched third-party drop shipping in fiscal 2015 to give our customers a wider assortment of product offerings. We plan on continued expansion of our third-party drop shipping product offerings in fiscal 2017. Additionally, we are continuing to use the e-Commerce channel to enrich the brick-and-mortar store experience, and have plans to improve our ship to store options to support the blending of the channels into one omni-channel experience. For fiscal 2016, our e-Commerce channel accounted for approximately \$47.3 million in revenue, or about 8.0% of our total revenue, a 22.4% increase over fiscal 2015. We expect our e-Commerce business to continue to grow at a pace greater than brick-and-mortar for the foreseeable future, with an interim goal of 10% of the overall business.

Merchandising

Merchandising strategy. Our merchandising strategy is to (i) offer unique, distinctive and often exclusive, 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 core items within targeted categories, (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 product margin information helps us to maximize the productivity of successful products and categories, and minimize the accumulation of slow-moving inventory. The composition of our merchandise assortment is relatively consistent across the chain. We address regional differences where applicable by tailoring inventories to geographic considerations by reviewing specific store sales results in selected categories and classes of product. 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 5,200 Stock Keeping Units (“SKUs”). Online we carry approximately 4,100 SKUs, of which 1,400 are exclusively online. We regularly monitor the sell-through on each item; therefore, the number and make-up of our active SKUs is continuously changing based on changes in selling trends. We purchase merchandise from approximately 200 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.

Product assortment. Our major merchandise categories include wall décor, art, mirrors, lamps, decorative accessories, accent furniture, textiles, fragrance and accessories, frames, housewares, impulse and personal accessories, outdoor living, 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.

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 2016	Fiscal 2015	Fiscal 2014
Holiday	14%	13%	12%
Art	12	14	14
Wall Décor	11	11	11
Accent Furniture	10	9	10
Fragrance and Accessories	9	9	8
Mirrors	7	7	7
Textiles	7	7	7
Lamps	6	6	7
Decorative Accessories	6	6	7
Housewares	5	5	4
Impulse	3	2	2
Floral	3	3	3
Frames	2	3	3
Clocks	2	2	1
Personal Accessories	2	2	2
Outdoor Living	1	1	2
Total	100%	100%	100%

Value proposition. 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.

Approximately 84% of our total purchases are from importers of merchandise manufactured primarily in China and other South-Asian countries, 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.

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 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

General. In addition to corporate management and three Regional Directors, approximately 30 Multi-Unit Managers (who generally have responsibility for an average of 14 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 seven days a week with an average of 12 to 16 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.

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, our success depends on our ability to promote and/or recruit qualified Multi-Unit and Store Managers and maintain quality full-time and part-time employees. 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. All employees are trained utilizing the “K University” training program. Store Managers train at a designated “training store” where they work directly with a qualified Training Store Manager. Multi-Unit Managers onboard at our Corporate office in addition to spending time with designated Senior Multi-Unit Manager Trainers.

Compensation and incentives. Multi-Unit and Store Managers are compensated with a base salary plus periodic bonuses based on performance. 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 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 Nashville, Tennessee and Kansas City, Missouri; and smaller markets such as Palmdale, California and Amarillo, Texas. As we execute our store growth strategy, we are focused on infill opportunities in some of our existing markets as well as expansion opportunities in under-penetrated markets in the United States such as the Mid-Atlantic states, the Midwest, portions of the Northeast, and California to provide us with the unit growth to achieve our goals.

Formats. We operate stores in a variety of off-mall venues and enclosed malls. As of January 28, 2017, we operated 27 stores in enclosed malls, of which 16 were outward-facing, and 377 stores in off-mall venues. Off-mall stores included 333 in “power” strip centers and “lifestyle” centers, 14 in outlet centers and 30 freestanding locations. The average size of the new stores we opened in fiscal 2016 was approximately 8,200 square feet, and we currently expect our fiscal 2017 new stores to be primarily in off-mall shopping centers of similar average size.

Site selection. Our site selection strategy is to locate our stores in venues which are destinations for large numbers of shoppers and which reinforce our 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.

The following table provides a history of our store openings and closings for the last five fiscal years:

	Fiscal 2016	Fiscal 2015	Fiscal 2014	Fiscal 2013	Fiscal 2012
Stores open at beginning of period	376	344	324	323	309
Store openings	42	43	34	24	42
Store closings	(14)	(11)	(14)	(23)	(28)
Stores open at end of period	404	376	344	324	323

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 has a warehouse management system and material handling equipment that streamline the flow of goods within the distribution center. To support our e-Commerce growth, we entered into a three-year lease in March 2015 for an additional 303,000 square-foot facility in Jackson, Tennessee which began serving as the fulfillment center for e-Commerce in March 2016. We continue to evaluate the impact of our omni-channel strategies on our business, and are currently implementing enhancements to our supply chain infrastructure and warehouse management system to support our store unit growth and e-Commerce goals.

In fiscal 2016, we implemented a new west coast distribution operation, which provides for better flow of merchandise through our supply chain network. By virtue of this operation, we also gain control of inventory earlier, which expands our options for future store and e-Commerce fulfillment capabilities.

We currently utilize third-party carriers to transport merchandise from our distribution center to our stores. Approximately 97% of our stores utilize direct, full truckload deliveries, which results in lower distribution costs and allows our field personnel to better schedule store associates 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.

Information Systems

We have invested considerable resources in our management information systems to manage the purchase, pricing and distribution of our merchandise, improve our operating efficiencies and support online operations. Our key management information systems include a merchandise management system, point-of-sale system, an e-Commerce platform, an e-Commerce order management system, a warehouse management system, a financial system and a labor management tool. Our merchandise management system provides us with tools to manage aspects of our merchandise assortment and integrates all merchandising and inventory management applications including inventory tracking, purchase order management, merchandise financial planning, allocation, and replenishment and sales audit and ultimately interfaces with our financial system.

We continue to evaluate and improve the functionality of our systems to maximize their effectiveness. Such efforts include ongoing hardware and software evaluations, refreshes and upgrades to support optimal software configurations and application performance. We plan to continue to invest in information technology and implement efficiency-driving system enhancements. We continue to strengthen the security of our information systems and invest in technology to support store, distribution facility and omni-channel expansion. These efforts are directed toward improving business processes, maintaining secure, efficient and stable systems, and enabling the continued growth and success of our business.

Marketing

Although our overall marketing efforts encompass various techniques, in recent years, we have had a significant focus on e-mail communication. We now manage a database of approximately 3.2 million active 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 continuously evaluating other forms of advertising as we seek to further enhance the visibility of our products and our brands. Our marketing efforts inside the store emphasize signage, store and window banners, displays and other techniques to attract customers and provide an exciting shopping experience. The growth of our e-Commerce business has also increased our investment in online marketing channels such as paid search and affiliate marketing.

We have a customer loyalty program, K Club, which allows us to reward customers based on dollars spent on eligible purchases with certificates towards future purchases. In addition to the K Club, 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. Customers using the Kirkland's private-label credit card visit our stores and purchase merchandise more frequently, as well as spend more money per visit, than our customers not using the card.

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, join our K Club loyalty program, apply for a Kirkland's credit card, and purchase gift cards online. We are also very active in social media and maintain a presence on Facebook, Twitter, Pinterest and Instagram.

The information contained or incorporated in our website is not a part of this Form 10-K.

Trademarks

All of our stores operate under the names “Kirkland’s”, “Kirkland’s Home”, “Kirkland’s Home Outlet”, “Kirkland’s Outlet,” and “The Kirkland Collection.”

We have registered several trademarks with the United States Patent and Trademark Office on the Principal Register that are used in connection with the Kirkland’s stores, including KIRKLAND’S® logo design, KIRKLAND’S®, THE KIRKLAND COLLECTION®, KIRKLAND’S OUTLET®, KIRKLAND’S HOME®, MARKET AND VINE™ and LOVE THE POSSIBILITIES, LOVE THE PRICE®. These marks have historically been important components in our merchandising and marketing strategy. We are not aware of any claims of infringement or other challenges to our right to use our marks in the United States.

Competition

The retail market for home décor and gifts is highly competitive. Accordingly, we compete against a diverse group of retailers, including specialty stores, department stores, discount stores, catalog and Internet-based retailers, which sell similar lines of merchandise to those carried by us. Some of our main competitors include HomeGoods, Bed, Bath & Beyond, Cost Plus World Market, Hobby Lobby, Pier 1 Imports, Target, Ebay, Amazon and Wayfair. Department stores typically have higher prices than our stores for similar merchandise. Specialty retailers tend to have higher prices and a narrower assortment of home décor products. Wholesale clubs may have lower prices than our stores, but the product assortment is generally more limited. We believe that the principal competitive factors influencing our business are merchandise selection, price, customer service, visual appeal of the merchandise and the store, and the convenience of our store locations. The number of companies offering a selection of home décor products that overlaps generally with our product assortment has increased over the last 10 to 15 years. We believe we compete effectively with other retailers due to our experience in identifying a broad collection of distinctive merchandise, pricing it to be attractive to the target Kirkland’s customer, presenting it in a visually appealing manner, and providing a quality shopping experience.

In addition to competing for customers, we compete with other retailers for suitable store locations and qualified management personnel and sales associates. Many of our competitors are larger and have substantially greater financial, marketing and other resources than we do. See Item 1A of this Form 10-K, captioned “Risk Factors.”

Employees

We employed approximately 7,900 employees as of January 28, 2017. The number of employees fluctuates with seasonal needs. None of our employees are covered by a collective bargaining agreement. We believe that we maintain a positive relationship with our employees.

Seasonality

We have experienced, and expect to continue to experience, substantial seasonal fluctuations in our net sales and operating results, which are typical of many specialty retailers and common to most retailers generally. Due to the importance of the fall selling season, which includes Thanksgiving and Christmas, the last quarter of our fiscal year has historically contributed, and is expected to continue to contribute, a disproportionate amount of our net sales, net income and cash flow for the entire fiscal year.

Availability of SEC Reports

We file annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K and other information with the Securities Exchange Commission (“SEC”). Members of the public may read and copy materials that we file with the SEC at the SEC’s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Members of the public may also obtain information on the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet web site that contains reports, proxy and information statements and other information regarding issuers, including Kirkland’s, that file electronically with the SEC. The address of that site is <http://www.sec.gov>. Our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K and amendments to those documents and other information filed by us with the SEC are available, without charge, on our Internet web site, <http://www.kirklands.com>, as soon as reasonably practicable after they are filed electronically with the SEC. Copies are also available, without charge, by written request to: Secretary, Kirkland’s, Inc., 5310 Maryland Way, Brentwood, Tennessee 37027.

Executive Officers of Kirkland's

The name, age and position of each of our executive officers as of March 31, 2017 are as follows:

W. Michael Madden, 47, has been a Director of Kirkland's and President and Chief Executive Officer since February 2015. Prior to his appointment as Chief Executive Officer, Mr. Madden served as President and Chief Operating Officer since August 2014. He also served as Senior Vice President and Chief Financial Officer from January 2008 to July 2014, Vice President and Chief Financial Officer from May 2006 to December 2007, and Vice President of Finance from May 2005 to April 2006. From July 2000 to May 2005, he served as Director of Finance. Prior to joining Kirkland's, Mr. Madden served as Assistant Controller with Trammell Crow Company, a real estate development, investment, and operations company, and was with PricewaterhouseCoopers LLP. At PricewaterhouseCoopers LLP, he served in positions of increasing responsibility over six years culminating as Manager-Assurance and Business Advisory Services where he worked with various clients, public and private, in the retail and consumer products industries.

Michael Cairnes, 57, has been Executive Vice President and Chief Operating Officer since November 2016. Prior to his appointment as Chief Operating Officer, Mr. Cairnes was with Michael's Stores, where he served concurrently as President of its Aaron's Brothers retail business, since 2015, and President of its Artistree framing business, since 2007. Prior to Michael's, Mr. Cairnes held senior leadership positions at Brushstrokes, a publisher of art canvases, and Larson-Juhl, a manufacturer of home décor products. He also has served as a board and strategy advisor to Bain Capital and Blackstone.

Michelle R. Graul, 51, has been Executive Vice President of Stores and Real Estate since November 2016. Prior to her appointment as Executive Vice President of Stores and Real Estate, Mrs. Graul served as Executive Vice President of Stores and Merchandising from August 2014 to November 2016, Senior Vice President of Human Resources and Stores from January 2010 to August 2014, Senior Vice President of Human Resources from August 2008 to December 2009, and Vice President of Human Resources from March 2005 to July 2008. Prior to joining Kirkland's, Mrs. Graul was employed with Pier 1 Imports and served in various positions of increasing responsibility over 13 years culminating as Zone Human Resources Director. Prior to joining Pier 1 Imports, Mrs. Graul had positions with four other retailers serving in various store operational roles and as a buyer.

Adam C. Holland, 38, has been Vice President and Chief Financial Officer since February 2015. Prior to his appointment as Vice President and Chief Financial Officer, Mr. Holland served as Chief Accounting Officer from August 2014 to January 2015 and Vice President of Finance from August 2008 to July 2014. He also served as Director of Finance from June 2006 to July 2008 and Manager of Financial Reporting from May 2005 to June 2006. Prior to joining Kirkland's, Mr. Holland served as Manager of Corporate Accounting with Walter Industries, Inc., a holding company that owned home building, natural resources development, and industrial manufacturing companies, and prior to that was a senior auditor with Ernst & Young LLP.

No family relationships exist among any of the above-listed executive officers, and there are no arrangements or understandings between any of the above-listed officers and any other person pursuant to which they serve as an officer. All executive officers are elected to hold office for one year or until their successors are elected and qualified.

Item 1A. Risk Factors

Investing in our common stock involves risk. You should carefully consider the risks described below and the other information contained in this report and other filings that we make from time to time with the SEC, including our consolidated financial statements and accompanying notes before investing in our common stock. Any of the following risks could materially and adversely affect our business, financial condition, results of operations or liquidity. These risks are not the only risks we face. Our business, financial condition, results of operations or liquidity could also be adversely affected by additional factors that apply to all companies generally or by risks not currently known to us or that we currently view to be immaterial. We can provide no assurance and make no representation that our risk mitigation efforts, although we believe they are reasonable, will be successful.

Risks Related to Strategy and Strategy Execution

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

The rate of our expansion will depend on, among other factors, the availability of adequate capital, which in turn will depend in large part on cash flow generated by our business and the availability of equity and debt capital. The cost of opening new stores, expanding, remodeling and relocating existing stores — which is part of our growth strategy — may increase in the future compared to historical costs. There can be no assurance that our business will generate adequate cash flow or that we will be able to obtain equity or debt capital on acceptable terms, or at all. Moreover, our senior credit facility contains provisions that restrict the amount of debt we may incur in the future. If we are not successful in obtaining sufficient capital, we may be unable to open additional stores or expand, remodel and relocate existing stores as planned, which may adversely affect our growth strategy resulting in a decrease in net sales. There can be no assurances that we will be able to achieve our current plans for the opening of new stores and the expansion, remodeling or relocation of existing stores.

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.

A key element of our growth strategy is to open new stores, both in existing markets and in new geographic markets that we select based on customer data and demographics. Our future operating results will depend to a substantial extent on whether we are able to continue to open and operate new stores successfully at a rate that exceeds our planned store closings.

Our ability to open new stores and to expand, remodel and relocate existing stores depends on a number of factors, including the prevailing conditions in the commercial real estate market and our ability to:

- locate and obtain favorable store sites and negotiate acceptable lease terms;
- construct or refurbish store sites;
- obtain and distribute adequate product supplies to our stores;
- maintain adequate warehousing and distribution capability at acceptable costs;
- hire, train and retain skilled managers and personnel; and
- continue to upgrade our information and other operating systems to control the anticipated growth and expanded operations.

There also can be no assurance that we will be able to open, expand, remodel and relocate stores at the anticipated rate, if at all. Furthermore, there is no assurance that new stores that we open will generate net sales levels necessary to achieve store-level profitability. New stores that we open in our existing markets may draw customers away from our existing stores resulting in lower net sales growth compared to stores opened in new markets.

Every year we decide to close certain stores based on a number of factors, including but not limited to planned location of new stores nearby, excessive rent or other operating cost increases, inadequate profitability, short term leases, or the landlord's ability to replace us with another tenant at more favorable terms to the landlord. Store closings have the effect of reducing net sales. We may choose to close underperforming stores before lease expiration and incur termination costs associated with those closings. If we are not able to open new stores at a pace that exceeds the closing of existing stores we may not achieve our planned revenue growth.

New stores also may face greater competition and have lower anticipated net sales volumes relative to previously opened stores during their comparable years of operations. New stores opened in new markets, where we are less well known and where we are less familiar with the target customer, may face different or additional risks and increased costs compared to stores operated in existing markets. Also, stores opened in off-mall locations may require greater marketing costs in order to attract customer traffic. These factors, together with increased pre-opening expenses at our new stores, may reduce our average store contribution and operating margins. If we are unable to profitably open and operate new stores and maintain the profitability of our existing stores, our net income could suffer.

The success of our growth plan will be dependent on our ability to promote and/or recruit a sufficient number of qualified Multi-Unit Managers, Store Managers and sales associates to support the expected growth in the number of our stores. In addition, the time and effort required to train and supervise a large number of new managers and associates may divert resources from our existing stores and adversely affect our operating and financial performance.

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 use marketing and promotional programs to attract customers to our stores and to encourage purchases by our customers. We use various media for our promotional efforts, including print, database marketing, email communications and other electronic communications such as paid search advertising and online social networks. If we fail to choose the appropriate medium for our efforts, or fail to implement and execute new marketing opportunities, our competitors may be able to attract some of our customers.

If our competitors increase their spending on advertising and promotions, if our advertising, media or marketing expenses increase, if our advertising and promotions become less effective than those of our competitors, or if we do not adequately leverage technology and data analytic capabilities needed to generate concise competitive insight, we could experience a material adverse effect on our results of operations. A failure to sufficiently innovate, develop customer relationship initiatives, or maintain adequate and effective advertising could inhibit our ability to maintain brand relevance and drive increased sales.

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.

Our success depends on our ability to anticipate and respond to changing merchandise trends and consumer demands in a timely manner. While we devote considerable effort and resources to shape, analyze and respond to consumer preferences, consumer spending patterns and preferences cannot be predicted with certainty and can change rapidly. Our product introductions and product

improvements, along with our other marketplace initiatives, are designed to capitalize on consumer trends. In order to remain successful, we must anticipate and react to these trends and develop new products or processes to address them. If we fail to identify and respond to emerging trends, consumer acceptance of the merchandise in our stores and our image with our customers may be harmed, which could reduce customer traffic in our stores and materially adversely affect our net sales.

Additionally, if we misjudge market trends, we may significantly overstock unpopular products and be forced to take significant inventory markdowns, which would have a negative impact on our gross profit and cash flow. Conversely, shortages of items that prove popular could reduce our net sales. In addition, a major shift in consumer demand away from home décor could also have a material adverse effect on our business, results of operations and financial condition.

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.

We maintain a corporate website through which we market and sell our products to customers and publicize Company information to customers, investors and other constituencies. Maintenance of our website requires substantial development and maintenance efforts, and entails significant technical and business risks. To remain competitive, we must continue to enhance and improve the responsiveness, functionality and features of our website. The sale of products through e-Commerce is characterized by rapid technological change, the emergence of new industry standards and practices and changes in customer requirements and preferences. Therefore, we may be required to license emerging technologies, enhance our existing website, develop new services and technology that address the increasingly sophisticated and varied needs of our current and prospective customers, and adapt to technological advances and emerging industry and regulatory standards and practices in a cost-effective and timely manner. Our ability to remain technologically competitive may require substantial expenditures and lead time, and our failure to do so may harm our business and results of operations.

Risks Related to Profitability

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

We are subject to the risk of inventory loss and theft. We have experienced inventory shrinkage in the past, and we cannot assure that incidences of inventory loss and theft will decrease in the future or that the measures we are taking will effectively reduce the problem of inventory shrinkage. Although some level of inventory shrinkage is an unavoidable cost of doing business, if we were to experience higher rates of inventory shrinkage or incur increased security costs to combat inventory theft, our financial condition could be affected adversely.

Efficient inventory management is a key component of our business success and profitability. To be successful, we must maintain sufficient inventory levels to meet our customers' demands without allowing those levels to increase to such an extent that the costs to store and hold the goods unduly impacts our financial results. If our buying decisions do not accurately predict customer trends or purchasing actions, we may have to take unanticipated markdowns to dispose of the excess inventory, which also can adversely impact our financial results. Though we attempt to reduce these risks, we cannot assure you that we will continue to be successful in our inventory management, which may negatively impact our cash flows and results of operations.

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

Our business has evolved from an in-store experience to interactions with customers across multiple channels (in-store, online, mobile and social media, among others). Our customers are using computers, tablets, mobile phones and other devices to shop on our website and provide feedback and public commentary about all aspects of our business. Omni-channel retailing is rapidly evolving, and we must keep pace with changing customer expectations and new developments and technology investments by our competitors.

Successful operation of our e-Commerce initiatives are dependent on our ability to maintain uninterrupted availability of the Company's website and supporting applications, adequate inventory levels, timely fulfillment of customer orders, and accurate shipping of undamaged products. In addition, the Company's call center must maintain a high standard of customer care. Failure to successfully manage this process may negatively impact sales, result in the loss of customers, and damage our reputation.

If we are unable to attract and retain team members or contract with third parties having the specialized skills needed to support our omni-channel efforts, implement improvements to our customer-facing technology in a timely manner, or provide a convenient and consistent experience for our customers regardless of the ultimate sales channel, our ability to compete and our results of operations could be adversely affected. In addition, if www.kirklands.com and our other customer-facing technology systems do not appeal to our customers or reliably function as designed, we may experience a loss of customer confidence, lost sales or be exposed to fraudulent purchases, which, if significant, could adversely affect our reputation and results of operations.

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

Maintaining, promoting and growing our merchandise offering will depend largely on the success of our design, merchandising, and marketing efforts and our ability to provide a consistent, high quality customer experience. If we fail to achieve these objectives, our public image and reputation could be tarnished by negative publicity.

If our merchandise offerings do not meet applicable safety standards or customer expectations regarding safety, we could experience lost sales and increased costs and be exposed to legal and reputational risk. All of our vendors must comply with applicable product safety laws, and we are dependent on them to ensure that the products we buy comply with all safety standards. Events that give rise to actual, potential or perceived product safety concerns with respect to our products could expose us to government enforcement action or private litigation and result in costly product recalls and other liabilities. In addition, negative customer perceptions regarding the safety of the products we sell could cause our customers to seek alternative sources for their needs, resulting in lost sales. In those circumstances, it may be difficult and costly for us to regain customer confidence.

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.

The retail market is a highly competitive market. We compete against a diverse group of retailers, including specialty stores, department stores, discount stores, catalog and Internet-based retailers, which sell similar lines of merchandise to those carried by us. Our competitors, many of which are larger and have substantially greater financial and other resources than us, include HomeGoods, Bed, Bath & Beyond, Cost Plus World Market, Hobby Lobby, Pier 1 Imports, Target, Ebay, Amazon and Wayfair. Our “brick-and-mortar” stores and our www.kirklands.com website also compete with the ever-increasing number of Internet retail websites offering home décor and gift merchandise. The availability of home décor and gift merchandise from various competitors on the Internet could result in increased price competition as our customers are more readily able to comparison shop, which could reduce our sales, prices and margins and adversely affect our results of operations.

Competitors may have greater financial, distribution, logistics, marketing and other resources available to them and may be able to adapt to changes in customer requirements more quickly, devote greater resources to the design, sourcing, distribution, marketing and sale of their products, generate greater national brand recognition or adopt more aggressive pricing policies. Our competitors may also be able to increase sales in their new and existing markets faster than we do by emphasizing different distribution channels than we do. If we are unable to overcome these potential competitive disadvantages, such factors could have an adverse effect on our business, financial condition and results of operations.

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

Our operating results may be adversely affected by severe or unexpected weather conditions. Adverse weather conditions or other extreme changes in the weather, including resulting electrical and technological failures, may disrupt our business and may adversely affect our ability to sell and distribute products. Frequent or unusual snow, ice or rain storms or extended periods of unseasonable temperatures in our markets could adversely affect our performance by affecting customer shopping patterns or diminishing demand for seasonal merchandise. For example, extended periods of unseasonably warm temperatures during the winter season or cool weather during the summer season could reduce demand for a portion of our inventory and thereby reduce our sales and profitability.

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 headquarters, store locations, distribution center and warehouses, as well as certain of our vendors and customers, are located in areas which have been and could be subject to natural disasters such as floods, hurricanes, tornadoes, fires or earthquakes. In addition, we operate in markets that may be susceptible to pandemic outbreaks, war, terrorist acts or disruptive global political events, such as civil unrest in countries in which our vendors are located or products are manufactured. Our business may be harmed if our ability to sell and distribute products is impacted by any such events, any of which could influence customer trends and purchases and may negatively impact our net sales, properties or operations. Such events could result in physical damage to one or more of our properties, the temporary closure of some or all of our stores or distribution center, the temporary lack of an adequate work force in a market, temporary or long-term disruption in the transport of goods, delay in the delivery of goods to our distribution center or stores, disruption of our technology support or information systems, or fuel shortages or dramatic increases in fuel prices, which increase the cost of doing business. These events also can have indirect consequences such as increases in the costs of insurance if they result in significant loss of property or other insurable damage. Any of these factors, or combination thereof, could adversely affect our operations.

Our Performance May be Affected by General Economic Conditions.

Our performance is subject to worldwide economic conditions and their impact on levels of consumer spending. Some of the factors that have had, and may in the future have, an impact on discretionary consumer spending include national or global economic downturns, an increase in consumer debt (and a corresponding decrease in the availability of affordable consumer credit), reductions in net worth based on recent severe market declines, softness in the residential real estate and mortgage markets, changes in taxation, increases in fuel and energy prices, fluctuation in interest rates, low consumer confidence and other macroeconomic factors.

Specialty retail is a cyclical industry that is heavily dependent upon the overall level of consumer spending. Purchases of home décor and gifts tend to be highly correlated with cycles in consumers' disposable income and trends in the housing market. A weak retail environment could impact customer traffic in our stores and also adversely affect our net sales. Because of the seasonality of our business, economic downturns, increased sourcing costs, or scarcity in equipment during the last quarter of our fiscal year could adversely affect us to a greater extent than if such downturns occurred at other times of the year. As purchases of home décor items may decline during recessionary periods, a prolonged recession, including any related decrease in consumers' disposable incomes, may have a material adverse effect on our business, financial condition and results of operations.

Should credit markets tighten or turmoil in the financial markets develop, our ability to access funds, refinance our existing indebtedness, enter into agreements for new indebtedness or obtain funding through the issuance of our securities would be adversely impacted.

The impact of any such credit crisis or market turmoil on our major suppliers cannot be accurately predicted. The inability of key suppliers to access liquidity, or the insolvency of key suppliers, could lead to their failure to deliver our merchandise. Worsening economic conditions could also result in difficulties for financial institutions (including bank failures) and other parties with whom we do business, which could potentially impair our ability to access financing under existing arrangements or to otherwise recover amounts as they become due under our other contractual arrangements.

Our Profitability is Vulnerable to Inflation and Cost Increases.

Future increases in costs such as the cost of merchandise, shipping rates, freight costs, fuel costs and store occupancy costs may reduce our profitability. These cost increases may be the result of inflationary pressures that could further reduce our sales or profitability. Increases in other operating costs, including changes in energy prices, wage rates and lease and utility costs, may increase our cost of goods sold or operating expenses. Competitive pressures in our industry may have the effect of inhibiting our ability to reflect these increased costs in the prices of our products and therefore reduce our profitability.

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.

We have experienced, and expect to continue to experience, substantial seasonal fluctuations in our net sales and operating results, which are typical of many specialty retailers and common to most retailers generally. Due to the importance of the fall selling season, which includes Thanksgiving and Christmas, the last quarter of our fiscal year has historically contributed, and is expected to continue to contribute, a disproportionate amount of our net sales, net income and cash flow for the entire fiscal year. Any factors negatively affecting us during the last quarter of our fiscal year, including unfavorable economic or weather conditions, could have a material adverse effect on our financial condition and results of operations, reducing our 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 have established a provision for estimated merchandise returns based upon historical experience and other known factors. If actual returns are greater than those projected by management, additional reductions of revenue could be recorded in the future. Also, to the extent that returned merchandise is damaged, we may not receive full retail value from the resale of the returned merchandise. Introductions of new merchandise, changes in merchandise mix, associate selling behavior, merchandise quality issues, changes to our return policy, e-Commerce return behavior, changes in consumer confidence, or other competitive and general economic conditions may cause actual returns to exceed the provision for estimated merchandise returns. An increase in merchandise returns that exceeds our current provision could negatively impact the business and financial results.

We May Experience Significant Variations in Our Quarterly Results.

Our quarterly results of operations may also fluctuate significantly based upon such factors as the timing of new store openings, pre-opening expenses associated with new stores, the relative proportion of new stores to mature stores, net sales contributed by new stores, increases or decreases in comparable store net sales, adverse weather conditions, shifts in the timing of holidays, the timing and level of markdowns, changes in fuel and other shipping costs, changes in our product mix and actions taken by our competitors. Consequently, comparisons between quarters are not necessarily meaningful and the results for any quarter are not necessarily indicative of future results.

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

Numerous factors affect our comparable store net sales results, including among others, weather conditions, retail trends, the retail sales environment, economic conditions, the impact of competition and our ability to execute our business strategy efficiently. Our comparable store net sales results have historically experienced fluctuations, including declines in some fiscal periods. Our comparable store net sales may not increase from quarter to quarter, or may decline. As a result, the unpredictability of our comparable store net sales may cause our revenues and operating results to vary quarter to quarter, and an unanticipated decline in revenues or comparable store net sales may cause the price of our common stock to fluctuate significantly.

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

Our freight cost is impacted by changes in fuel prices through surcharges. Fuel prices and surcharges affect freight costs with respect to both inbound freight from vendors to our distribution center and outbound freight from our distribution center to our stores. Increased fuel prices or surcharges may increase freight costs and thereby increase our cost of goods sold.

Risks Related to New Legislation, Regulation and Litigation

New Tax Policies Could Adversely Affect Our Operating Results

Proposed changes to the corporate tax code by the new Presidential Administration and Congress could have a significant impact on our profitability. Specifically, the proposed “Border Adjusted Tax”, which is designed to encourage companies like ours not to sell imported goods, could eliminate all or part of the deduction for the cost of goods sold if those goods were imported. Since most of our merchandise is purchased through vendors in the United States who import the merchandise from foreign countries, the proposed Border Adjusted Tax could have a profound negative effect on us. These proposed tax changes might also provide a significant advantage to our competitors in the home décor industry that sell primarily domestically-produced goods. There is some chance that the proposed tax changes could result in the strengthening of the U.S. dollar thereby offsetting the impact of non-deductibility of cost of goods sold by making imports less expensive, but there is a risk that currency valuation adjustments could lag significantly after the adoption of any new tax legislation. Companies like ours could raise the prices of their products to offset the impact of the tax changes, but our industry is highly competitive and customers tend to be price sensitive. The impact of proposed tax legislation cannot be determined with certainty at this time.

New Legal Requirements Could Adversely Affect Our Operating Results.

Our business is subject to numerous federal, state and local laws and regulations. We routinely incur costs in complying with these laws and regulations. We are exposed to the risk that federal, state or local legislation may negatively impact our operations. Changes in product regulations (including changes in labeling or disclosure requirements), federal or state wage requirements, employee rights (including changes in the process for our employees to join a union), health care, social welfare or entitlement programs such as health insurance, paid leave programs, or other changes in workplace regulation or tax laws could adversely impact our ability to achieve our financial targets. Changes in other regulatory areas, such as consumer credit, privacy and information security, or environmental regulation may result in significant added expenses or may require extensive system and operating changes that may be difficult to implement and/or could materially increase our costs of doing business. Untimely compliance or noncompliance with applicable laws and regulations may subject us to legal risk, including government enforcement action, significant fines and penalties and class action litigation, as well as reputational damage, which could adversely affect our results of operations.

Concern over climate change, including global warming, has led to legislative and regulatory initiatives directed at limiting greenhouse gas (“GHG”) emissions. If domestic or international laws or regulations were expanded to require GHG emission reporting or reduction by us or our third-party manufacturers, or if we engage third-party contract manufacturers in countries that have existing GHG emission reporting or reduction laws or regulations, we would need to expend financial and other resources to comply with such regulations and/or to monitor our third-party manufacturers’ compliance with such regulations. In addition, we cannot control the actions of our third-party manufacturers or the public’s perceptions of them, nor can we assure that these manufacturers will conduct their businesses using climate change proactive or sustainable practices. Violations of climate change laws or regulations by third parties with whom we do business could result in negative public perception of us and/or delays in shipments and receipt of

goods, and could subject us to fines or other penalties, any of which could restrict our business activities, increase our operating expenses or cause our sales to decline.

The costs and other effects of new legal requirements cannot be determined with certainty. Additional laws may directly or indirectly affect our production, distribution, packaging, cost of raw materials, fuel, ingredients or water, any of which could impact our business and financial results. In addition, our efforts to comply with new legislation or regulations may increase our costs.

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

Our business is subject to the risk of litigation by employees, consumers, vendors, competitors, intellectual property rights holders, shareholders, government agencies and others through private actions, class actions, administrative proceedings, regulatory actions or other litigation means. The outcome of litigation, particularly class action lawsuits, regulatory actions and intellectual property claims, is difficult to assess or quantify. Plaintiffs in these types of lawsuits may seek recovery of very large or indeterminate amounts, and the magnitude of the potential loss relating to these lawsuits may remain unknown for substantial periods of time. In addition, certain of these lawsuits, if decided adversely to us or settled by us, may result in liability material to our consolidated financial statements as a whole or may negatively affect our operating results if changes to our business operation are required. The cost to defend future litigation may be significant. There also may be adverse publicity associated with litigation that could negatively affect customer perception of our business, regardless of whether the allegations are valid or whether we are ultimately found liable. As a result, litigation may adversely affect our business, financial condition, results of operations or liquidity.

Product Liability Claims Could Adversely Affect Our Reputation.

Despite our best efforts to ensure the quality and safety of the products we sell, we may be subject to product liability claims from customers or penalties from government agencies relating to allegations that the products sold by us are misbranded, contain contaminants or impermissible ingredients, provide inadequate instructions regarding their use or misuse, or include inadequate warnings concerning flammability or interactions with other substances. Such claims may result from tampering by unauthorized third parties, product contamination or spoilage, including the presence of foreign objects, substances, chemicals, other agents, or residues introduced during the growing, storage, handling and transportation phases. All of our vendors and their products must comply with applicable product and safety laws. We generally seek contractual indemnification and insurance coverage from our suppliers. However, if we do not have adequate insurance or contractual indemnification available, such claims could have a material adverse effect on our business, financial condition and results of operation. Our ability to obtain indemnification from foreign suppliers may be hindered by the manufacturer's lack of understanding of United States product liability or other laws, which may make it more likely that we be required to respond to claims or complaints from customers as if we were the manufacturer of the products. Even with adequate insurance and indemnification, such claims could significantly damage our reputation and consumer confidence in our products. Our litigation expenses could increase as well, which also could have a materially negative impact on our results of operations even if a product liability claim is unsuccessful or is not fully pursued.

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

We may be unable or unwilling to strictly enforce our trademarks in each jurisdiction in which we do business. Also, we may not always be able to successfully enforce our trademarks against competitors or against challenges by others. Our failure to successfully protect our trademarks could diminish the value and efficacy of our brand recognition and could cause customer confusion, which could, in turn, adversely affect our sales and profitability.

Risks Related to Dependence on Technology

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.

We receive and maintain certain personal information about our customers and employees in the ordinary course of business. Our use of this information is regulated at the international, federal and state levels, as well as by certain third-parties with whom we contract for such services. If our security and information systems are compromised or our business associates fail to comply with these laws and regulations and this information is obtained by unauthorized persons or used inappropriately, it could adversely affect our reputation, as well as operations, results of operations, and financial condition and could result in litigation or the imposition of penalties. As privacy and information security laws and regulations change, we may incur additional costs to ensure we remain in compliance. Our business requires collection of large volumes of internal and customer data, including credit card numbers and other personally identifiable information of our customers in various information systems and those of our service providers. The integrity and protection of customer, employee, and company data is critical to us. If that data is inaccurate or incomplete, we or the store managers could make faulty decisions. Customers and employees also have a high expectation that we and our service providers will adequately protect their personal information. The regulatory environment surrounding information, security and privacy is also

increasingly demanding. Our existing systems may be unable to satisfy changing regulatory requirements and employee and customer expectations, or may require significant additional investments or time to do so. Despite implementation of various measures designed to protect our information systems and records, including those we maintain with our service providers, we or the store managers may be subject to security breaches, system failures, viruses, operator error or inadvertent releases of data. A significant theft, loss, or fraudulent use of customer, employee, or company data maintained by us or by a service provider or failure to comply with the various United States and international laws and regulations applicable to the protection of such data or with Payment Card Industry data security standards, could adversely impact our reputation and could result in remedial and other expenses, fines, or litigation. A breach in the security of our information systems or those of our service providers could lead to an interruption in the operation of our systems, resulting in operational inefficiencies and a loss of profits.

Certain aspects of the business, particularly our website, heavily depend on consumers entrusting personal financial information to be transmitted securely over public networks. We have experienced increasing e-Commerce sales over the past several years, which increases our exposure to cybersecurity risks. We invest considerable resources in protecting the personal information of our customers but are still subject to the risks of security breaches and cyber incidents resulting in unauthorized access to stored personal information. Any breach of our cybersecurity measures could result in violation of privacy laws, potential litigation, and a loss of confidence in our security measures, all of which could have a negative impact on our financial results and our reputation. In addition, a privacy breach could cause us to incur significant costs to restore the integrity of our system and could result in significant costs in government penalties and private litigation.

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

We rely upon our existing information systems for operating and monitoring all major aspects of our business, including sales, warehousing, distribution, purchasing, inventory control, merchandise planning and replenishment, as well as various financial functions. These systems and our operations are vulnerable to damage or interruption from:

- fire, flood and other natural disasters;
- power loss, computer systems failures, internet and telecommunications or data network failure, operator negligence, improper operation by or supervision of employees, physical and electronic loss of data or security breaches, misappropriation and similar events; and
- computer viruses and malicious attacks and security breaches.

Any disruption in the operation of our information systems, the loss of employees knowledgeable about such systems or our failure to continue to effectively modify such systems could interrupt our operations or interfere with our ability to monitor inventory, which could result in reduced net sales and affect our operations and financial performance. We also need to ensure that our systems are consistently adequate to handle our anticipated store growth and are upgraded as necessary to meet our needs. The cost of any such system upgrades or enhancements would be significant. If our systems are damaged or fail to function properly, we may incur substantial costs to repair or replace them, and may experience loss of critical data and interruptions or delays in our ability to manage inventories or process customer transactions, which could adversely affect our results of operations.

We also rely heavily on our information technology staff. Failure to meet these staffing needs may negatively affect our ability to fulfill our technology initiatives while continuing to provide maintenance on existing systems. We rely on certain vendors to maintain and periodically upgrade many of these systems so that they can continue to support our business. The software programs supporting many of our systems were licensed to us by independent software developers. The inability of these developers or us to continue to maintain and upgrade these information systems and software programs would disrupt or reduce the efficiency of our operations if we are unable to convert to alternate systems in an efficient and timely manner. In addition, costs and potential problems and interruptions associated with the implementation of new or upgraded systems and technology, or with maintenance or adequate support of existing systems could also disrupt or reduce the efficiency of our operations.

Risks Associated with Vendors and Distribution

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.

Any disruption in the supply or increase in pricing of our merchandise could negatively impact our ability to achieve anticipated operating results. We purchase our products from approximately 200 vendors with which we have no long-term purchase commitments or exclusivity contracts. Historically, we have retained our vendors and we have generally not experienced difficulty in obtaining desired merchandise from vendors on acceptable terms. However, our arrangements with these vendors do not guarantee the availability of merchandise, establish guaranteed prices or provide for the continuation of particular pricing practices. Our current vendors may not continue to sell products to us on current terms or at all, and we may not be able to establish relationships with new vendors to ensure delivery of products in a timely manner or on terms acceptable to us. In addition, a period of unfavorable financial performance may make it difficult for some of our vendors to arrange for the financing or factoring of their orders with manufacturers, which could result in our inability to obtain desired merchandise from those vendors.

Our largest vendor is deemed to be a related party because its principal owner is the spouse of the Company's Vice President of Merchandising. During fiscal 2016, the Company's purchases from this related party vendor totaled approximately \$44.7 million, or 17.6% of total merchandise purchases. While this relationship has been approved by the Company's Audit Committee, any disruption in the relationship could negatively impact our ability to achieve anticipated operating results.

We may not be able to acquire desired merchandise in sufficient quantities on terms acceptable to us in the future. Also, our business would be adversely affected if there were delays in product shipments to us due to freight difficulties, strikes or other difficulties at our principal transport providers or otherwise. We have from time to time experienced delays of this nature. We are also dependent on vendors for assuring the quality of merchandise supplied to us. Our inability to acquire suitable merchandise in the future or the loss of one or more of our vendors and our failure to replace any one or more of them may harm our relationship with our customers resulting 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.

Most of our merchandise is purchased through vendors in the United States who import the merchandise from foreign countries, primarily China. Our vendors are subject to the risks involved with relying on products manufactured abroad, and we remain subject to those risks to the extent that their effects are passed through to us by our vendors or cause disruptions in supply. These risks include changes in import duties, quotas, loss of "most favored nation" trading status with the United States for a particular foreign country, work stoppages, delays in shipments, first cost price increases, freight cost increases, exchange rate fluctuations, terrorism, war, economic uncertainties (including inflation, foreign government regulations and political unrest), trade restrictions (including the United States imposing antidumping or countervailing duty orders, safeguards, remedies or compensation and retaliation due to illegal foreign trade practices) and other factors relating to foreign trade, including costs and uncertainties associated with efforts to identify and disclose sources of "conflict minerals" used in products that the Company causes to be manufactured and potential sell-through difficulties and reputational damage that may be associated with the inability of the Company to determine that such products are classified as "DRC conflict-free." If any of these or other factors were to cause a disruption of trade from the countries in which the suppliers of our vendors are located, our inventory levels may be reduced or the cost of our products may increase.

Historically, instability in the political and economic environments of the countries in which our vendors obtain our products has not had a material adverse effect on our operations. However, we cannot predict the effect that future changes in economic or political conditions in such foreign countries may have on our operations. Although we believe that we could access alternative sources in the event of disruptions or delays in supply due to economic, political or health conditions in foreign countries, such disruptions or delays may adversely affect our results of operations unless and until alternative supply arrangements can be made. In addition, merchandise purchased from alternative sources may be of lesser quality or more expensive than the merchandise we currently purchase abroad.

Countries from which our vendors obtain these products may, from time to time, impose new or adjust prevailing quotas or other restrictions on exported products, and the United States may impose new duties, quotas and other restrictions on imported products. This could disrupt the supply of such products to us and adversely affect our operations. The United States Congress periodically considers other restrictions on the importation of products obtained for us by vendors. The cost of such products may increase for us if applicable duties are raised or import quotas with respect to such products are imposed or made more restrictive.

We are also subject to the risk that the manufacturers abroad who ultimately manufacture our products may employ labor practices that are not consistent with acceptable practices in the United States. In any such event we could be hurt by negative publicity with respect to those practices and, in some cases, face liability for those practices.

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.

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. In addition, recent increases in energy prices have resulted, and are expected to continue to result, in increased merchandise and freight costs, which cannot readily be offset through higher prices because of competitive factors.

A significant portion of the distribution of products to our stores is coordinated through our distribution facility in Jackson, Tennessee. We have also recently opened an e-Commerce distribution center, also in Jackson, Tennessee. We depend on the orderly operation of these receiving and distribution facilities, which rely on adherence to shipping schedules and effective management. We are also currently exploring alternative distribution methods and from time to time we make significant upgrades to our warehouse management software. If these changes or upgrades do not go smoothly, then we could face significant disruptions with our distribution process. In addition, we cannot assure that events beyond our control, such as disruptions due to fire or other catastrophic

events, labor disagreements or shipping problems, will not result in delays in the delivery of merchandise to our stores. We also cannot guarantee that our insurance will be sufficient, or that insurance proceeds will be timely paid to us, in the event our distribution center is shut down for any reason. Any significant disruption in the operations of our distribution facilities would have a material adverse effect on our ability to maintain proper inventory levels in our stores and satisfy our e-Commerce customers, which could result in a loss of net sales and net income.

Risks Related to Company Governance and Ownership

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.

We have benefited substantially from the leadership and performance of our senior management team. Our success will depend on our ability to retain our current senior management members and to attract and retain qualified personnel in the future. Competition for senior management personnel is intense, and there can be no assurances that we will be able to retain our personnel. The loss of a member of senior management would require the remaining executive officers to divert immediate and substantial attention to seeking a replacement.

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.

Our charter authorizes the issuance of "blank check" preferred stock with such designations, rights and preferences as may be determined from time to time by our Board of Directors. Accordingly, the Board of Directors is empowered, without shareholder approval, to issue preferred stock with dividend, liquidation, conversion, voting or other rights that could materially adversely affect the voting power or other rights of the holders of our common stock. Holders of the common stock do not have preemptive rights to subscribe for a pro rata portion of any capital stock which may be issued by us. In the event of issuance, such preferred stock could be utilized, under certain circumstances, as a method of discouraging, delaying or preventing a change in control of Kirkland's.

Our charter and bylaws contain certain corporate governance provisions that may make it more difficult to challenge management, deter and inhibit unsolicited changes in control of Kirkland's and have the effect of depriving our shareholders of an opportunity to receive a premium over the prevailing market price of our common stock in the event of an attempted hostile takeover. First, the charter provides for a classified Board of Directors, with directors (after the expiration of the terms of the initial classified board of directors) serving three year terms from the year of their respective elections and being subject to removal only for cause and upon the vote of 80% of the voting power of all outstanding capital stock entitled to vote (the "Voting Power"). Second, our charter and bylaws do not generally permit shareholders to call, or require that the Board of Directors call, a special meeting of shareholders. The charter and bylaws also limit the business permitted to be conducted at any such special meeting. In addition, Tennessee law permits action to be taken by the shareholders by written consent only if the action is consented to by holders of the number of shares required to authorize shareholder action and if all shareholders entitled to vote are parties to the written consent. Third, the bylaws establish an advance notice procedure for shareholders to nominate candidates for election as directors or to bring other business before meetings of the shareholders. Only those shareholder nominees who are nominated in accordance with this procedure are eligible for election as directors of Kirkland's, and only such shareholder proposals may be considered at a meeting of shareholders as have been presented to Kirkland's in accordance with the procedure. Finally, the charter provides that the amendment or repeal of any of the foregoing provisions of the charter mentioned previously in this paragraph requires the affirmative vote of at least 80% of the Voting Power. In addition, the bylaws provide that the amendment or repeal by shareholders of any bylaws made by our Board of Directors requires the affirmative vote of at least 80% of the Voting Power.

Furthermore, Kirkland's is subject to certain provisions of Tennessee law, including certain Tennessee corporate takeover acts that are, or may be, applicable to us. These acts, which include the Investor Protection Act, the Business Combination Act and the Tennessee Greenmail Act, seek to limit the parameters in which certain business combinations and share exchanges occur. The charter, bylaws and Tennessee law provisions may have an anti-takeover effect, including possibly discouraging takeover attempts that might result in a premium over the market price for our common stock.

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

As a public company, we are required to document and test our internal controls over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act of 2002 so that our management can certify the effectiveness of our internal controls and our independent registered public accounting firm can render an opinion on the effectiveness of our internal control over financial reporting. As a result, we may incur substantial expenses to test our systems, to make any necessary improvements, and to hire additional personnel.

We maintain a system of internal control over financial reporting, but there are limitations inherent in internal control systems. If we are unable to maintain adequate and effective internal control over financial reporting, our financial reporting could be adversely affected. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the

objectives of the control system are met. In addition, the design of a control system must reflect the fact that there are resource constraints and the benefit of controls must be appropriate relative to their costs.

If our management is unable to certify the effectiveness of our internal controls or if our independent registered public accounting firm cannot render an opinion on the effectiveness of our internal control over financial reporting, or if material weaknesses in our internal controls are identified, we could be subject to regulatory scrutiny and a loss of public confidence, which could harm our business and cause a decline in our common stock price. In addition, if we do not maintain adequate financial and management personnel, processes and controls, we may not be able to accurately report our financial performance on a timely basis, which could cause a decline in our common stock price and harm our ability to raise capital. Failure to accurately report our financial performance on a timely basis could also jeopardize our continued listing on The NASDAQ Stock Market LLC or any other stock exchange on which our common stock may be listed. Delisting of our common stock on any exchange could reduce the liquidity of the market for our common stock, which could reduce the price of our common stock and increase the volatility of our common stock price.

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

The price at which our common stock trades may be volatile. The market price of our common stock could be subject to significant fluctuations in response to our operating results, general trends and prospects for the retail industry, announcements by our competitors, analyst recommendations, our ability to meet or exceed analysts' or investors' expectations, the condition of the financial markets and other factors. In addition, the stock market in recent years has experienced extreme price and volume fluctuations that often have been unrelated or disproportionate to the operating performance of companies. These fluctuations, as well as general economic and market conditions, may adversely affect the market price of our common stock notwithstanding our actual operating performance.

Item 1B. *Unresolved Staff Comments*

None.

Item 2. *Properties*

We lease all of our store locations and expect to continue our practice of leasing rather than owning. Our leases typically provide for 5 to 10 year initial terms, many with the ability for us (or the landlord) to terminate the lease at specified points during the term if net sales at the leased premises do not reach a certain annual level. Many of our leases provide for payment of percentage rent (i.e., a percentage of net sales in excess of a specified level), and the rate of increase in key ancillary charges is generally capped.

As current leases expire, we believe we have the option to obtain favorable lease renewals for present store locations or obtain new leases for equivalent or better locations in the same general area. To date, we have not experienced unusual difficulty in either renewing or extending leases for existing locations or securing leases for suitable locations for new stores.

We currently lease one central distribution facility, consisting of 771,000 square feet, located in Jackson, Tennessee. We also lease 303,000 square feet of additional warehouse space at a second location in Jackson, Tennessee, which services our e-Commerce fulfillment, and we lease additional overflow warehouse space in Jackson, Tennessee on a month to month basis. We currently lease 76,000 square feet of office space in Brentwood, Tennessee.

The following table indicates the states where our stores are located and the number of stores within each state as of January 28, 2017:

State	Number of Stores	State	Number of Stores
Texas	65	Pennsylvania	9
Florida	38	South Carolina	9
California	26	Arkansas	8
Georgia	24	Colorado	5
North Carolina	24	Kansas	5
Tennessee	18	Minnesota	5
Alabama	16	New Jersey	5
Arizona	16	New York	5
Louisiana	15	Nevada	4
Virginia	13	Wisconsin	4
Mississippi	11	Delaware	2
Indiana	10	Iowa	2
Missouri	10	Maryland	2
Illinois	9	North Dakota	2
Kentucky	9	Nebraska	2
Michigan	9	New Mexico	2
Ohio	9	Wyoming	1
Oklahoma	9	West Virginia	1
		Total	404

Item 3. *Legal Proceedings*

We are involved in various routine legal proceedings incidental to the conduct of our business. We believe any resulting liability from existing legal proceedings, individually or in the aggregate, will not have a material adverse effect on our operations or financial condition. Although the outcome of such proceedings and claims cannot be determined with certainty, we believe that it is unlikely that these proceedings and claims in excess of insurance coverage will have a material effect on our operations, financial condition or cash flows.

Item 4. *Mine Safety Disclosures*

Not applicable.

PART II

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock is listed on The Nasdaq Stock Market, LLC (“Nasdaq”) under the symbol “KIRK”. We commenced trading on Nasdaq on July 11, 2002. On March 16, 2017, there were approximately 46 holders of record and approximately 3,271 beneficial owners of our common stock. The following table sets forth the high and low last sale prices of our common stock for the periods indicated.

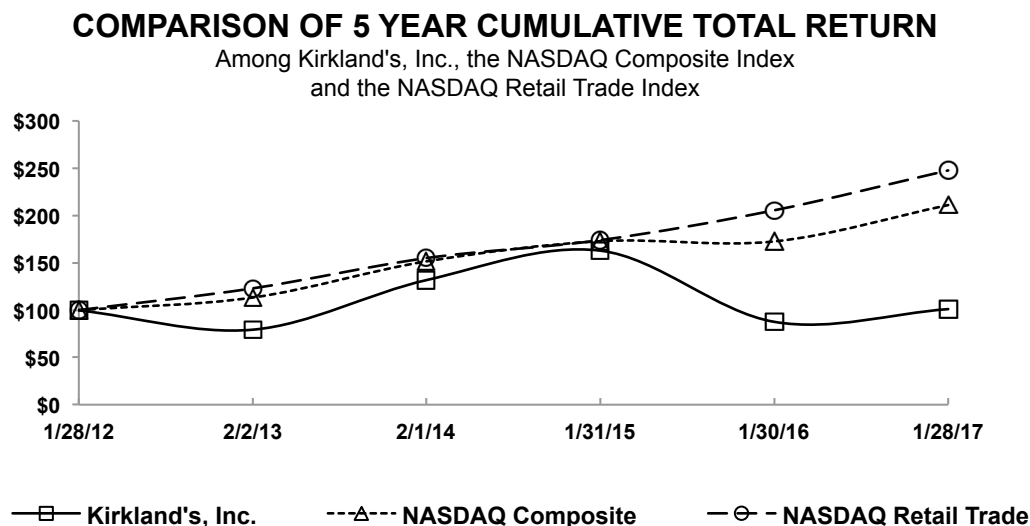
	Fiscal 2016		Fiscal 2015	
	High	Low	High	Low
First Quarter	\$ 17.51	\$ 11.57	\$ 26.49	\$ 22.47
Second Quarter	\$ 16.41	\$ 13.02	\$ 28.72	\$ 23.97
Third Quarter	\$ 15.51	\$ 11.90	\$ 27.97	\$ 21.03
Fourth Quarter	\$ 17.22	\$ 11.66	\$ 24.11	\$ 11.39

Dividend Policy

There have been no dividends declared on any class of our common stock during the past three fiscal years, except 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. Our senior credit facility restricts our ability to pay cash dividends. See “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources – Revolving Credit Facility.” Future cash dividends, if any, will be determined by our Board of Directors and will be based upon our earnings, capital requirements, financial condition, debt covenants and other factors deemed relevant by our Board of Directors.

Stock Price Performance Graph

This graph shows changes in the value of Kirkland’s stock as compared to the NASDAQ Composite Index and the NASDAQ Retail Trade Index from January 28, 2012 to January 28, 2017 (the Company’s fiscal year-end). The comparison assumes that \$100 was invested on January 28, 2012 in the Company’s common stock and in each of the foregoing indices and in each case assumes reinvestment of dividends.



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. The Company completed this \$30 million share repurchase plan during the year ended January 30, 2016 by repurchasing and retiring a total of 1,921,423 shares at a weighted average cost of \$15.61 per share. The Company's Board of Directors has not authorized any additional repurchase plan as of the date of this filing.

Item 6. Selected Financial Data

The following selected financial data is derived from our consolidated financial statements. The data below should be read in conjunction with Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and notes thereto.

	Fiscal Year (1)				
	2016	2015	2014	2013	2012
(Numbers in thousands, except store, square footage data and per share amounts)					
Summary of Operations					
Total revenue (2)	\$ 594,328	\$ 561,807	\$ 507,621	\$ 460,563	\$ 448,365
Gross profit	221,471	218,794	202,897	180,816	168,616
Operating expenses, excluding depreciation	179,150	170,421	155,617	140,877	133,913
Depreciation	25,322	22,182	18,639	15,947	13,175
Operating income	16,999	26,191	28,641	23,992	21,528
Income before income taxes	16,975	26,097	28,820	23,959	21,494
Net income	11,046	16,573	17,814	14,530	13,795
GAAP diluted earnings per share	\$ 0.68	\$ 0.94	\$ 1.00	\$ 0.82	\$ 0.77
Dividends declared per common share outstanding	\$ -	\$ 1.50	\$ -	\$ -	\$ -
Other Financial Data					
Comparable store sales increase (decrease) (3)	(2.9)%	2.9%	6.1%	0.5%	(3.0)%
Number of stores at year end	404	376	344	324	323
Average net sales per store (4)	\$ 1,385	\$ 1,454	\$ 1,441	\$ 1,383	\$ 1,408
Average net sales per gross square foot (5)	\$ 179	\$ 191	\$ 191	\$ 186	\$ 201
Average net sales per selling square foot (6)	\$ 241	\$ 257	\$ 257	\$ 251	\$ 271
Average gross square footage per store at fiscal year end	7,798	7,666	7,550	7,464	7,263
Merchandise margin as a percentage of total revenue (7)	54.5%	54.7%	55.4%	54.5%	52.7%
Gross profit as a percentage of total revenue	37.3%	38.9%	40.0%	39.3%	37.6%
Compensation and benefits as a percentage of total revenue	18.5%	18.2%	18.7%	18.8%	18.6%
Other operating expenses as a percentage of total revenue	11.6%	12.1%	12.0%	11.8%	11.3%
Effective tax rate	34.9%	36.5%	38.2%	39.4%	35.8%
Inventory yield (8)	278.0%	304.0%	336.3%	323.8%	319.6%
Return on assets (ROA) (9) (10)	4.4%	6.7%	7.3%	6.6%	6.7%
Return on equity (ROE) (11)	8.7%	12.2%	12.4%	11.5%	11.7%
Balance Sheet Data					
Current assets (10)	\$ 153,040	\$ 127,780	\$ 163,791	\$ 150,504	\$ 127,576
Current liabilities	\$ 74,441	\$ 59,495	\$ 57,380	\$ 52,647	\$ 44,003
Working capital (10)	\$ 78,599	\$ 68,285	\$ 106,411	\$ 97,857	\$ 83,573
Total assets (10)	\$ 270,146	\$ 235,256	\$ 256,949	\$ 232,671	\$ 207,634
Total liabilities (10)	\$ 136,333	\$ 115,561	\$ 105,887	\$ 97,442	\$ 89,759
Total shareholders' equity	\$ 133,813	\$ 119,695	\$ 151,062	\$ 135,229	\$ 117,875

(1) Fiscal 2012 includes 53 weeks. Other fiscal years presented include 52 weeks.

(2) Total revenue includes gift card breakage revenue of approximately \$1.1 million in fiscal 2016, as compared to approximately \$994,000, \$853,000, \$1.1 million, and \$970,000 in fiscal years 2015, 2014, 2013, and 2012, respectively.

- (3) Comparable store sales are calculated by including new stores in the comparable store sales base on the first day of the month following the 13th full fiscal month of sales. Stores closed during the year are included in the comparable store sales calculation only for the full fiscal months of the year in which the stores were open. Relocated stores are removed from the comparable store base and treated as a new store for comparable store sales purposes. The e-Commerce store is included in comparable store sales. The fiscal 2012 comparable store sales decrease is shown on a 52-week basis.
- (4) Based on the average net sales of all stores that were open at both the beginning and end of the period and excludes e-Commerce store sales and gift card breakage revenue.
- (5) Calculated using the gross square footage of all stores open at both the beginning and the end of the period.
- (6) Calculated using the selling square footage (excluding storage, receiving and office space square footage) of all stores open at both the beginning and the end of the period.
- (7) Merchandise margin is calculated as net sales minus product cost of sales (including inbound freight), shrink expense and discounts associated with our loyalty program. Merchandise margin excludes outbound freight, store occupancy and central distribution costs.
- (8) Inventory yield is defined as gross profit divided by average inventory for each of the preceding four quarters.
- (9) Return on assets equals net income divided by average total assets.
- (10) Prior periods have been adjusted for deferred taxes being reclassified from current assets to noncurrent liabilities in the consolidated balance sheets. Amounts related to deferred taxes that were reclassified from current assets to noncurrent liabilities are \$3,329,000, \$3,538,000, \$2,777,000 and \$1,602,000 for fiscal 2015, 2014, 2013 and 2012, respectively.
- (11) Return on equity equals net income divided by average total shareholders' equity.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read with our consolidated financial statements and related notes included elsewhere in this Form 10-K. A number of the matters and subject areas discussed in "Management's Discussion and Analysis of Financial Condition and Results of Operations", "Business" and elsewhere in this Form 10-K are not limited to historical or current facts and deal with potential future circumstances and developments and are accordingly "forward-looking statements." You are cautioned that such forward-looking statements, which may be identified by words such as "anticipate," "believe," "expect," "estimate," "intend," "plan" and similar expressions, are only predictions and that actual events or results may differ materially.

Our fiscal year is comprised of the 52 or 53-week period ending on the Saturday closest to January 31. Accordingly, fiscal 2016 represented the 52 weeks ended on January 28, 2017. Fiscal 2015 represented the 52 weeks ended on January 30, 2016. Fiscal 2014 represented the 52 weeks ended on January 31, 2015.

Introduction

We are a specialty retailer of home décor and gifts in the United States, operating 404 stores in 36 states as of January 28, 2017. Our stores present a broad selection of distinctive merchandise, including framed art, mirrors, ornamental 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 and other seasonal merchandise, as well as items carried throughout the year suitable for gift-giving. We provide our customers with 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. As a result, we have achieved substantial growth during our 50-year history and have expanded our store base into different regions of the country.

Overview of Key Financial Measures

Total revenue and gross profit are the most significant drivers to our operating performance. Total revenue consists of all merchandise sales to customers, gift card breakage and shipping revenue associated with internet sales, net of returns and exclusive of sales taxes. Our total revenue for fiscal 2016 increased by 5.8% to \$594.3 million from \$561.8 million in fiscal 2015. The net sales increase in fiscal 2016 resulted primarily from the net growth in the store base of 28 stores and increased e-Commerce sales, partially offset by a decrease in brick-and-mortar comparable store sales. Comparable store sales, including the increase in e-Commerce sales, decreased 2.9% for fiscal 2016. We use comparable store sales to measure our ability to achieve sales increases from stores that have been open for at least 13 full fiscal months. Stores closed during the year are included in the comparable store sales calculation only for the full fiscal months of the year the stores were open. Relocated stores are removed from the comparable store base and treated as a new store for comparable store sales purposes. Increases in comparable store sales are an important factor in maintaining or increasing the profitability of existing stores.

Gross profit is the difference between total revenue and cost of sales (exclusive of depreciation). Cost of sales (exclusive of depreciation) has various distinct components including: product cost of sales (including inbound freight, inventory shrinkage and loyalty reward program charges), store occupancy costs, outbound freight costs (including e-Commerce shipping) and central distribution costs. Product and outbound freight costs are variable, while occupancy and central distribution costs are largely fixed.

Accordingly, gross profit expressed as a percentage of total revenue can be influenced by many factors including overall sales performance. For fiscal 2016, gross profit increased 1.2% to \$221.5 million from \$218.8 million for fiscal 2015. Gross profit percentage for fiscal 2016 decreased to 37.3% of total revenue from 38.9% of total revenue for fiscal 2015, due primarily to higher store occupancy, central distribution and outbound freight costs as well as lower merchandise margins.

Operating expenses, including the costs of operating our stores and corporate headquarters, are also an important component of our operating performance. Compensation and benefits comprise the majority of our operating expenses. Operating expenses contain fixed and variable costs, and managing the operating expense ratio (operating expenses expressed as a percentage of net sales) is an important focus of management as we seek to increase our overall profitability. Operating expenses include cash costs as well as non-cash costs such as depreciation and amortization. Because many operating expenses are fixed costs, and because operating costs tend to rise over time, increases in comparable store sales typically are necessary to prevent meaningful increases in the operating expense ratio. Operating expenses can also include certain costs that are of a one-time or non-recurring nature. While these costs must be considered to understand fully our operating performance, we typically identify such costs separately where significant in the consolidated statements of income so that we can evaluate comparable expense data across different periods.

Strategic Areas of Emphasis

For fiscal 2016, we ended the year with 404 stores versus 376 stores at the end of fiscal 2015, representing a 7.4% increase in store units and a 9.3% increase in store square footage. In the near term, we will focus on infill opportunities in some of our core markets, as well as expansion opportunities in under-penetrated markets in the United States such as the Mid-Atlantic states, the Midwest, portions of the Northeast, and California. We expect to open 25 to 30 new locations during fiscal 2017 and expect to close approximately 20 locations. The new store openings during fiscal 2017 are expected to be weighted towards the second and third quarters of the year, while closings during fiscal 2017 are expected to be weighted towards the first half of the year.

The following table summarizes our stores in terms of size as of January 28, 2017 and January 30, 2016:

	As of January 28, 2017	As of January 30, 2016
Number of stores	404	376
Square footage	3,150,311	2,882,402
Average square footage per store	7,798	7,666

An important part of our growth strategy includes investing in technology to provide the infrastructure to support our future needs. Looking forward, we are focusing on process improvements as well as improving our supply chain and advancing our omni-channel model. We plan to upgrade our warehouse management system and plan to further develop our e-Commerce capabilities by adding numerous new features and functions, including expanding our vendor “drop-ship” product offerings and improving our ship to store options, allowing us to further expand our product assortment on the website. We continue to make other investments in our e-Commerce store with functionality enhancements designed to drive sales and conversion. We view these projects as essential and supportive to the execution of our omni-channel growth strategy.

Our cash balances increased from \$44.4 million at January 30, 2016 to \$63.9 million at January 28, 2017 reflecting our operating performance and changes in working capital. No common stock repurchases or cash dividends occurred during fiscal 2016. Our objective is to finance all of our operating and investing activities for fiscal 2017 with cash provided by operations as we have done in fiscal 2016. We expect that capital expenditures for fiscal 2017 will range from \$23 million to \$27 million, before landlord construction allowances for new stores, and estimate \$13 million to \$16 million of the total capital expenditures will relate to new store construction, \$4 million to \$6 million will relate to omni-channel capabilities and information technology, \$1 million to \$2 million will relate to the distribution center and supply chain, with the balance of our capital expenditures relating to visual displays and fixtures for stores and maintenance items.

Fiscal 2016 Compared to Fiscal 2015

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

	Fiscal 2016		Fiscal 2015		Change	
	\$	%	\$	%	\$	%
Net sales	\$ 593,221	99.8%	\$ 560,813	99.8%	\$ 32,408	5.8%
Gift card breakage revenue	1,107	0.2%	994	0.2%	113	11.4%
Total revenue	594,328	100.0%	561,807	100.0%	32,521	5.8%
Cost of sales (exclusive of depreciation)	372,857	62.7%	343,013	61.1%	29,844	8.7%
Gross profit	221,471	37.3%	218,794	38.9%	2,677	1.2%
Operating expenses:						
Compensation and benefits	110,277	18.5%	102,471	18.2%	7,806	7.6%
Other operating expenses	68,873	11.6%	67,950	12.1%	923	1.4%
Depreciation	25,322	4.3%	22,182	3.9%	3,140	14.2%
Operating income	16,999	2.9%	26,191	4.7%	(9,192)	(35.1)%
Interest expense	276	-%	346	0.1%	(70)	(20.2)%
Other income, net	(252)	-%	(252)	-%	-	-%
Income before income taxes	16,975	2.9%	26,097	4.6%	(9,122)	(35.0)%
Income tax expense	5,929	1.0%	9,524	1.7%	(3,595)	(37.7)%
Net income	\$ 11,046	1.9%	\$ 16,573	2.9%	\$ (5,527)	(33.3)%

Total revenue. Total revenue increased by 5.8% to \$594.3 million for fiscal 2016 from \$561.8 million for fiscal 2015. The total revenue increase of \$32.5 million in fiscal 2016 resulted primarily from net-new store sales growth of approximately of \$47.8 million, partially offset by a decrease in total comparable store sales of approximately \$15.3 million. We opened 42 new stores and closed 14 stores in fiscal 2016 compared to 43 new store openings and 11 store closures in fiscal 2015.

Comparable store sales decreased 2.9% for fiscal 2016 compared to an increase of 2.9% for fiscal 2015. The comparable store sales decrease was comprised of a 4.7% decrease in brick-and-mortar comparable store sales, partially offset by a 21.7% increase in e-Commerce sales, which excludes shipping revenue. The decrease in brick-and-mortar comparable stores sales was driven by a decrease in transactions resulting from lower traffic, partially offset by higher conversion. Average ticket also decreased slightly year-over-year due to lower items per transaction, partially offset by a higher average unit retail price. The increase in e-Commerce comparable sales was due to an increase in website traffic coupled with an increase in conversion, slightly offset by a decrease in average order size. Merchandise categories performing below last year's level were art and textiles. Merchandise categories that contributed positively to fiscal 2016 comparable store sales included holiday and furniture.

Gross profit. Gross profit increased \$2.7 million or 1.2% to \$221.5 million for fiscal 2016 from \$218.8 million for fiscal 2015. Gross profit expressed as a percentage of total revenue decreased to 37.3% for fiscal 2016 from 38.9% for fiscal 2015 due to deleveraging of store occupancy, central distribution and outbound freight costs, as well as lower merchandise margins. Merchandise margin is calculated as total revenue 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.

Merchandise margin decreased to 54.5% of total revenue in fiscal 2016 from 54.7% of total revenue in fiscal 2015. The decrease as a percentage of total revenue was primarily driven from increased promotional activity to stimulate traffic and manage inventory levels, partially offset by lower inbound freight costs as compared to fiscal 2015.

Store occupancy costs increased to \$59.9 million, or 10.1% of total revenue, in fiscal 2016 from \$51.5 million, or 9.2% of total revenue, in fiscal 2015. The increase in dollars year-over-year was mainly due to store growth. The increase as a percentage of total revenue was due to a combination of deleverage from lower comparable store sales and higher new store occupancy costs.

Our central distribution costs increased to \$18.8 million, or 3.2% of total revenue, in fiscal 2016 from \$15.0 million, or 2.7% of total revenue, in fiscal 2015. The increase in fiscal 2016 was mainly due to the addition of a 303,000 square-foot fulfillment facility in Jackson, Tennessee. We began fulfilling e-Commerce orders out of this facility in the first quarter of 2016, which resulted in additional startup, labor and operating costs.

Outbound freight costs, which include e-Commerce shipping expense, increased to \$23.7 million, or 4.0% of total revenue, in fiscal 2016 from \$21.8 million, or 3.9% of total revenue, in fiscal 2015. Increases in e-Commerce shipping expenses were driven by

both increased e-Commerce sales and a shift in our e-Commerce business to more ship-to-home sales, which carry a higher fulfillment cost. These increases were partially offset by lower outbound-to-store shipping expense.

Compensation and benefits. Compensation and benefits expenses, including both store and corporate personnel, were \$110.3 million, or 18.5% of total revenue, for fiscal 2016 compared to \$102.5 million, or 18.2% of total revenue, for fiscal 2015. The year-over-year dollar increase in fiscal 2016 was mainly due to store growth. The increase as a percentage of total revenue in fiscal 2016 was primarily due to deleverage from lower comparable store sales and higher employee benefit expenses.

Other operating expenses. Other operating expenses, including both store and corporate costs, were \$68.9 million, or 11.6% of total revenue, for fiscal 2016 compared to \$68.0 million, or 12.1% of total revenue, for fiscal 2015. Operating expenses at the store level were down as a percentage of sales due to lower workers' compensation and general liability expense as well as lower advertising costs. At the corporate level, professional and legal fees, as well as travel and insurance costs were down as a percentage of total revenue.

Depreciation. Depreciation expense was \$25.3 million, or 4.3% of total revenue, for fiscal 2016 as compared to \$22.2 million, or 3.9% of total revenue, for fiscal 2015. The increase in depreciation expense reflects the impact of the increase in capital expenditures in recent fiscal years, including new store growth and the implementation of major technology initiatives.

Income tax expense. We recorded income tax expense of \$5.9 million, or 34.9% of pre-tax income, during fiscal 2016 compared to income tax expense of \$9.5 million, or 36.5% of pre-tax income, during the prior year period. The decrease in the tax rate reflects the reversal of unrecognized tax benefits due to the lapse of the statute of limitations in Q4 2016.

Net income. As a result of the foregoing, we reported net income of \$11.0 million, or \$0.68 per diluted share, for fiscal 2016 compared to net income of \$16.6 million, or \$0.94 per diluted share, for fiscal 2015.

Fiscal 2015 Compared to Fiscal 2014

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

	Fiscal 2015		Fiscal 2014		Change	
	\$	%	\$	%	\$	%
Net sales	\$ 560,813	99.8%	\$ 506,768	99.8%	\$ 54,045	10.7%
Gift card breakage revenue	994	0.2%	853	0.2%	141	16.5%
Total revenue	561,807	100.0%	507,621	100.0%	54,186	10.7%
Cost of sales (exclusive of depreciation)	343,013	61.1%	304,724	60.0%	38,289	12.6%
Gross profit	218,794	38.9%	202,897	40.0%	15,897	7.8%
Operating expenses:						
Compensation and benefits	102,471	18.2%	94,738	18.7%	7,733	8.2%
Other operating expenses	67,950	12.1%	60,879	12.0%	7,071	11.6%
Depreciation	22,182	3.9%	18,639	3.7%	3,543	19.0%
Operating income	26,191	4.7%	28,641	5.6%	(2,450)	(8.6)%
Interest expense	346	0.1%	275	-%	71	25.8%
Other income, net	(252)	-%	(454)	(0.1)%	202	(44.5)%
Income before income taxes	26,097	4.6%	28,820	5.7%	(2,723)	(9.4)%
Income tax expense	9,524	1.7%	11,006	2.2%	(1,482)	(13.5)%
Net income	\$ 16,573	2.9%	\$ 17,814	3.5%	\$ (1,241)	(7.0)%

Total revenue. Total revenue increased by 10.7% to \$561.8 million for fiscal 2015 from \$507.6 million for fiscal 2014. The total revenue increase in fiscal 2015 resulted primarily from the comparable brick-and-mortar store sales increase, new store sales and an increase in e-Commerce sales, partially offset by store closings. We opened 43 new stores in fiscal 2015 and 34 new stores in fiscal 2014, and we closed 11 stores in fiscal 2015 and 14 stores in fiscal 2014. Comparable store sales increased 2.9% for fiscal 2015. During fiscal 2014, comparable store sales increased 6.1%. The comparable store sales increase in fiscal 2015 accounted for a \$14.0 million increase in overall sales, while the net growth of the store base accounted for a \$40.2 million increase in sales. The comparable store sales increase was comprised of a 0.7% increase in brick-and-mortar comparable store sales and a 41.1% increase in e-Commerce sales, which excludes shipping revenue. The increase in brick-and-mortar comparable stores sales was driven by an increase in transactions resulting from higher conversion, partially offset by lower traffic. Average ticket decreased slightly year-over-year due to lower items per transaction, partially offset by a higher average unit retail. Merchandise categories that performed the

strongest in fiscal 2015 were holiday, fragrance and accessories, housewares, frames, and personal accessories. Categories performing below fiscal 2014 levels were art, ornamental wall décor, lamps, and furniture.

Gross profit. Gross profit increased \$15.9 million or 7.8% to \$218.8 million for fiscal 2015 from \$202.9 million for fiscal 2014. Gross profit expressed as a percentage of total revenue decreased to 38.9% for fiscal 2015 from 40.0% for fiscal 2014. The decrease in gross profit as a percentage of total revenue was in part driven by lower merchandise margins, which decreased to 54.7% in fiscal 2015 from 55.4% in fiscal 2014. The decrease in merchandise margin was primarily the result of higher inbound freight charges and an increase in promotional markdowns to stimulate traffic and manage inventory levels. Store occupancy costs increased to \$51.5 million or 9.2% of total revenue in fiscal 2015 from \$45.6 million or 9.0% of total revenue in fiscal 2014. Outbound freight costs decreased as a percentage of total revenue 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. Central distribution expenses increased as a percentage of total revenue due to the addition of a 303,000 square-foot fulfillment facility in Jackson, Tennessee and increased labor expenses due to peak season challenges.

Compensation and benefits. Compensation and benefits expenses, including both store and corporate personnel, were \$102.5 million, or 18.2% of total revenue, for fiscal 2015 compared to \$94.7 million, or 18.7% of total revenue, for fiscal 2014. The decrease in the compensation and benefits expenses as a percentage of total revenue was primarily due to lower corporate bonus expense.

Other operating expenses. Other operating expenses, including both store and corporate costs, were \$68.0 million, or 12.1% of total revenue, for fiscal 2015 compared to \$60.9 million, or 12.0% of total revenue, for fiscal 2014. Operating expenses as a percentage of total revenue slightly increased compared to the prior year. At the corporate level, professional and legal fees and information technology related expenses increased in dollars and as a percent of total revenue. At the store level, advertising expense and workers' compensation and general liability expense decreased as a percentage of total revenue compared to the prior year period.

Depreciation. Depreciation expense was \$22.2 million, or 3.9% of total revenue, for fiscal 2015 as compared to \$18.6 million, or 3.7% of total revenue, for fiscal 2014. The increase in depreciation reflects the impact of the increase in capital expenditures in recent fiscal years, including new store growth and the implementation of major technology initiatives.

Income tax expense. Income tax expense was 36.5% of pre-tax income for fiscal 2015 compared to 38.2% of pre-tax income for fiscal 2014 primarily due to higher tax credits.

Net income. As a result of the foregoing, we reported net income of \$16.6 million, or \$0.94 per diluted share, for fiscal 2015 compared to net income of \$17.8 million, or \$1.00 per diluted share, for 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 in 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 (including e-Commerce), 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 provided by operating activities was \$51.8 million, \$32.0 million and \$44.5 million for fiscal 2016, fiscal 2015 and fiscal 2014, respectively. Net cash provided by operating activities depends 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 provided by operations from fiscal 2015 to fiscal 2016 was primarily the result of changes in working capital as well as cash received for landlord construction allowances, partially offset by a decline in operating performance. Inventory increased over the prior year period due to the growth in store count and e-Commerce, as well as gaining control and ownership of inventory earlier in the supply chain from our new west coast distribution operation. This also resulted in a corresponding increase in our accounts payable, thereby having a net positive effect on cash provided by operating activities in the current fiscal year compared to the prior fiscal year. In addition, cash received for landlord construction allowances also increased over the prior year period due in part to the timing of both prior year and current year new store openings.

The change in the amount of cash provided by operations from fiscal 2014 to fiscal 2015 was primarily the result of an increase in inventory and prepaid and other current assets and a decrease in accrued expenses as compared to the prior year. The increase in inventory is related to a higher store count, as well as growth in the e-Commerce business, although below plan sales results in the back-half of fiscal 2015 also contributed higher inventory levels at the end of the year. The increase in prepaid and other current assets was due to an increase in tenant allowance receivables and other receivables.

Cash flows from investing activities. Net cash used in investing activities was \$32.2 million, \$35.1 million and \$29.6 million for fiscal 2016, fiscal 2015 and fiscal 2014, respectively. For each period presented, the amounts of cash used in investing activities consisted principally of capital expenditures related to new store construction, existing store expenditures, distribution center projects and information technology projects. The decrease in capital expenditures from fiscal 2015 to fiscal 2016 was primarily due to new store construction, distribution center projects and existing store projects. The increase in capital expenditures from fiscal 2014 to fiscal 2015 was primarily due to new store construction, existing store projects and distribution center projects. During fiscal 2016, we opened 42 stores compared to 43 stores in fiscal 2015 and 34 stores in fiscal 2014.

Cash flows from financing activities. Net cash used in financing activities was \$0.1 million, \$51.7 million and \$4.8 million for fiscal 2016, fiscal 2015 and fiscal 2014, respectively. During fiscal 2014, we authorized a share repurchase plan allowing for the use of up to \$30 million in cash for repurchases of our common stock, which we completed during fiscal 2015. Net cash used in fiscal 2015 primarily related to a special cash dividend of \$26.0 million and the repurchase and retirement of common stock of \$25.2 million. Net cash used in fiscal 2014 primarily related to the repurchase and retirement of common stock of \$4.8 million. No shares were repurchased or dividends issued during fiscal 2016. During fiscal 2016, fiscal 2015 and fiscal 2014, we did not make any draws on our revolving credit facility.

Revolving credit facility. During the period of August 19, 2011 through February 26, 2016, we were party to an Amended and Restated Credit Agreement (the “2011 Credit Agreement”) with Bank of America, N.A. as administrative agent and collateral agent, and the lenders named therein (the “Lenders”). The 2011 Credit Agreement included a senior secured revolving credit facility of \$50 million, a swingline availability of \$5 million and a maturity date of August 2016. Borrowings under the 2011 Credit Agreement bore interest at an annual rate equal to LIBOR plus a margin ranging from 175 to 225 basis points with no LIBOR floor, and the fee paid to the Lenders on the unused portion of the credit facility was 37.5 basis points per annum.

On February 26, 2016, the Company, entered into a Joinder and First Amendment to Amended and Restated Credit Agreement (the “2016 Credit Agreement”). The 2016 Credit Agreement increased our senior secured revolving credit facility from \$50 million to \$75 million, increased the swingline availability from \$5 million to \$10 million and extended the maturity date from August 2016 to February 2021, along with adding a \$25 million incremental accordion feature. Borrowings under the 2016 Credit Agreement bear interest at an annual rate equal to LIBOR plus a margin ranging from 125 to 175 basis points with no LIBOR floor, and the fee paid to the Lenders on the unused portion of the credit facility is 25 basis points per annum.

Borrowings under the Credit Agreements 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 Agreements 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.

We are subject to an Amended and Restated Security Agreement (“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 Agreements.

As of January 28, 2017, we were in compliance with the covenants in the 2016 Credit Agreement, and there were no outstanding borrowings under the credit facility, with approximately \$50.6 million available for borrowing.

As of January 28, 2017, our balance of cash and cash equivalents was approximately \$63.9 million. We did not borrow from our credit facility during fiscal 2016, nor do we expect any borrowings during fiscal 2017. 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 from time to time until May 2016. We completed this \$30 million share repurchase plan during the year ended January 30, 2016 by repurchasing and retiring a total of 1,921,423 shares at a weighted average cost of \$15.61 per share. There were no stock repurchases in fiscal 2016.

Contractual Obligations

The following table identifies payment obligations for the periods indicated under our current contractual arrangements. The amounts set forth below reflect contractual obligations as of January 28, 2017. The timing and/or the amount of the payments may be changed in accordance with the terms of the contracts or new contractual obligations may be added. A summary of our contractual obligations and other commercial commitments as of January 28, 2017 is listed below (in thousands):

	Amount of Commitment per Period				
	Total Contractual Obligations	Less Than 1 Year	1 to 3 Years	3 to 5 Years	More Than 5 Years
Operating leases(1)	\$ 341,876	\$ 60,243	\$ 106,969	\$ 85,001	\$ 89,663
Purchase obligations(2)	70,452	70,452	-	-	-
Construction commitments(3)	475	475	-	-	-
Total	\$ 412,803	\$ 131,170	\$ 106,969	\$ 85,001	\$ 89,663

- (1) These amounts represent future minimum lease payments under non-cancelable operating leases.
- (2) Purchase obligations consist entirely of open purchase orders of merchandise inventory as of January 28, 2017; such orders are generally cancelable at our discretion until the order has been shipped.
- (3) These amounts represent commitments for new store construction projects.

Related Party Transactions

In July 2009, we entered into a Vendor Agreement with a related party vendor to purchase merchandise inventory. The vendor is considered a related party because its principal owner is the spouse of our Vice President of Merchandising. The table below sets forth selected results related to this vendor in dollars (in thousands) and percentages for the periods indicated:

	52 Weeks Ended January 28, 2017	52 Weeks Ended January 30, 2016	52 Weeks Ended January 31, 2015
Related Party Vendor			
Purchases	\$ 44,703	\$ 39,178	\$ 29,114
Purchases as a percent of total merchandise purchases	17.6%	14.8%	12.5%
Cost of sales	\$ 40,560	\$ 35,170	\$ 27,613
Payable amounts outstanding at fiscal year end	\$ 5,008	\$ 2,258	\$ 2,077

Off-Balance Sheet Arrangements

None.

Seasonality and Quarterly Results

We have historically experienced and expect to continue to experience substantial seasonal fluctuations in our net sales and operating income. We believe this is the general pattern typical of our segment of the retail industry and, as a result, expect that this pattern will continue in the future. Our quarterly results of operations may also fluctuate significantly as a result of a variety of other factors, including the timing of new store openings, net sales contributed by new stores, shifts in the timing of certain holidays and competition. Consequently, comparisons between quarters are not necessarily meaningful and the results for any quarter are not necessarily indicative of future results.

Our strongest sales period is the fourth quarter of our fiscal year when we generally realize a disproportionate amount of our net sales and a substantial majority of our operating and net income. In anticipation of the increased sales activity during the fourth quarter of our fiscal year, we purchase large amounts of inventory and hire temporary staffing help for our stores. Our operating performance could suffer if net sales were below seasonal norms during the fourth quarter of our fiscal year.

The following table sets forth certain unaudited financial and operating data for Kirkland's in each fiscal quarter during fiscal 2016 and fiscal 2015 (dollars in thousands). The unaudited quarterly information includes all normal recurring adjustments that we consider necessary for a fair statement of the information shown.

	Fiscal 2016 Quarter Ended			
	April 30, 2016	July 30, 2016	October 29, 2016	January 28, 2017
Total revenue	\$129,911	\$ 123,017	\$ 138,240	\$ 203,160
Gross profit	49,537	42,273	50,478	79,183
Operating income (loss)	1,524	(5,895)	(1,608)	22,978
Net income (loss)	916	(3,567)	(846)	14,543
Earnings (loss) per share:				
Basic	0.06	(0.22)	(0.05)	0.91
Diluted	0.06	(0.22)	(0.05)	0.90
Stores open at end of period	382	391	401	404
Comparable store net sales increase (decrease)	0.5%	(4.3)%	(2.3)%	(4.6)%

	Fiscal 2015 Quarter Ended			
	May 2, 2015	August 1, 2015	October 31, 2015	January 30, 2016
Total revenue	\$ 118,310	\$ 115,289	\$ 129,238	\$ 198,970
Gross profit	47,663	42,512	48,101	80,518
Operating income (loss)	4,097	(3,702)	(932)	26,728
Net income (loss)	2,529	(2,288)	(270)	16,602
Earnings (loss) per share:				
Basic	0.15	(0.13)	(0.02)	0.99
Diluted	0.14	(0.13)	(0.02)	0.97
Stores open at end of period	342	351	370	376
Comparable store net sales increase	3.0%	6.7%	1.8%	1.3%

Inflation

We do not believe that our operating results have been materially affected by inflation during the preceding three fiscal years. There can be no assurance, however, that our operating results will not be adversely affected by inflation in the future.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and the results of our operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates that affect the reported amounts contained in the financial statements and related disclosures. We base our estimates on historical experience and on various other assumptions which are believed to be reasonable under the circumstances. Actual results may differ from these estimates. Our critical accounting policies are discussed in the notes to our consolidated financial statements. Certain judgments and estimates utilized in implementing these accounting policies are likewise discussed in the notes to our consolidated financial statements. The following discussion aggregates the various critical accounting policies addressed throughout the financial statements, the judgments and uncertainties affecting the application of these policies and the likelihood that materially different amounts would be reported under varying conditions and assumptions.

Inventory valuation — Our inventory is stated at the lower of cost or market, net of reserves and allowances, with cost determined using the average cost method with average cost approximating current cost. The carrying value of our inventory is affected by reserves for shrinkage and obsolescence.

We estimate as a percentage of sales the amount of shrinkage that has occurred between the most recently completed store physical count and the end of the financial reporting period based upon historical physical inventory count results. Management adjusts these estimates based on changes, if any, in the trends yielded by our physical inventory counts, which occur throughout the fiscal year. Historically the variation between our recorded estimates and observed results has been insignificant, and although possible, significant future variation is not expected. If our estimated shrinkage reserve varied by 10% from the amount recorded, the carrying value of inventory would have changed approximately \$180,000 as of January 28, 2017.

We also evaluate the cost of our inventory by category and class of merchandise in relation to the estimated sales price. This evaluation is performed to ensure that we do not carry inventory at a value in excess of the amount we expect to realize upon the sale of the merchandise. Our reserves for excess inventory and inventory obsolescence (in connection with which we reduce merchandise inventory to the lower of cost or market) are also estimated based upon our historical experience of selling goods below cost. Historically, the variation between our estimates to account for excess and obsolete inventory and actual results has been insignificant. As of January 28, 2017, our reserve for obsolescence was approximately \$547,000.

Impairments — In accordance with the provisions of Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 360, “Property, Plant, and Equipment”, we evaluate the recoverability of the carrying amounts of long-lived assets whenever events or changes in circumstances indicate that the carrying values may not be recoverable. This review includes the evaluation of individual underperforming retail stores and assessing the recoverability of the carrying values of the assets related to such stores. Future cash flows are projected for the remaining lease life. The key assumptions used to determine the estimated cash flows for these stores include net sales and gross margin performance, payroll and related items, occupancy costs and other costs to operate. We calculate the fair values of long-lived assets using the age-life method. Under this method, the replacement cost of an asset is estimated and reduced by depreciation based on the effective age of the asset and its expected useful life. This method takes into consideration the fact that we will continue to use these assets based on a presumed investment decision where the expected cash flows from operating the store are greater than the expected cash flows that result from not operating the store. If the estimated fair values are less than the carrying values of the assets, we record an impairment charge equal to the difference, if any, between the assets’ fair values and carrying values.

We have not made any material changes to our impairment loss assessment methodology in the financial periods presented. Additionally, we do not believe that there will be a material change in the estimates or assumptions we use to calculate long-lived asset impairment losses. However, if actual results are not consistent with our estimates and assumptions used in estimating future cash flows and asset fair values, we may be exposed to losses that could be material.

Insurance reserves — Workers’ compensation, general liability and employee medical insurance programs are predominately self-insured. It is our policy to record a self-insurance liability using estimates of claims incurred but not yet reported or paid, based on historical claims experience and trends. As of January 28, 2017, our net self-insurance reserve estimates were \$5.0 million compared to \$5.2 million as of January 30, 2016. The assumptions made by management in estimating our self-insurance reserves include consideration of historical cost experience, judgments about the present and expected levels of cost per claim and retention levels. We utilize various methods, including analyses of historical trends and actuarial methods, to estimate the cost to settle reported claims and claims incurred, but not yet reported. As we obtain additional information and refine our methods regarding the assumptions and estimates we use to recognize liabilities incurred, we will adjust our reserves accordingly.

Actuarial methods are used to develop estimates of the future ultimate claim costs based on the claims incurred as of the balance sheet date. Management believes that the various assumptions developed and actuarial methods used to determine our self-insurance reserves are reasonable and provide meaningful data and information that management uses to make its best estimate of our exposure to these risks. Arriving at these estimates, however, requires a significant amount of subjective judgment by management; and, as a result, these estimates are uncertain and our actual exposure may be different from our estimates. For example, changes in our assumptions about health care costs, the severity of accidents, the average size of claims and other factors could cause actual claim costs to vary materially from our assumptions and estimates, causing our reserves to be understated or overstated. For instance, a 10% change in our self-insurance liabilities would have affected pre-tax income by approximately \$540,000 for fiscal 2016.

Income taxes — We record income tax liabilities utilizing known obligations and estimates of potential obligations. A deferred tax asset or liability is recognized whenever there are future tax effects from existing temporary differences and operating loss and tax credit carryforwards. We record a valuation allowance to reduce deferred tax assets to the balance that is more likely than not to be realized. We must make estimates and judgments on future taxable income, considering feasible tax planning strategies and taking into account existing facts and circumstances, to determine the proper valuation allowance. When we determine that deferred tax assets could be realized in greater or lesser amounts than recorded, the asset balance and income statement reflects the change in the period such determination is made. Due to changes in facts and circumstances and the estimates and judgments that are involved in determining the proper valuation allowance, differences between actual future events and prior estimates and judgments could result in adjustments to this valuation allowance. We use an estimate of our annual effective tax rate 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.

Additionally, our income tax returns are subject to audit by United States federal, state and local tax authorities, which include questions regarding our tax filing positions including the timing and amount of deductions and the allocation of income among various tax jurisdictions. In evaluating the tax exposures associated with our filing positions, we record reserves for probable exposures. We adjust our tax contingencies reserve and income tax provision in the period in which actual results of a settlement with tax authorities differs from our established reserve, the statute of limitations expires for the relevant tax authority to examine the tax position or when more information becomes available. Our tax contingencies reserve contains uncertainties because management is required to make assumptions and to apply judgment to estimate the exposures associated with our various filing positions and whether or not the

minimum requirements for recognition of tax benefits have been met. We do not believe that there is a reasonable likelihood that there will be a material change in the reserves established for tax benefits not recognized. Although we believe our judgments and estimates are reasonable, actual results could differ, and we may be exposed to losses or gains that could be material. A 10% change in our unrecognized tax benefit reserve at January 28, 2017 would have affected net earnings by approximately \$14,000 in fiscal 2016.

Stock-based compensation — We have stock-based compensation plans which include incentive and non-qualified stock options, restricted stock units and an employee stock purchase plan. See Note 7, Stock-Based Compensation, to the Notes to the Consolidated Financial Statements included in Item 8, Financial Statements and Supplementary Data, of this Form 10-K, for a complete discussion of our stock-based compensation programs. We recognize stock-based compensation expense based on the fair value of the respective awards. We estimate the fair value of our stock option awards as of the grant date based upon a Black-Scholes option pricing model. We estimate the fair value of our restricted stock units as of the grant date utilizing the closing price of our stock on that date. The compensation expense associated with these awards is recorded in the consolidated statements of income with a corresponding credit to common stock.

The Black-Scholes option pricing model requires the input of highly subjective assumptions. These assumptions include estimating the length of time employees will retain their stock options before exercising them (“expected term”) and the estimated volatility of our common stock price over the expected term. Changes in the subjective assumptions can materially affect the estimate of fair value of stock-based compensation and, consequently, the related amount recognized in the consolidated statements of income.

We update our assumptions at each grant date. Historically, there have not been significant changes in our estimates or assumptions used to determine stock-based compensation expense. We have not experienced a significant increase in the estimated fair value of awards granted during fiscal 2016, fiscal 2015 or fiscal 2014. If actual results are not consistent with our estimates or assumptions, we may be exposed to changes in stock-based compensation expense that could be material. A 10% change in our stock-based compensation expense for the year ended January 28, 2017 would have affected pre-tax income by approximately \$319,000.

Item 7A. Quantitative and Qualitative Disclosure About Market Risk

As of January 28, 2017, we had no outstanding borrowings under our revolving credit facility. We did not borrow from our credit facility during fiscal 2016, nor do we expect any borrowings during fiscal 2017. We were not engaged in any foreign exchange contracts, hedges, interest rate swaps, derivatives or other financial instruments with significant market risk as of January 28, 2017.

Item 8. Financial Statements and Supplementary Data

The financial statements and schedules are listed under Item 15(a) and filed as part of this annual report on Form 10-K. The supplementary financial data is set forth under Item 7 of this annual report on Form 10-K.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We have established and maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended (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 that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of January 28, 2017. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of January 28, 2017.

Management’s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a and 15d- 15(f) under the Exchange Act). Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we carried out an evaluation of the effectiveness of our internal control over financial reporting as of January 28, 2017 based on the *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (“COSO”). Based on this evaluation, our management concluded that our internal control over financial reporting was effective as of January 28, 2017.

Attestation Report of the Registered Public Accounting firm

Ernst & Young LLP, the independent registered public accounting firm that audited our financial statements included elsewhere in this Form 10-K, has issued an attestation report on our internal control over financial reporting. That report appears in Item 15 of Part IV in this Form 10-K and is incorporated by reference to this Item 9A.

Changes in Internal Control 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.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Information concerning directors, appearing under the caption “Board of Directors” in our Proxy Statement (the “Proxy Statement”) to be filed with the SEC in connection with our Annual Meeting of Shareholders scheduled to be held on June 2, 2017; information concerning executive officers, appearing under the caption “Item 1. Business — Executive Officers of Kirkland’s” in Part I of this Form 10-K; information concerning our nominating and audit committees, appearing under the caption “Information About the Board of Directors and Corporate Governance” in our Proxy Statement; and information under the caption “Other Matters — Section 16(a) Beneficial Ownership Reporting Compliance” in the Proxy Statement are incorporated herein by reference in response to this Item 10.

The Board of Directors has adopted a Code of Business Conduct and Ethics applicable to our directors, officers and employees, including our Chief Executive Officer and Chief Financial Officer, which has been posted on the “Investor Relations” section of our web site. We intend to satisfy the amendment and waiver disclosure requirements under applicable securities regulations by posting any amendments of, or waivers to, the Code of Business Conduct and Ethics on our web site.

Item 11. Executive Compensation

The information contained in the sections titled “Executive Compensation” and “Information About the Board of Directors and Corporate Governance — Board of Directors Compensation” in the Proxy Statement is incorporated herein by reference in response to this Item 11.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information contained in the following section of the Proxy Statement is incorporated herein by reference in response to this Item 12: the section titled “Security Ownership of Kirkland’s — Security Ownership of Certain Beneficial Owners and Management”, with respect to security ownership of certain beneficial owners and management.

The following table provides information regarding the number of securities already issued and those remaining available for issuance under our equity compensation plans as of January 28, 2017.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	1,436,222	\$15.33	1,014,533
Equity compensation plans not approved by security holders	---	---	---
Total	1,436,222	\$15.33	1,014,533

Item 13. Certain Relationships and Related Transactions, and Director Independence

Information contained in the section titled “Related Party Transactions” in the Proxy Statement is incorporated herein by reference in response to this Item 13.

The information contained in the section titled “Information About the Board of Directors and Corporate Governance — Board Independence” in the Proxy Statement is incorporated herein by reference in response to this Item 13.

Item 14. Principal Accounting Fees and Services

The information contained in the section titled “Other Matters — Audit and Non-Audit Fees” in the Proxy Statement is incorporated herein by reference in response to this Item 14.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) 1. Financial Statements

The financial statements set forth below are filed on the indicated pages as part of this annual report on Form 10-K.

Reports of Independent Registered Public Accounting Firm	37
Consolidated Balance Sheets as of January 28, 2017 and January 30, 2016	39
Consolidated Statements of Income for the 52 Weeks Ended January 28, 2017, January 30, 2016 and January 31, 2015	40
Consolidated Statements of Shareholders' Equity for the 52 Weeks Ended January 28, 2017, January 30, 2016 and January 31, 2015	41
Consolidated Statements of Cash Flows for the 52 Weeks Ended January 28, 2017, January 30, 2016 and January 31, 2015	42
Notes to Consolidated Financial Statements	43

(b) Exhibits

The Exhibit Index following this document's Notes to Consolidated Financial Statements is incorporated herein by reference in response to this item.

(c) Financial Statement Schedules

Schedules are omitted because the information is not required or because the information is included in the financial statements or notes thereto.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders of Kirkland's, Inc.

We have audited Kirkland's, Inc.'s internal control over financial reporting as of January 28, 2017, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). Kirkland's, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Kirkland's, Inc. maintained, in all material respects, effective internal control over financial reporting as of January 28, 2017, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Kirkland's, Inc. as of January 28, 2017 and January 30, 2016, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended January 28, 2017, of Kirkland's, Inc. and our report dated March 31, 2017 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Nashville, Tennessee
March 31, 2017

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders of Kirkland's, Inc.

We have audited the accompanying consolidated balance sheets of Kirkland's, Inc. as of January 28, 2017 and January 30, 2016, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended January 28, 2017. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Kirkland's, Inc. at January 28, 2017 and January 30, 2016, and the consolidated results of its operations and its cash flows for each of the three years in the period ended January 28, 2017, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Kirkland's, Inc.'s internal control over financial reporting as of January 28, 2017, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated March 31, 2017 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Nashville, Tennessee
March 31, 2017

KIRKLAND'S, INC.
CONSOLIDATED BALANCE SHEETS

	January 28, 2017	January 30, 2016
	(In thousands, except share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 63,937	\$ 44,352
Inventories, net	75,447	68,222
Prepaid expenses and other current assets	13,656	15,206
Total current assets	153,040	127,780
Property and equipment, gross	265,771	240,020
Accumulated depreciation	(154,901)	(134,478)
Property and equipment, net	110,870	105,542
Deferred income taxes	1,198	-
Other assets	5,038	1,934
Total assets	\$ 270,146	\$ 235,256
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 32,890	\$ 26,431
Accounts payable to related party vendor	5,008	2,258
Income taxes payable	6,273	4,863
Accrued expenses	30,270	25,943
Total current liabilities	74,441	59,495
Deferred rent	52,656	48,280
Deferred income taxes	479	1,342
Other liabilities	8,757	6,444
Total liabilities	136,333	115,561
Commitments and contingencies (Note 9)	-	-
Shareholders' equity:		
Preferred stock, no par value, 10,000,000 shares authorized; no shares issued or outstanding at January 28, 2017, and January 30, 2016	-	-
Common stock, no par value, 100,000,000 shares authorized; 15,906,635 and 15,774,681 shares issued and outstanding at January 28, 2017 and January 30, 2016, respectively	165,245	162,173
Accumulated deficit	(31,432)	(42,478)
Total shareholders' equity	133,813	119,695
Total liabilities and shareholders' equity	\$ 270,146	\$ 235,256

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

KIRKLAND'S, INC.
CONSOLIDATED STATEMENTS OF INCOME

	52 Weeks Ended January 28, 2017	52 Weeks Ended January 30, 2016	52 Weeks Ended January 31, 2015
(In thousands, except per share data)			
Net sales	\$ 593,221	\$ 560,813	\$ 506,768
Gift card breakage revenue	1,107	994	853
Total revenue	594,328	561,807	507,621
Cost of sales	332,297	307,843	277,111
Cost of sales related to merchandise purchased from related party vendor	40,560	35,170	27,613
Cost of sales (exclusive of depreciation as shown below)	372,857	343,013	304,724
Gross profit	221,471	218,794	202,897
Operating expenses:			
Compensation and benefits	110,277	102,471	94,738
Other operating expenses	68,873	67,950	60,879
Depreciation	25,322	22,182	18,639
Total operating expenses	204,472	192,603	174,256
Operating income	16,999	26,191	28,641
Interest expense, net	276	346	275
Other income, net	(252)	(252)	(454)
Income before income taxes	16,975	26,097	28,820
Income tax expense	5,929	9,524	11,006
Net income	\$ 11,046	\$ 16,573	\$ 17,814
Earnings per share:			
Basic	\$ 0.70	\$ 0.97	\$ 1.03
Diluted	\$ 0.68	\$ 0.94	\$ 1.00
Weighted average shares for basic earnings per share	15,859	17,131	17,262
Effect of dilutive common stock equivalents	286	438	531
Adjusted weighted average shares for diluted earnings per share	16,145	17,569	17,793
Dividends declared per common share outstanding	\$ -	\$ 1.50	\$ -

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

KIRKLAND'S, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Common Stock		Accumulated Deficit	Total Shareholders' Equity
	Shares	Amount		
	(In thousands, except share data)			
Balance at February 1, 2014	17,304,285	\$ 156,193	\$ (20,964)	\$ 135,229
Exercise of stock options and employee stock purchases	49,847	298	-	298
Tax benefit from exercise of stock options and vesting of restricted stock	-	99	-	99
Net share settlement of stock options and restricted stock	(39,512)	(347)	-	(347)
Restricted stock issued	82,000	-	-	-
Stock-based compensation expense	-	2,772	-	2,772
Repurchase and retirement of common stock	(268,745)	-	(4,803)	(4,803)
Net income	-	-	17,814	17,814
Balance at January 31, 2015	17,127,875	159,015	(7,953)	151,062
Exercise of stock options and employee stock purchases	494,873	354	-	354
Tax benefit from exercise of stock options and vesting of restricted stock	-	1,109	-	1,109
Net share settlement of stock options and restricted stock	(301,253)	(2,029)	-	(2,029)
Restricted stock issued	105,864	-	-	-
Stock-based compensation expense	-	3,773	-	3,773
Repurchase and retirement of common stock	(1,652,678)	(49)	(25,147)	(25,196)
Dividends paid	-	-	(25,951)	(25,951)
Net income	-	-	16,573	16,573
Balance at January 30, 2016	15,774,681	162,173	(42,478)	119,695
Exercise of stock options and employee stock purchases	66,879	369	-	369
Tax shortfall from exercise of stock options and vesting of restricted stock	-	(228)	-	(228)
Net share settlement of stock options and restricted stock	(31,676)	(263)	-	(263)
Restricted stock issued	96,751	-	-	-
Stock-based compensation expense	-	3,194	-	3,194
Net income	-	-	11,046	11,046
Balance at January 28, 2017	15,906,635	\$ 165,245	\$ (31,432)	\$ 133,813

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

KIRKLAND'S, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	52 Weeks Ended January 28, 2017	52 Weeks Ended January 30, 2016	52 Weeks Ended January 31, 2015
	(In thousands)		
Cash flows from operating activities:			
Net income	\$ 11,046	\$ 16,573	\$ 17,814
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation of property and equipment	25,322	22,182	18,639
Amortization of deferred rent	(5,779)	(5,260)	(5,397)
Cash received for landlord construction allowances	13,035	9,785	7,822
Amortization of debt issue costs	89	77	77
Loss on disposal of property and equipment	313	145	345
Stock-based compensation expense	3,194	3,773	2,772
Excess tax benefits from exercise of stock options and vesting of restricted stock	(78)	(1,109)	(99)
Deferred income taxes	(2,242)	742	40
Changes in assets and liabilities:			
Inventories, net	(7,225)	(12,447)	(3,138)
Prepaid expenses and other current assets	(173)	(3,911)	230
Other noncurrent assets	(2,922)	155	(405)
Accounts payable	7,672	2,040	1,345
Accounts payable to related party vendor	2,750	181	258
Income taxes payable	1,363	324	318
Accrued expenses and other current and noncurrent liabilities	5,483	(1,209)	3,867
Net cash provided by operating activities	<u>51,848</u>	<u>32,041</u>	<u>44,488</u>
Cash flows from investing activities:			
Proceeds from sales of property and equipment	4	-	-
Capital expenditures	(32,180)	(35,114)	(29,647)
Net cash used in investing activities	<u>(32,176)</u>	<u>(35,114)</u>	<u>(29,647)</u>
Cash flows from financing activities:			
Refinancing costs	(271)	-	-
Excess tax benefits from exercise of stock options and restricted stock	78	1,109	99
Cash used in net share settlement of stock options and restricted stock	(263)	(2,029)	(347)
Employee stock purchases	369	354	298
Cash dividends paid to stockholders	-	(25,951)	-
Repurchase and retirement of common stock	-	(25,196)	(4,803)
Net cash used in financing activities	<u>(87)</u>	<u>(51,713)</u>	<u>(4,753)</u>
Cash and cash equivalents:			
Net increase (decrease)	19,585	(54,786)	10,088
Beginning of the year	44,352	99,138	89,050
End of the year	<u>\$ 63,937</u>	<u>\$ 44,352</u>	<u>\$ 99,138</u>
Supplemental cash flow information:			
Interest paid	<u>\$ 159</u>	<u>\$ 192</u>	<u>\$ 190</u>
Income taxes paid	<u>\$ 7,214</u>	<u>\$ 8,300</u>	<u>\$ 10,621</u>

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

KIRKLAND'S, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 — Description of Business and Significant Accounting Policies

Kirkland's, Inc. (the "Company") is a specialty retailer of home décor and gifts in the United States with 404 stores in 36 states as of January 28, 2017. The 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. and Kirkland's Texas, LLC. Significant intercompany accounts and transactions have been eliminated.

The preparation of the 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 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, customer loyalty program accruals and contingent liabilities.

Fiscal year — The Company's fiscal year is comprised of the 52 or 53-week period ending on the Saturday closest to January 31. Accordingly, fiscal 2016 represented the 52 weeks ended on January 28, 2017, fiscal 2015 represented the 52 weeks ended on January 30, 2016 and fiscal 2014 represented the 52 weeks ended on January 31, 2015.

Reclassifications — Certain amounts in the fiscal 2015 consolidated financial statements have been reclassified to conform to the fiscal 2016 presentation. These reclassifications had no effect on reported net income. In the fourth quarter of fiscal 2016, the Company concluded that it was appropriate to classify related party transactions separately in the consolidated financial statements. In fiscal 2015, this information was provided in the notes to the consolidated financial statements. See "Note 10 — Related Party Transactions" for further discussion.

Also, in the first quarter of fiscal 2016, the Company adopted accounting guidance which affected the presentation of deferred tax liabilities and assets as discussed below in *Recently Issued Accounting Pronouncements*. This guidance was applied retrospectively for all periods presented and therefore the presentation of previously reported deferred tax assets has been changed to conform to the presentation used in the current period. The adoption of this guidance resulted in the reclassification of deferred tax assets of \$3.3 million from current assets to a reduction in noncurrent liabilities in the condensed consolidated balance sheets as of January 30, 2016.

Cash equivalents — Cash and cash equivalents consist of cash on deposit in banks and payments due from banks for customer credit cards, as they generally settle within 24-48 hours.

Cost of sales (exclusive of depreciation) and inventory valuation — Cost of sales (exclusive of depreciation) includes costs of product purchased from vendors, including inbound freight, receiving costs, inspection costs, warehousing costs, outbound freight, inventory damage and shrinkage, loyalty reward program charges, payroll and overhead associated with our distribution facility and its network and store occupancy costs. The Company's inventory is stated at the lower of cost or market, net of reserves and allowances, with cost determined using the average cost method, with average cost approximating current cost. The Company estimates the amount of shrinkage that has occurred through theft or damage and adjusts that amount to actual at the time of its physical inventory counts which occur throughout the fiscal year. The Company also evaluates the cost of inventory by category and class of merchandise in relation to the estimated sales price. This evaluation is performed to ensure that inventory is not carried at a value in excess of the amount expected to be realized upon the sale of the merchandise.

Vendor allowances — The Company receives various payments and allowances from vendors, including rebates and other credits. The amounts received are subject to the terms of vendor agreements, which generally do not state an expiration date, but are subject to ongoing negotiations that may be impacted in the future based on changes in market conditions and changes in the profitability, quality, or sell-through of the related merchandise. For all such vendor allowances, the Company records the vendor funds as a reduction of inventories. As the related inventory is sold, such allowances and credits are recognized as a reduction to cost of sales.

Property and equipment — Property and equipment are stated at cost less accumulated depreciation. Depreciation is computed on a straight-line basis over the estimated useful lives of the respective assets. Furniture, fixtures and equipment are generally depreciated over five years. Leasehold improvements are amortized over the shorter of the useful life of the asset or the expected lease term, typically ranging from five to 10 years. Maintenance and repairs are expensed as incurred, and improvements are capitalized. Gains or losses on the disposition of fixed assets are recorded upon disposal of the related asset. As of January 28, 2017 and January

30, 2016, non-cash investing activities related to property and equipment being purchased, but awaiting payment in accounts payable, was approximately \$1.4 million and \$2.6 million, respectively.

Cost of internal use software — The Company capitalizes the cost of computer software developed or obtained for internal use. Capitalized computer software costs consist primarily of payroll-related and consulting costs incurred during the application development stage. The Company expenses costs related to preliminary project assessments, research and development, re-engineering, training and application maintenance as they are incurred. Capitalized software costs are amortized on a straight-line basis over an estimated life of three to 10 years. For fiscal years 2016, 2015 and 2014, the Company recorded approximately \$6.1 million, \$5.3 million and \$4.0 million, respectively, for depreciation of capitalized software. The net book value of these assets totaled \$24.9 million and \$22.8 million at the end of fiscal years 2016 and 2015, respectively. At the end of fiscal years 2016 and 2015, property and equipment included capitalized computer software currently under development of \$3.1 million and \$2.0 million, respectively.

Asset retirement obligations — The Company recognizes a liability for the fair value of required asset retirement obligations (“ARO”) when such obligations are incurred. The Company’s AROs are primarily associated with leasehold improvements which, at the end of a lease, the Company is contractually obligated to remove in order to comply with the lease agreement. At the inception of a lease with such conditions, the Company records an ARO liability and a corresponding capital asset in an amount equal to the estimated fair value of the obligation. The liability is estimated based on various assumptions requiring management’s judgment and is accreted to its projected future value over time. The capitalized asset is depreciated using the convention for depreciation of leasehold improvement assets. Upon satisfaction of the ARO conditions, any difference between the recorded ARO liability and the actual retirement costs incurred is recognized as an operating gain or loss in the consolidated statements of income. As of January 28, 2017 and January 30, 2016, the liability for asset retirement obligations was approximately \$659,000 and \$574,000, respectively.

Impairment of long-lived assets — The Company evaluates the recoverability of the carrying amounts of long-lived assets whenever events or changes in circumstances dictate that their carrying values may not be recoverable. This review includes the evaluation of individual underperforming retail stores and assessing the recoverability of the carrying values of the assets related to the stores. Future cash flows are projected for the remaining lease life. The Company calculates the fair values of long-lived assets using the age-life method. If the estimated fair values are less than the carrying values of the assets, the Company records an impairment charge equal to the difference, if any, between the assets’ fair values and carrying values.

Insurance reserves — Workers’ compensation, general liability and employee medical insurance programs are predominately self-insured. It is the Company’s policy to record a self-insurance liability using estimates of claims incurred but not yet reported or paid, based on historical claims experience and actuarial methods. Actual results can vary from estimates for many reasons, including, among others, inflation rates, claim settlement patterns, litigation trends and legal interpretations. The Company monitors its claims experience in light of these factors and revises its estimates of insurance reserves accordingly. The level of insurance reserves may increase or decrease as a result of these changing circumstances or trends.

During the fourth quarter of fiscal year 2016 and 2015, the Company recorded an adjustment related to positive changes in its actuarial estimates for workers’ compensation and general liability reserves. The adjustments in the fourth quarter of fiscal 2016 and 2015 resulted in a quarter-over-quarter benefit of approximately \$1.7 million (\$1.1 million after tax) and \$1.1 million (\$0.7 million after tax), respectively, or \$0.07 and \$0.04 per diluted share, respectively. As of January 28, 2017, the Company’s net self-insurance reserve estimates were \$5.0 million compared to \$5.2 million as of January 30, 2016.

Customer loyalty program — The Company has established a loyalty program called the K Club, whereby members earn loyalty points in return for making purchases in the Company’s stores, including the e-Commerce store. Attaining specified loyalty point levels results in the issuance of discount certificates to the customer. The Company accrues for the expected liability associated with the discount certificates issued, as well as the accumulated points that have not yet resulted in the issuance of a certificate, adjusted for expected redemption rates. This liability is included as a component of accrued expenses on the consolidated balance sheet and the changes to the liability are included within cost of sales on the consolidated statements of income.

The Company has also established a private-label credit card program for its customers. Customers in the private label credit card program who enroll in K Club are eligible to earn double the points of a regular loyalty program member. The card program is operated and managed by a third-party bank that assumes all credit risk with no recourse to the Company.

Deferred rent — Many of the Company’s operating leases contain predetermined fixed escalations of minimum rentals during the initial term. Additionally, the Company does not typically pay rent during the construction period for new stores. For these leases, the Company recognizes the related rental expense on a straight-line basis over the life of the lease commencing with the date of initial access to the leased space, and records the difference between amounts charged to operations and amounts paid as a liability. As of January 28, 2017, the cumulative net excess of recorded rent expense over lease payments totaled \$14.8 million, of which \$1.6 million was reflected as a current liability in accrued expenses and \$13.2 million was reflected as a noncurrent liability in deferred rent on the consolidated balance sheet. As of January 30, 2016, the cumulative net excess of recorded rent expense over lease payments totaled

\$13.0 million, of which \$1.2 million was reflected as a current liability in accrued expenses and \$11.8 million was reflected as a noncurrent liability in deferred rent on the consolidated balance sheet.

The Company also receives incentives from landlords in the form of construction allowances. These construction allowances are recorded as deferred rent and amortized as a reduction to rent expense over the lease term. As of January 28, 2017, the unamortized amount of construction allowances totaled \$47.1 million, of which \$7.6 million was reflected as a current liability in accrued expenses and \$39.5 million was reflected as a noncurrent liability in deferred rent on the consolidated balance sheet. As of January 30, 2016, the unamortized amount of construction allowances totaled \$43.4 million, of which \$6.9 million was reflected as a current liability in accrued expenses and \$36.5 million was reflected as a noncurrent liability in deferred rent on the consolidated balance sheet.

Revenue recognition — The Company recognizes revenue at the time of sale of merchandise to customers in its stores. e-Commerce revenue is recorded when orders are shipped and title passes to customers. Net sales include the sale of merchandise, net of returns and exclusive of sales taxes.

Gift card sales are recognized as revenue when tendered for payment. While the Company honors all gift cards presented for payment, the Company determines the likelihood of redemption to be remote for certain gift card balances due to long periods of inactivity. The Company uses the redemption recognition method to account for breakage for unused gift card amounts where breakage is recognized as gift cards are redeemed for the purchase of goods based upon a historical breakage rate. In these circumstances, to the extent the Company determines there is no requirement for remitting card balances to government agencies under unclaimed property laws, such amounts are recognized in the consolidated statement of income as breakage revenue. The Company recognized approximately \$1.1 million, \$994,000 and \$853,000 in gift card breakage during fiscal 2016, fiscal 2015 and fiscal 2014, respectively.

Compensation and benefits — Compensation and benefits includes all store and corporate office salaries and wages and incentive pay as well as stock compensation, employee health benefits, 401(k) plan benefits, deferred compensation benefits, social security and unemployment taxes.

Stock-based compensation — Stock-based compensation includes expenses associated with stock option grants, restricted stock grants, and other transactions under the Company's stock plans. The Company recognizes compensation expense for its stock-based payments based on the fair value of the awards. The expense is recorded on a straight-line basis over the vesting period within compensation and benefits in the consolidated statements of income. See "Note 7 — Stock-Based Compensation" for further discussion.

Other operating expenses — Other operating expenses consist of such items as insurance, advertising, utilities, property taxes, supplies, travel, card processing and other bank fees, losses on disposal of assets and various other store and corporate expenses.

Store preopening expenses — Store preopening expenses, which consist primarily of payroll and occupancy costs, are expensed as incurred.

Advertising expenses — Advertising costs are expensed in the period in which the related activity first takes place. These expenses include costs associated with specific marketing campaigns, e-mail communications, paid search and other digital advertising, social media, public relations, in-store collateral and signage and other expenses related to the in-store experience. Total advertising expense was \$9.3 million, \$9.6 million and \$9.3 million for fiscal years 2016, 2015 and 2014, respectively.

Income taxes — Deferred tax assets and liabilities are recognized based on the differences between the financial statement and the tax law treatment of certain items. Realization of certain components of deferred tax assets is dependent upon the occurrence of future events. The Company records valuation allowances to reduce its deferred tax assets to the amount it believes is more likely than not to be realized. These valuation allowances can be impacted by changes in tax laws, changes to statutory tax rates, and future taxable income levels and are based on the Company's judgment, estimates and assumptions regarding those future events. In the event the Company were to determine that it would not be able to realize all or a portion of the net deferred tax assets in the future, the Company would increase the valuation allowance through a charge to income tax expense in the period that such determination is made. Conversely, if the Company were to determine that it would be able to realize its deferred tax assets in the future, in excess of the net carrying amounts, the Company would decrease the recorded valuation allowance through a decrease to income tax expense in the period that such determination is made.

The Company provides for uncertain tax positions and the related interest and penalties, if any, based upon management's assessment of whether a tax benefit is more likely than not to be sustained upon examination by tax authorities. The Company recognizes interest and penalties accrued related to unrecognized tax benefits in income tax expense. To the extent the Company prevails in matters for which a liability for an unrecognized tax benefit is established or is required to pay amounts in excess of the liability, the Company's effective tax rate in a given financial statement period may be affected.

The Company's income tax returns are subject to audit by local, state and federal authorities, and the Company is typically engaged in various tax examinations at any given time. Tax contingencies often arise due to uncertainty or differing interpretations of the application of tax rules throughout the various jurisdictions in which the Company operates. The contingencies are influenced by items such as tax audits, changes in tax laws, litigation, appeals and experience with previous similar tax positions. The Company regularly reviews its tax reserves for these items and assesses the adequacy of the amount recorded. The Company evaluates potential exposures associated with its various tax filings by estimating a liability for uncertain tax positions based on a two-step process. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step requires estimation and measurement of the tax benefit as the largest amount that is more than 50% likely to be recognized upon settlement.

Sales and use taxes — Governmental authorities assess sales and use taxes on the sale and purchase of goods and services. The Company excludes taxes collected from customers in its reported sales results. Such amounts are reflected as accrued expenses until remitted to the taxing authorities.

Concentrations of risk — Most of the Company's merchandise is purchased through vendors in the United States who import the merchandise manufactured primarily in China. However, the Company believes alternative merchandise sources could be procured over a relatively short period of time.

Fair value of financial instruments — The carrying amounts of cash and cash equivalents, accounts receivable, other current assets and accounts payable approximate fair value because of their short maturities.

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. 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 that were not included in the computation of diluted earnings per share, because to do so would have been antidilutive, were approximately 629,000 shares, 316,000 shares and 426,000 shares for fiscal 2016, 2015 and 2014, respectively.

Comprehensive income — Comprehensive income does not differ from the consolidated net income presented in the consolidated statements of income.

Operating segments — The Company has determined that each of its stores is an operating segment. The operating performance of all stores has been aggregated into one reportable segment. The Company's operating segments are aggregated for financial reporting purposes because they are similar in each of the following areas: economic characteristics, class of consumer, nature of products and distribution methods. Revenues from external customers are derived from merchandise sales, and the Company does not rely on any major customers as a source of revenue. Across its store base, the Company operates one store format under the Kirkland's name in which each store offers the same general mix of merchandise with similar categories and similar customers. The Company believes that disaggregating its operating segments would not provide meaningful additional information.

Recently Issued Accounting Pronouncements — In May 2014, the FASB issued Accounting Standards Update ("ASU") 2014-09, "Revenue from Contracts with Customers (Topic 606)" ("ASU 2014-09"). 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. Companies that transition to this new standard may either retrospectively restate each prior reporting period or reflect the cumulative effect of initially applying the updates with an adjustment to retained earnings at the date of adoption. The Company is still evaluating transition approaches as well as the impact the adoption of ASU 2014-09 will have on its consolidated financial statements.

In November 2015, the FASB issued ASU 2015-17, "Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes". This update requires that deferred tax liabilities and assets be classified as noncurrent in the consolidated balance sheet. ASU 2015-17 may be applied either prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented. The updated guidance is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years, with early adoption permitted. The Company adopted this guidance in the first quarter of fiscal 2016. The Company elected to apply this guidance retrospectively for all periods presented. The adoption of this guidance affected the presentation of the deferred tax liabilities and assets within the Company's consolidated balance sheet; however, the updated guidance did not affect the accounting for deferred tax liabilities and assets. Other than the change in presentation, the adoption of this guidance did not have any material impacts on the Company's consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842)”, which supersedes the existing guidance for lease accounting, Leases (Topic 840) (“ASU 2016-02”). ASU 2016-02 requires lessees to recognize a lease liability and a right-of-use asset for all leases. Lessor accounting remains largely unchanged. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. Early adoption is permitted for all entities. ASU 2016-02 requires a modified retrospective approach for all leases existing at, or entered into after the date of initial adoption, with an option to elect to use certain transition relief. The Company is currently evaluating the impact of this new standard on its consolidated financial statements and is anticipating a material impact on the Company’s consolidated financial statements because the Company is party to a significant number of lease contracts.

In March 2016, the FASB issued ASU 2016-09, “Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting” (“ASU 2016-09”). ASU 2016-09 addresses several aspects of the accounting for share-based compensation transactions including: (a) income tax consequences when awards vest or are settled, (b) classification of awards as either equity or liabilities, (c) a policy election to account for forfeitures as they occur rather than on an estimated basis and (d) classification of excess tax impacts on the statement of cash flows. The updated guidance is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years, with early adoption permitted. The Company will adopt this guidance in the first quarter of fiscal 2017. The amendments requiring recognition of excess tax benefits and tax deficiencies in the income statement will be applied prospectively. The inclusion of excess tax benefits and deficiencies as a component of our income tax expense will increase volatility within our provision for income taxes as the amount of excess tax benefits or deficiencies from share-based compensation awards are dependent on our stock price at the date the awards are exercised or settled. The Company does not expect the impact to be material to the consolidated results of operations; however, such determination is subject to change based on facts and circumstances at the time when awards vest or settle. The Company accounts for forfeitures of share-based awards when they occur. The Company will elect to apply the amendments related to the presentation of excess tax benefits on the statement of cash flows using a retrospective transition method, and as a result, excess tax benefits related to share-based awards which are currently classified as cash flows from financing activities will be reclassified as cash flows from operating activities.

Note 2 — Property and Equipment

Property and equipment is comprised of the following (in thousands):

	January 28, 2017	January 30, 2016
Equipment	\$ 72,265	\$ 65,579
Furniture and fixtures	78,492	70,908
Leasehold improvements	109,494	97,622
Projects in progress	5,520	5,911
	265,771	240,020
Less: Accumulated depreciation	(154,901)	(134,478)
	<u>\$ 110,870</u>	<u>\$ 105,542</u>

Note 3 — Accrued Expenses

Accrued expenses are comprised of the following (in thousands):

	January 28, 2017	January 30, 2016
Salaries and wages	\$ 2,516	\$ 2,084
Gift cards	9,547	8,360
Sales taxes	1,875	2,367
Deferred rent	9,274	8,117
Workers’ compensation and general liability reserves	2,225	946
Loyalty reward certificates	1,855	1,258
Other	2,978	2,811
	<u>\$ 30,270</u>	<u>\$ 25,943</u>

Note 4 — Income Taxes

The Company's income tax expense is computed based on the federal statutory rates and the state statutory rates, net of related federal benefit. Income tax expense consists of the following (in thousands):

	52 Weeks Ended January 28, 2017	52 Weeks Ended January 30, 2016	52 Weeks Ended January 31, 2015
Current			
Federal	\$ 7,325	\$ 8,120	\$ 9,299
State	845	761	1,668
Deferred			
Federal	(1,379)	601	93
State	(862)	42	(54)
	<u>\$ 5,929</u>	<u>\$ 9,524</u>	<u>\$ 11,006</u>

Income tax expense differs from the amount computed by applying the statutory federal income tax rate to pre-tax income. A reconciliation of income tax expense at the statutory federal income tax rate to the amount provided is as follows (in thousands):

	52 Weeks Ended January 28, 2017	52 Weeks Ended January 30, 2016	52 Weeks Ended January 31, 2015
Tax at federal statutory rate	\$ 5,941	\$ 9,134	\$ 10,087
State income taxes (net of federal benefit)	598	844	1,106
Tax credits	(255)	(506)	(207)
Other	(355)	52	20
Income tax expense	<u>\$ 5,929</u>	<u>\$ 9,524</u>	<u>\$ 11,006</u>

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets and liabilities are as follows (in thousands):

	January 28, 2017	January 30, 2016
Deferred tax assets:		
Accruals	\$ 3,208	\$ 3,383
Inventory valuation	898	754
State tax credit carryforwards	190	-
Deferred rent and other	11,667	10,045
Total deferred tax assets	<u>15,963</u>	<u>14,182</u>
Valuation allowance for deferred tax assets	(56)	-
Net deferred tax assets	15,907	14,182
Deferred tax liabilities:		
Depreciation	(14,421)	(14,887)
Prepaid assets	(767)	(637)
Total deferred tax liabilities	<u>(15,188)</u>	<u>(15,524)</u>
Net deferred tax assets (liabilities)	<u>\$ 719</u>	<u>\$ (1,342)</u>

As of January 28, 2017, the Company has state tax credit carryforwards of approximately \$190,000 expiring in years 2023 through 2028.

Future utilization of the deferred tax assets is evaluated by the Company and any valuation allowance is adjusted accordingly. At January 28, 2017, the Company recorded a \$56,000 valuation allowance related to state tax credit carryforwards. At January 30, 2016, there were no valuation allowances against the Company's deferred tax assets. Adjustments could be required in the future if the Company estimates that the amount of deferred tax assets to be realized is more or less than the net amount the Company has recorded.

The Company and one or more of its subsidiaries file income tax returns in the U.S. federal jurisdiction and various state and local jurisdictions. The Company is no longer subject to U.S. federal income tax examinations by authorities for years prior to 2013. With few exceptions, the Company is no longer subject to state and local income tax examinations for years prior to 2010. The Company is not currently engaged in any U.S. federal, state or local income tax examinations.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	52 Weeks Ended January 28, 2017	52 Weeks Ended January 30, 2016
	(In thousands)	
Balance at the beginning of the year	\$ 307	\$ 307
Additions based on tax positions related to the current year	-	-
Additions for tax positions of prior years	-	-
Reductions for tax positions of prior years	-	-
Reductions due to settlements	-	-
Reductions due to lapse of the statute of limitations	(163)	-
Balance at the end of the year	<u>\$ 144</u>	<u>\$ 307</u>

Included in the January 28, 2017 and January 30, 2016 balance is \$144,000 and \$307,000, respectively, of unrecognized tax benefits that, if recognized, would decrease the Company's effective tax rate. In fiscal 2017, it is reasonably possible that the Company's unrecognized tax benefits may be reduced by \$144,000 as a result of a lapse of the statute of limitations.

The Company accrues interest on unrecognized tax benefits as a component of income tax expense. Penalties, if incurred, would be recognized as a component of income tax expense. The Company had approximately \$122,000 and \$247,000 accrued for the payment of interest and penalties associated with unrecognized tax benefits at January 28, 2017 and January 30, 2016, respectively.

Note 5 — Senior Credit Facility

During the period of August 19, 2011 through February 26, 2016, the Company was party to an Amended and Restated Credit Agreement (the "2011 Credit Agreement") with Bank of America, N.A. as administrative agent and collateral agent, and the lenders named therein (the "Lenders"). The 2011 Credit Agreement included a senior secured revolving credit facility of \$50 million, a swingline availability of \$5 million and a maturity date of August 2016. Borrowings under the 2011 Credit Agreement bore interest at an annual rate equal to LIBOR plus a margin ranging from 175 to 225 basis points with no LIBOR floor, and the fee paid to the Lenders on the unused portion of the credit facility was 37.5 basis points per annum.

On February 26, 2016, the Company, entered into a Joinder and First Amendment to Amended and Restated Credit Agreement (the "2016 Credit Agreement"). The 2016 Credit Agreement increased the Company's senior secured revolving credit facility from \$50 million to \$75 million, increased the swingline availability from \$5 million to \$10 million and extended the maturity date from August 2016 to February 2021 along with adding a \$25 million incremental accordion feature. Borrowings under the 2016 Credit Agreement bear interest at an annual rate equal to LIBOR plus a margin ranging from 125 to 175 basis points with no LIBOR floor, and the fee paid to the Lenders on the unused portion of the credit facility is 25 basis points per annum.

Borrowings under the Credit Agreements are subject to certain 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 Agreements 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.

The Company subject to an Amended and Restated Security Agreement ("Securities Agreement") with its Lenders. Pursuant to the Security Agreement, the Company 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 the Company's assets to secure the payment and performance of the obligations under the Credit Agreements.

As of January 28, 2017, the Company was in compliance with the covenants in the 2016 Credit Agreement, and there were no outstanding borrowings under the credit facility, with approximately \$50.6 million available for borrowing.

Note 6 — Long-Term Leases

The Company leases retail store facilities, corporate office space, warehouse facilities and certain vehicles and equipment under operating leases with terms generally ranging up to 10 years and expiring at various dates through 2027. Most of the retail store lease agreements include renewal options and provide for minimum rentals. Some retail store lease agreements also contain contingent rentals based on sales performance in excess of specified minimums.

Rent expense under operating leases including cash rent, straight-line rent for lease escalations and construction allowance amortization is as follows (in thousands):

	52 Weeks Ended January 28, 2017	52 Weeks Ended January 30, 2016	52 Weeks Ended January 31, 2015
Minimum rent	\$ 53,329	\$ 46,073	\$ 39,348
Contingent rent	2,019	2,509	3,199
	<u>\$ 55,348</u>	<u>\$ 48,582</u>	<u>\$ 42,547</u>

Future minimum lease payments under all operating leases with initial terms of one year or more consist of the following:

(In thousands)	
2017	\$ 60,243
2018	54,906
2019	52,063
2020	46,899
2021	38,102
Thereafter	89,663
Total minimum lease payments	<u>\$ 341,876</u>

Note 7 — Stock-Based Compensation

Stock-based compensation — Stock-based compensation includes stock option grants, restricted stock unit grants, and other transactions under the Company's equity plans. Total stock-based compensation expense (a component of compensation and benefits) was approximately \$3.2 million, \$3.8 million and \$2.8 million for fiscal years 2016, 2015 and 2014, respectively. Included in stock-based compensation expense for fiscal 2015 is approximately \$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.

On June 4, 2013, the Company adopted the Kirkland's, Inc. Amended and Restated 2002 Equity Incentive Plan (the "2002 Plan"), replacing the plan adopted in July 2002. The 2002 Plan provides for the award of restricted stock, restricted stock units ("RSUs"), incentive stock options, non-qualified stock options and stock appreciation rights with respect to shares of common stock to employees, directors, consultants and other individuals who perform services for the Company. The 2002 Plan is authorized to provide awards for up to a maximum of 3,500,000 shares of common stock.

As of January 28, 2017, options to purchase 1,191,568 shares of common stock were outstanding under the 2002 Plan at exercise prices ranging from \$1.11 to \$25.52 per share. As of January 28, 2017, there were 244,654 RSUs outstanding under the 2002 Plan with fair value grant prices ranging from \$13.38 to \$25.52 per share. Shares reserved for future stock-based grants under the 2002 Plan approximated 873,243 at January 28, 2017.

Stock options — The Company allows for the settlement of vested stock options on a net share basis ("net settled stock options"), instead of settlement with a cash payment ("cash settled stock options"), if so desired by the holder. With net settled stock options, the employee does not surrender any cash or shares upon exercise. Rather, the Company withholds the number of shares to cover the option exercise price and the minimum statutory tax withholding obligations from the shares that would otherwise be issued upon exercise. The settlement of vested stock options on a net share basis results in fewer shares issued by the Company. Options issued to employees under the 2002 Plan have maximum contractual terms of 10 years generally vest ratably over 3 or 4 years.

As of January 28, 2017, there were 609,194 outstanding in-the-money options. The aggregate intrinsic value of in-the-money options outstanding and options exercisable as of January 28, 2017 were each approximately \$2.2 million. The weighted average grant date fair values of options granted during fiscal 2016, fiscal 2015 and fiscal 2014 were \$6.48, \$12.06 and \$9.68, respectively. The intrinsic value of options exercised was \$0.3 million in fiscal 2016, \$6.1 million in fiscal 2015, and \$0.2 million in fiscal 2014. At

January 28, 2017, unrecognized stock compensation expense related to the unvested portion of outstanding stock options was approximately \$2.8 million, which is expected to be recognized over a weighted average period of 2.0 years.

Stock option activity for the year ended January 28, 2017 was as follows:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)
Balance at January 30, 2016	1,055,568	\$ 14.51	
Options granted	201,000	13.52	
Options exercised	(35,000)	4.93	
Options forfeited	(30,000)	19.12	
Balance at January 28, 2017	1,191,568	\$ 14.52	5.8
Options Exercisable As of:			
January 28, 2017	827,709	\$ 13.18	4.6

The fair value of each option is recorded as compensation expense on a straight-line basis over the applicable vesting period. The Company has estimated the fair value of all stock option awards as of the date of the grant by applying the Black-Scholes option pricing model. The application of this valuation model involves assumptions that are judgmental and highly subjective in the determination of compensation expense. The weighted averages for key assumptions used in determining the fair value of options granted in fiscal years 2016, 2015 and 2014 and a summary of the methodology applied to develop each assumption are as follows:

	52 Weeks Ended January 28, 2017	52 Weeks Ended January 30, 2016	52 Weeks Ended January 31, 2015
Expected price volatility	48%	47%	53%
Risk-free interest rate	1.68%	1.80%	2.10%
Expected life	6.3 years	6.3 years	6.3 years
Forfeiture rate	5%	5%	5%
Dividend yield	0%	0%	0%

Expected price volatility — The expected price volatility is a measure of the amount by which the stock price has fluctuated or is expected to fluctuate. The Company uses actual historical changes in the market value of its stock to calculate the volatility assumption as it is management’s belief that this is the best indicator of future volatility. The Company calculates daily market value changes using the historical volatility of returns for the six years prior to the grant. An increase in the expected volatility will increase compensation expense.

Risk-free interest rate — The risk-free interest rate is the U.S. Treasury rate for the week of the grant having a term equal to the expected life of the option. An increase in the risk-free interest rate will increase compensation expense.

Expected life — The expected life is the period of time over which the options granted are expected to remain outstanding. The Company uses the “simplified” method found in the Securities and Exchange Commission’s Staff Accounting Bulletin No. 107 to estimate the expected life of stock option grants. Options granted have a maximum term of ten years. An increase in the expected life will increase compensation expense.

Forfeiture rate — The forfeiture rate is the estimated percentage of options granted that are expected to be forfeited or canceled before becoming fully vested. This estimate is based on historical experience of similar grants. An increase in the forfeiture rate will decrease compensation expense. The Company’s forfeiture estimate has a minimal effect on expense as the majority of the Company’s stock option awards vest quarterly.

Dividend yield — The dividend yield is the estimated dividend yield for the weighted average expected life of the option granted. The Company paid a dividend on its common stock in fiscal 2015. In fiscal 2016 and fiscal 2014, the Company did not pay a dividend on its common stock. The addition or increase of a dividend will decrease compensation expense.

Restricted stock units — The Company periodically grants restricted stock units for a fixed number of shares to various employees and directors. The RSUs granted to directors become 100% vested on the first anniversary of the grant date. The RSUs granted to employees prior to fiscal 2016 vest in full on the third anniversary of the grant date, while fiscal 2016 RSU grants vest 25% on the first anniversary of the grant date then vest quarterly thereafter over 4 years. The fair values of the RSUs are equal to the closing price of the Company’s common stock on the date of the grant. The Company granted 132,500, 107,000 and 97,000 RSUs during fiscal 2016, 2015 and 2014, respectively. The weighted average grant date fair values of the RSUs granted during fiscal 2016,

2015 and 2014 were \$13.49, \$25.52 and \$18.46, respectively. Compensation expense related to RSUs is recognized ratably over the requisite service period. Compensation expense for RSUs during fiscal 2016, 2015 and 2014 was approximately \$1.7 million, \$2.0 million and \$1.3 million, respectively. As of January 28, 2017, there was approximately \$2.0 million of unrecognized compensation expense related to RSUs which is expected to be recognized over a weighted average period of 1.4 years.

RSU activity for the year ended January 28, 2017, was as follows:

	Shares	Weighted Average Grant Date Fair Value
Non-vested at January 30, 2016	225,885	\$ 20.89
Granted	132,500	13.49
Vested	(96,751)	19.01
Forfeited	(16,980)	17.47
Non-vested at January 28, 2017	244,654	\$ 19.25

Employee stock purchase plan — In July 2002, the Company adopted an Employee Stock Purchase Plan (“ESPP”) which was amended in 2006, 2008 and 2016. Under the ESPP, full-time employees who have completed twelve consecutive months of service are allowed to purchase shares of the Company’s common stock, subject to certain limitations, through payroll deduction, at 85% of the fair market value. The Company’s ESPP was originally authorized to issue up to 500,000 shares of common stock. In June 2016, the shareholders ratified the amendment to the Company’s ESPP to increase the number of shares of common stock authorized to be issued under the ESPP by 125,000 shares with an annual increase thereafter each January 1 commencing on January 1, 2017 by up to an additional 35,000 shares. During fiscal 2016, 2015 and 2014, there were 31,879, 19,423 and 19,062 shares of common stock, respectively, issued to participants under the ESPP. As of January 28, 2017, the amount authorized under the ESPP was 660,000 with approximately 141,290 shares remaining under the authorization.

Note 8 — Retirement Benefit Plans

401(k) savings plan — The Company maintains a defined contribution 401(k) employee benefit plan, which covers all employees meeting certain age and service requirements. Up to 6% of the employee’s compensation may be matched at the Company’s discretion, subject to statutory limitations. For all fiscal years presented, this discretionary percentage was 50% of an employee’s contribution subject to Plan maximums. The Company’s matching contributions were approximately \$531,000, \$521,000 and \$457,000 in fiscal 2016, 2015 and 2014, respectively. The Company has the option to make additional contributions to the Plan on behalf of covered employees; however, no such contributions were made in fiscal 2016, 2015, or 2014.

Deferred compensation plan — The Company maintains The Executive Non-Qualified Excess Plan (the “Deferred Compensation Plan”). The Deferred Compensation Plan is available for certain employees whose benefits under the 401(k) Savings Plan are limited due to provisions of the Internal Revenue Code. The Company’s matching contributions to this Plan were approximately \$48,000, \$63,000 and \$52,000 in fiscal years 2016, 2015 and 2014, respectively.

Note 9 — Commitments and Contingencies

Financial instruments that potentially subject the Company to concentration of risk are primarily cash and cash equivalents. The Company places its cash and cash equivalents in insured depository institutions and limits the amount of credit exposure to any one institution within the covenant restrictions imposed by the Company’s debt agreements.

The Company is involved in various routine legal proceedings incidental to the conduct of its business. The Company believes that any resulting liability from existing legal proceedings, individually or in the aggregate, will not have a material adverse effect on its operations or financial condition. Although the outcome of such proceedings and claims cannot be determined with certainty, we believe that it is unlikely that these proceedings and claims in excess of insurance coverage will have a material effect on our operations, financial condition or cash flows.

Note 10 — Related Party Transactions

In July 2009, the Company entered into a Vendor Agreement with a related party vendor to purchase merchandise inventory. The vendor is considered a related party because its principal owner is the spouse of the Company's Vice President of Merchandising. The table below sets forth selected results related to this vendor in dollars (in thousands) and percentages for the periods indicated:

	52 Weeks Ended January 28, 2017	52 Weeks Ended January 30, 2016	52 Weeks Ended January 31, 2015
Related Party Vendor			
Purchases	\$ 44,703	\$ 39,178	\$ 29,114
Purchases as a percent of total merchandise purchases	17.6%	14.8%	12.5%

Note 11 — Stock Repurchase Plan

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. The Company completed this \$30 million share repurchase plan during the year ended January 30, 2016 by repurchasing and retiring a total of 1,921,423 shares at a weighted average cost of \$15.61 per share. There were no stock repurchases in fiscal 2016.

Note 12 — Quarterly Financial Information (Unaudited)

Summarized quarterly financial results for fiscal 2016 and fiscal 2015 follow (in thousands, except per share amounts):

	Fiscal 2016 Quarter Ended			
	April 30, 2016	July 30, 2016	October 29, 2016	January 28, 2017
Total revenue	\$ 129,911	\$ 123,017	\$ 138,240	\$ 203,160
Gross profit	49,537	42,273	50,478	79,183
Operating income (loss)	1,524	(5,895)	(1,608)	22,978
Net income (loss)	916	(3,567)	(846)	14,543
Earnings (loss) per share:				
Basic	0.06	(0.22)	(0.05)	0.91
Diluted	0.06	(0.22)	(0.05)	0.90

	Fiscal 2015 Quarter Ended			
	May 2, 2015	August 1, 2015	October 31, 2015	January 30, 2016
Total revenue	\$ 118,310	\$ 115,289	\$ 129,238	\$ 198,970
Gross profit	47,663	42,512	48,101	80,518
Operating income (loss)	4,097	(3,702)	(932)	26,728
Net income (loss)	2,529	(2,288)	(270)	16,602
Earnings (loss) per share:				
Basic	0.15	(0.13)	(0.02)	0.99
Diluted	0.14	(0.13)	(0.02)	0.97

3. *Exhibits*: (see (b) below)

(b) *Exhibits*.

The following is a list of exhibits filed as part of this annual report on Form 10-K. For exhibits incorporated by reference, the location of the exhibit in the Company's previous filing is indicated in parentheses.

Exhibit Number	Description
3.1*	— Amended and Restated Charter of Kirkland's, Inc. (Exhibit 3.1 to our Quarterly Report on Form 10-Q for the quarter ended August 1, 2015)
3.2*	— Amended and Restated Bylaws of Kirkland's, Inc. (Exhibit 3.2 to our Current Report on Form 8-K dated March 31, 2006)
4.1*	— Form of Specimen Stock Certificate (Exhibit 4.1 to Amendment No. 1 to our registration statement on Form S-1 filed on June 5, 2002, Registration No. 333-86746 ("Amendment No. 1 to 2002 Form S-1"))
10.1*	— Amended and Restated Credit Agreement, dated as of August 19, 2011, by and among Kirkland's, Inc., the borrowers named therein, and Bank of America, N.A., as agent, and the lenders named therein (Exhibit 10.1 to our Current Report on Form 8-K dated August 24, 2011)
10.2*	— Amended and Restated Security Agreement, dated as of August 19, 2011, by and among Kirkland's, Inc., the other guarantors named therein and Bank of America, N.A., as agent, and the lenders named therein (Exhibit 10.2 to our Current Report on Form 8-K dated August 24, 2011)
10.3+*	— Amended and Restated 2002 Equity Incentive Plan (Exhibit 10.1 to our Quarterly Report on Form 10-Q for the quarter ended May 4, 2013)
10.4+*	— Form of Non-Qualified Stock Option Award Agreement for Director Grants (Exhibit 10.1 to our Quarterly Report on Form 10-Q for the quarter ended October 30, 2004 ("October 2004 Form 10-Q"))
10.5+*	— Form of Incentive Stock Option Agreement (Exhibit 10.2 to the October 2004 Form 10-Q)
10.6+*	— Executive Non-Qualified Excess Plan (Exhibit 10.19 to our Annual Report on Form 10-K for the year ended January 29, 2005)
10.7*	— First Amendment to Kirkland's, Inc. 2002 Equity Incentive Plan effective March 17, 2006 (Exhibit 99.2 to our Current Report on Form 8-K dated March 22, 2006 (the "March 22, 2006 Form 8-K"))
10.8*	— Office Lease Agreement dated April 17, 2015 by and between Kirkland's and Highwoods Realty, L.P. (Exhibit 10.1 to our Quarterly Report on Form 10-Q for the quarter ended May 3, 2014)
10.9*	— Distribution Center Lease Agreement dated March 6, 2015 by and between Kirkland's, Inc. and Hollingsworth Capital Partners – Tennessee, LLC (Exhibit 10.1 to our Quarterly Report on Form 10-Q for the quarter ended May 2, 2015)
10.10*	— Joinder and First Amendment to Amended and Restated Credit Agreement dated as of February 26, 2016, by and among Kirkland's Inc., the borrowers and guarantors named therein, Bank of America, N.A., as administrative agent, and the lenders named therein (Exhibit 10.1 to our Current Report on Form 8-K dated March 1, 2016)
10.11+*	— Employment Agreement, effective June 1, 2016, by and between W. Michael Madden and the Company (Exhibit 10.1 to the Company's Current Report on Form 8-K dated June 3, 2016)
10.12+*	— Employment Agreement, effective November 28, 2016, by and between Mike Cairnes and the Company (Exhibit 10.1 to the Company's Current Report on Form 8-K dated November 22, 2016)
10.13+	— 2002 Employee Stock Purchase Plan (as amended and restated, effective June 1, 2016)
21.1	— Subsidiaries of Kirkland's, Inc.
23.1	— Consent of Ernst & Young LLP
31.1	— Certification of the President and Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	— Certification of the Vice President and Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	— Certification of the President and Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	— Certification of the Vice President and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	— Interactive Data File (Annual Report on form 10-K, for the year ended January 28, 2017, furnished in XBRL (eXtensible Business Reporting Language))

* Incorporated by reference.

+ Management contract or compensatory plan or arrangement.

Item 16. Form 10-K Summary

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

KIRKLAND'S, INC.

By: /s/ W. MICHAEL MADDEN
W. Michael Madden
President and Chief Executive Officer

Date: March 31, 2017

Pursuant to the requirements of the Securities and Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant in the capacities and on the dates indicated.

Signature	Title	Date
/s/ W. MICHAEL MADDEN W. Michael Madden	President and Chief Executive Officer, and Director (Principal Executive Officer)	March 31, 2017
/s/ ADAM C. HOLLAND Adam C. Holland	Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	March 31, 2017
/s/ CARL KIRKLAND Carl Kirkland	Director	March 31, 2017
/s/ STEVEN J. COLLINS Steven J. Collins	Director	March 31, 2017
/s/ MILES T. KIRKLAND Miles T. Kirkland	Director	March 31, 2017
/s/ SUSAN S. LANIGAN Susan S. Lanigan	Director	March 31, 2017
/s/ R. WILSON ORR, III R. Wilson Orr, III	Director	March 31, 2017
/s/ JEFFERY C. OWEN Jeffery C. Owen	Director	March 31, 2017
/s/ CHARLIE PLEAS, III Charlie Pleas, III	Director	March 31, 2017

KIRKLAND'S, INC.
INDEX OF EXHIBITS FILED WITH THIS ANNUAL REPORT ON 10-K

Exhibit Number	Description
10.13	2002 Employee Stock Purchase Plan (as amended and restated, effective June 1, 2016)
21.1	Subsidiaries of Kirkland's, Inc.
23.1	Consent of Ernst & Young LLP
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 (Annual Report on Form 10-K, for the year ended January 28, 2017, furnished in XBRL (eXtensible Business Reporting Language))

Directors and Officers

DIRECTORS

R. WILSON ORR, III

Chairman of the Board of Directors
Managing Partner, SSM Partners

CARL T. KIRKLAND

Retired Co-Founder
Kirkland's, Inc.

STEVEN J. COLLINS

Managing Director
Advent International

SUSAN S. LANIGAN

Executive Vice President and
General Counsel
Chico's FAS, Inc.

MILES T. KIRKLAND, CFA

Senior Vice President and
Portfolio Manager
Truxton Trust

W. MICHAEL MADDEN

President and Chief Executive Officer
Kirkland's, Inc.

JEFFERY C. OWEN

Executive Vice President of Store Operations
Dollar General Corporation

CHARLIE PLEAS, III

Senior Vice President and Contoller
AutoZone, Inc.

OFFICERS

W. MICHAEL MADDEN

President and Chief Executive Officer

MIKE CAIRNES

Executive Vice President and
Chief Operating Officer

MICHELLE R. GRAUL

Executive Vice President of Stores

KARLA Q. CALDERON

Vice President of Merchandising

ADAM C. HOLLAND

Vice President and Chief Financial Officer

SARAH E. HUSSEY

Vice President of Planning and Allocation

GARY F. JORDAN

Vice President of Logistics

KATHY W. KRAHN

Vice President of Store Operations

KAREN MILLER

Vice President of Merchandising

ANTHONY PRICE

Vice President of Marketing

GARA A. PRYOR

Vice President of Human Resources

CARTER R. TODD

Vice President, General Counsel and
Corporate Secretary

Corporate Data

CORPORATE HEADQUARTERS

Kirkland's, Inc.
5310 Maryland Way
Brentwood, Tennessee 37027
615.872.4800
www.kirklands.com

TRANSFER AGENT AND REGISTRAR

Broadridge Corporate Issuer Solutions
1717 Arch Street
Suite 1300
Philadelphia, PA 19103
877.830.4936
Shareholders seeking information concerning
stock transfers, change of address, and lost
certificates should contact Broadridge Corporate
Issuer Solutions directly.

INDEPENDENT AUDITORS

Ernst & Young LLP
Nashville, Tennessee

ANNUAL REPORT ON FORM 10-K

A copy of the Company's fiscal 2016 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 9:00 a.m. Central Daylight Time on
June 2, 2017, at Kirkland's Headquarters, 5310
Maryland Way, Brentwood, Tennessee.

FORWARD-LOOKING STATEMENTS

Except for historical information contained
herein, the statements made herein 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 March 31, 2017. 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 Global Market under the
symbol KIRK. On March 31, 2017, there were
46 holders of record and 3,262 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:

Fiscal 2016:	High	Low
First Quarter	\$ 17.51	\$ 11.57
Second Quarter	\$ 16.41	\$ 13.02
Third Quarter	\$ 15.51	\$ 11.90
Fourth Quarter	\$ 17.22	\$ 11.66

Fiscal 2015:	High	Low
First Quarter	\$ 26.49	\$ 22.47
Second Quarter	\$ 28.72	\$ 23.97
Third Quarter	\$ 27.97	\$ 21.03
Fourth Quarter	\$ 24.11	\$ 11.39

KIRKLAND'S®

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