WILLIAMS SONOMA INC
Form 10-Q
December 07, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended October 30, 2016.

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ________ to ________

Commission File Number: 001-14077

WILLIAMS-SONOMA, INC.

(Exact name of registrant as specified in its charter)

Delaware	**94-2203880**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
3250 Van Ness Avenue, San Francisco, CA	**94109**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (415) 421-7900

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	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 Exchange Act). Yes ¨ No x

As of November 27, 2016, 87,845,738 shares of the registrant s Common Stock were outstanding.

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WILLIAMS-SONOMA, INC.

REPORT ON FORM 10-Q

FOR THE QUARTER ENDED OCTOBER 30, 2016

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PART I. FINANCIAL INFORMATION

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ITEM 1. FINANCIAL STATEMENTS

WILLIAMS-SONOMA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited)

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	October 30,	November 1,	October 30,	November 1,
In thousands, except per share amounts	2016	2015	2016	2015
E-commerce net revenues	$ 648,743	$ 628,191	$ 1,824,660	$ 1,730,677
Retail net revenues	596,642	603,891	1,677,571	1,659,109
Net revenues	1,245,385	1,232,082	3,502,231	3,389,786
Cost of goods sold	787,162	780,894	2,240,952	2,153,132
Gross profit	458,223	451,188	1,261,279	1,236,654
Selling, general and administrative expenses	348,244	340,505	1,004,499	970,700
Operating income	109,979	110,683	256,780	265,954
Interest (income) expense, net	488	342	587	625
Earnings before income taxes	109,491	110,341	256,193	265,329
Income taxes	40,113	39,859	95,433	96,389
Net earnings	$ 69,378	$ 70,482	$ 160,760	$ 168,940
Basic earnings per share	$ 0.78	$ 0.78	$ 1.81	$ 1.85
Diluted earnings per share	$ 0.78	$ 0.77	$ 1.79	$ 1.82
Shares used in calculation of earnings per share:				
Basic	88,382	90,437	88,906	91,129
Diluted	89,144	91,801	89,764	92,576

See Notes to Condensed Consolidated Financial Statements.

WILLIAMS-SONOMA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Thirteen Weeks Ended		Thirty-nine Weeks Ended	
	October 30,	November 1,	October 30,	November 1,
In thousands	2016	2015	2016	2015
Net earnings	$ 69,378	$ 70,482	$ 160,760	$ 168,940
Other comprehensive income (loss):				
Foreign currency translation adjustments	(1,731)	(1,370)	472	(4,197)
Change in fair value of derivative financial instruments, net of tax	520	118	(587)	539

Reclassification adjustment for realized loss (gain) on derivative financial instruments, net of tax	299	(250)	(41)	(922)
Comprehensive income	$ 68,466	$ 68,980	$ 160,604	$ 164,360

See Notes to Condensed Consolidated Financial Statements.

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WILLIAMS-SONOMA, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

In thousands, except per share amounts	October 30, 2016	January 31, 2016	November 1, 2015
ASSETS			
Current assets			
Cash and cash equivalents	$ 75,381	$ 193,647	$ 72,264
Accounts receivable, net	96,386	79,304	88,535
Merchandise inventories, net	1,063,747	978,138	1,102,349
Prepaid catalog expenses	25,329	28,919	35,762
Prepaid expenses	74,195	44,654	59,276
Deferred income taxes, net			130,684
Other assets	12,176	11,438	12,966
Total current assets	1,347,214	1,336,100	1,501,836
Property and equipment, net	918,020	886,813	883,459
Non-current deferred income taxes, net	136,558	141,784	2,560
Other assets, net	51,540	52,730	47,821
Total assets	$ 2,453,332	$ 2,417,427	$ 2,435,676
LIABILITIES AND STOCKHOLDERS EQUITY			
Current liabilities			
Accounts payable	$ 450,144	$ 447,412	$ 395,033
Accrued salaries, benefits and other	111,445	127,122	115,720
Customer deposits	289,737	296,827	293,317
Borrowings under revolving line of credit	125,000		200,000
Income taxes payable	1,122	67,052	35,317
Other liabilities	53,423	58,014	55,152
Total current liabilities	1,030,871	996,427	1,094,539
Deferred rent and lease incentives	192,948	173,061	174,059
Other long-term obligations	70,031	49,713	50,545
Total liabilities	1,293,850	1,219,201	1,319,143
Commitments and contingencies			
Stockholders equity			
Preferred stock: $.01 par value; 7,500 shares authorized; none issued			
Common stock: $.01 par value; 253,125 shares authorized; 88,014, 89,563 and 90,010 shares issued and outstanding at October 30, 2016, January 31, 2016 and November 1, 2015, respectively	881	896	901
Additional paid-in capital	547,513	541,307	538,737
Retained earnings	623,243	668,545	585,928
Accumulated other comprehensive loss	(10,772)	(10,616)	(7,127)
	(1,383)	(1,906)	(1,906)

Treasury stock, at cost: 20, 29 and 29 shares as of October 30, 2016, January 31, 2016 and November 1, 2015, respectively			
Total stockholders equity	1,159,482	1,198,226	1,116,533
Total liabilities and stockholders equity	$ 2,453,332	$ 2,417,427	$ 2,435,676

See Notes to Condensed Consolidated Financial Statements.

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WILLIAMS-SONOMA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Thirty-nine Weeks Ended	
	October 30,	November 1,
In thousands	2016	2015
Cash flows from operating activities:		
Net earnings	$ 160,760	$ 168,940
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Depreciation and amortization	127,745	125,093
Loss on disposal/impairment of assets	1,852	3,558
Amortization of deferred lease incentives	(18,789)	(18,326)
Deferred income taxes	(14,461)	(13,526)
Tax benefit related to stock-based awards	23,571	29,603
Excess tax benefit related to stock-based awards	(4,817)	(14,283)
Stock-based compensation expense	37,975	36,182
Other	(647)	91
Changes in:		
Accounts receivable	(17,400)	(21,875)
Merchandise inventories	(82,410)	(216,294)
Prepaid catalog expenses	3,591	(1,820)
Prepaid expenses and other assets	(29,205)	(20,909)
Accounts payable	(17,403)	(10,179)
Accrued salaries, benefits and other current and long-term liabilities	(507)	(13,494)
Customer deposits	(7,445)	32,016
Deferred rent and lease incentives	25,969	25,561
Income taxes payable	(65,915)	2,707
Net cash provided by operating activities	122,464	93,045
Cash flows from investing activities:		
Purchases of property and equipment	(127,169)	(136,069)
Other	370	535
Net cash used in investing activities	(126,799)	(135,534)
Cash flows from financing activities:		
Borrowings under revolving line of credit	125,000	200,000
Repurchase of common stock	(115,167)	(196,497)
Payment of dividends	(100,854)	(96,020)
Tax withholdings related to stock-based awards	(26,518)	(31,019)
Excess tax benefit related to stock-based awards	4,817	14,283
Proceeds related to stock-based awards	1,532	2,647
Repayment of long-term obligations		(1,968)
Other	(48)	

Net cash used in financing activities		(111,238)		(108,574)
Effect of exchange rates on cash and cash equivalents		(2,693)		400
Net decrease in cash and cash equivalents		(118,266)		(150,663)
Cash and cash equivalents at beginning of period		193,647		222,927
Cash and cash equivalents at end of period	$	75,381	$	72,264

See Notes to Condensed Consolidated Financial Statements.

WILLIAMS-SONOMA, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE A. FINANCIAL STATEMENTS - BASIS OF PRESENTATION

These financial statements include Williams-Sonoma, Inc. and its wholly owned subsidiaries (we, us or our). The Condensed Consolidated Balance Sheets as of October 30, 2016 and November 1, 2015, the Condensed Consolidated Statements of Earnings, the Condensed Consolidated Statements of Comprehensive Income for the thirteen and thirty-nine weeks then ended, and the Condensed Consolidated Statements of Cash Flows for the thirty-nine weeks then ended, have been prepared by us, without audit. In our opinion, the financial statements include all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position at the balance sheet dates and the results of operations for the thirteen and thirty-nine weeks then ended. Intercompany transactions and accounts have been eliminated. The balance sheet as of January 31, 2016, presented herein, has been derived from our audited Consolidated Balance Sheet included in our Annual Report on Form 10-K for the fiscal year ended January 31, 2016.

The results of operations for the thirteen and thirty-nine weeks ended October 30, 2016 are not necessarily indicative of the operating results of the full year.

Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) have been omitted. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended January 31, 2016.

In November 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2015-17, *Balance Sheet Classification of Deferred Taxes*, which requires entities to present both deferred tax assets and deferred tax liabilities as noncurrent in a classified balance sheet. We early adopted this ASU prospectively as of January 31, 2016, and have presented both deferred tax assets and deferred tax liabilities as noncurrent in our Condensed Consolidated Balance Sheets as of January 31, 2016 and October 30, 2016. In accordance with the provisions of the ASU, the balance sheet as of November 1, 2015, presented herein, has not been retrospectively adjusted.

New Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, to clarify the principles of recognizing revenue and create common revenue recognition guidance between U.S. GAAP and International Financial Reporting Standards. In addition, in March 2016, the FASB issued ASU 2016-08, *Revenue from Contracts with Customers: Principal versus Agent Considerations*. The amendments are intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations. The FASB also issued ASU 2016-10, *Identifying Performance Obligations and Licensing* in April 2016, which amends certain aspects of ASU 2014-09 for identifying performance obligations and the implementation guidance on licensing. These ASUs are effective retrospectively for fiscal years and interim periods within those years beginning after December 15, 2017. We are currently assessing the potential impact of these ASUs on our Condensed Consolidated Financial Statements.

In January 2016, the FASB issued ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*, which revises an entity s accounting related to the classification and measurement of investments in equity securities and the presentation of certain fair value changes for financial liabilities measured at fair value. This ASU is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2017. We are currently assessing the potential impact of this ASU on our Condensed Consolidated Financial Statements.

In February 2016, the FASB issued ASU 2016-02, *Leases*, which will require lessees to recognize a right-of-use asset and a lease liability for virtually all of their leases (other than short-term leases). This ASU is effective for fiscal years and interim periods within those years beginning after December 15, 2018. We are currently assessing the impact of this ASU on our Condensed Consolidated Financial Statements, but expect that it will result in a significant increase in our long-term assets and liabilities.

In March 2016, the FASB issued ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting*, which simplifies the accounting for share-based payment transactions (including the accounting for income taxes and forfeitures, among other areas). The ASU requires entities to, among other things, recognize all excess tax benefits and deficiencies in the income statement in the period in which they occur. This ASU is effective for fiscal years and interim periods within those years beginning after December 15, 2016. We are currently assessing the potential impact of this ASU on our Condensed Consolidated Financial Statements.

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NOTE B. BORROWING ARRANGEMENTS

Credit Facility

We have a $500,000,000 unsecured revolving line of credit (credit facility) that may be used to borrow revolving loans or request the issuance of letters of credit. We may, upon notice to the administrative agent, request existing or new lenders to increase the credit facility by up to $250,000,000, at such lenders option, to provide for a total of $750,000,000 of unsecured revolving credit. As of October 30, 2016, we were in compliance with the financial covenants under the credit facility and based on current projections, we expect to remain in compliance throughout the next twelve months. The credit facility matures on November 19, 2019, at which time all outstanding borrowings must be repaid and all outstanding letters of credit must be cash collateralized.

We may elect interest rates calculated at (i) Bank of America s prime rate (or, if greater, the average rate on overnight federal funds plus one-half of one percent, or a rate based on LIBOR plus one percent) plus a margin based on our leverage ratio or (ii) LIBOR plus a margin based on our leverage ratio. During the third quarter of fiscal 2016, we had no borrowings under the credit facility. For year-to-date 2016, we borrowed $125,000,000 (at a weighted average interest rate of 1.55%), all of which was outstanding as of October 30, 2016. During the third quarter of fiscal 2015, we borrowed $50,000,000 under the credit facility. For year-to-date 2015, we borrowed $200,000,000 (at a weighted average interest rate of 1.11%), all of which was outstanding as of November 1, 2015. Additionally, as of October 30, 2016, $12,289,000 issued but undrawn standby letters of credit was outstanding under the credit facility. The standby letters of credit were issued to secure the liabilities associated with workers compensation and other insurance programs.

Letter of Credit Facilities

We have three unsecured letter of credit reimbursement facilities for a total of $70,000,000, each of which matures on August 26, 2017. The letter of credit facilities contain covenants that are consistent with our unsecured revolving line of credit. Interest on unreimbursed amounts under the letter of credit facilities accrues at the lender s prime rate (or, if greater, the average rate on overnight federal funds plus one-half of one percent) plus 2.0%. As of October 30, 2016, an aggregate of $6,585,000 was outstanding under the letter of credit facilities, which represents only a future commitment to fund inventory purchases to which we had not taken legal title. The latest expiration possible for any future letters of credit issued under the facilities is January 23, 2018.

NOTE C. STOCK-BASED COMPENSATION

Equity Award Programs

Our Amended and Restated 2001 Long-Term Incentive Plan (the Plan) provides for grants of incentive stock options, nonqualified stock options, stock-settled stock appreciation rights (collectively, option awards), restricted stock awards, restricted stock units (including those that are performance-based), deferred stock awards (collectively, stock awards) and dividend equivalents up to an aggregate of 32,310,000 shares. As of October 30, 2016, there were approximately 7,421,000 shares available for future grant. Awards may be granted under the Plan to officers, employees and non-employee members of the board of directors of the company (the Board) or any parent or subsidiary. Shares issued as a result of award exercises or releases are primarily funded with the issuance of new shares.

Option Awards

Annual grants of option awards are limited to 1,000,000 shares on a per person basis and have a maximum term of seven years. The exercise price of these option awards is not less than 100% of the closing price of our stock on the day prior to the grant date. Option awards granted to employees generally vest evenly over a period of four years for service-based awards. Certain option awards contain vesting acceleration clauses resulting from events including, but not limited to, retirement, merger or a similar corporate event.

Stock Awards

Annual grants of stock awards are limited to 1,000,000 shares on a per person basis. Stock awards granted to employees generally vest evenly over a period of four years for service-based awards. Certain performance-based awards, which have variable payout conditions based on predetermined financial targets, v