

WILLIAMS SONOMA INC
Form 10-Q
June 08, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended April 29, 2018.

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 (State or other jurisdiction of incorporation or organization)	94-2203880 (I.R.S. Employer Identification No.)
3250 Van Ness Avenue, San Francisco, CA (Address of principal executive offices)	94109 (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 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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company and emerging growth company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company
Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of May 27, 2018, 83,104,613 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 APRIL 29, 2018**

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(Unaudited)

	Thirteen Weeks Ended	
	April 29,	April 30,
	2018	2017
<i>In thousands, except per share amounts</i>		
E-commerce net revenues	\$ 646,180	\$ 580,510
Retail net revenues	556,820	530,997
Net revenues	1,203,000	1,111,507
Cost of goods sold	770,836	715,747
Gross profit	432,164	395,760
Selling, general and administrative expenses	365,614	333,286
Operating income	66,550	62,474
Interest (income) expense, net	1,201	(103)
Earnings before income taxes	65,349	62,577
Income taxes	20,181	23,022
Net earnings	\$ 45,168	\$ 39,555
Basic earnings per share	\$ 0.54	\$ 0.45
Diluted earnings per share	\$ 0.54	\$ 0.45
Shares used in calculation of earnings per share:		
Basic	83,392	86,962
Diluted	84,174	87,710

*See Notes to Condensed Consolidated Financial Statements.***WILLIAMS-SONOMA, INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(Unaudited)

	Thirteen Weeks Ended	
	April 29,	April 30,
	2018	2017
<i>In thousands</i>		
Net earnings	\$ 45,168	\$ 39,555
Other comprehensive income (loss):		
Foreign currency translation adjustments	(1,145)	(1,566)
	1,123	655

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Change in fair value of derivative financial instruments, net of tax (tax benefit) of \$68 and \$237

Reclassification adjustment for realized (gain) loss on derivative financial instruments, net of tax (tax benefit) of \$(3) and \$5	49	(16)
Comprehensive income	\$ 45,195	\$ 38,628

See Notes to Condensed Consolidated Financial Statements.

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(Unaudited)

	April 29, 2018	January 28, 2018	April 30, 2017
<i>In thousands, except per share amounts</i>			
ASSETS			
Current assets			
Cash and cash equivalents	\$ 290,244	\$ 390,136	\$ 93,975
Accounts receivable, net	102,630	90,119	63,982
Merchandise inventories, net	1,052,892	1,061,593	1,037,107
Prepaid catalog expenses		20,517	20,341
Prepaid expenses	56,333	62,204	64,739
Other current assets	21,118	11,876	10,901
Total current assets	1,523,217	1,636,445	1,291,045
Property and equipment, net	926,320	932,283	920,531
Deferred income taxes, net	58,842	67,306	124,977
Other long-term assets, net	148,526	149,715	54,624
Total assets	\$ 2,656,905	\$ 2,785,749	\$ 2,391,177
LIABILITIES AND STOCKHOLDERS EQUITY			
Current liabilities			
Accounts payable	\$ 393,025	\$ 457,144	\$ 397,442
Accrued expenses	99,823	134,207	87,184
Gift card and other deferred revenue	256,534	300,607	298,113
Borrowings under revolving line of credit			45,000
Income taxes payable	72,036	56,783	37,792
Other current liabilities	61,403	59,082	47,134
Total current liabilities	882,821	1,007,823	912,665
Deferred rent and lease incentives	204,599	202,134	195,201
Long-term debt	299,472	299,422	
Other long-term liabilities	72,779	72,804	73,160
Total liabilities	1,459,671	1,582,183	1,181,026
Commitments and contingencies	See Note F		
Stockholders equity			
Preferred stock: \$.01 par value; 7,500 shares authorized; none issued			
Common stock: \$.01 par value; 253,125 shares authorized; 83,222, 83,726 and 86,883 shares issued and outstanding at April 29, 2018, January 28, 2018 and April 30, 2017, respectively	833	837	869
Additional paid-in capital	564,685	562,814	549,281
Retained earnings	638,774	647,422	671,758
Accumulated other comprehensive loss	(6,755)	(6,782)	(10,830)
Treasury stock, at cost: 3, 11 and 13 shares as of April 29, 2018, January 28, 2018 and April 30, 2017, respectively	(303)	(725)	(927)

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Total stockholders' equity	1,197,234	1,203,566	1,210,151
Total liabilities and stockholders' equity	\$ 2,656,905	\$ 2,785,749	\$ 2,391,177

See Notes to Condensed Consolidated Financial Statements.

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WILLIAMS-SONOMA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

<i>In thousands</i>	Thirteen Weeks Ended	
	April 29, 2018	April 30, 2017
Cash flows from operating activities:		
Net earnings	\$ 45,168	\$ 39,555
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Depreciation and amortization	47,873	44,950
Loss on disposal/impairment of assets	414	519
Amortization of deferred lease incentives	(6,724)	(6,477)
Deferred income taxes	(3,241)	(3,848)
Tax benefit related to stock-based awards	6,126	13,742
Stock-based compensation expense	12,889	9,817
Other	64	(76)
Changes in:		
Accounts receivable	(9,556)	24,610
Merchandise inventories	2,388	(60,246)
Prepaid catalog expenses		(844)
Prepaid expenses and other assets	(4,399)	(11,069)
Accounts payable	(76,823)	(65,483)
Accrued expenses and other liabilities	(32,047)	(47,248)
Gift card and other deferred revenue	4,815	(4,648)
Deferred rent and lease incentives	10,004	5,806
Income taxes payable	13,818	14,564
Net cash provided by (used in) operating activities	10,769	(46,376)
Cash flows from investing activities:		
Purchases of property and equipment	(34,029)	(32,153)
Other	120	5
Net cash used in investing activities	(33,909)	(32,148)
Cash flows from financing activities:		
Repurchases of common stock	(37,713)	(38,350)
Payment of dividends	(34,081)	(34,189)
Tax withholdings related to stock-based awards	(7,438)	(13,780)
Borrowings under revolving line of credit		45,000
Net cash used in financing activities	(79,232)	(41,319)
Effect of exchange rates on cash and cash equivalents	2,480	105
Net decrease in cash and cash equivalents	(99,892)	(119,738)
Cash and cash equivalents at beginning of period	390,136	213,713
Cash and cash equivalents at end of period	\$ 290,244	\$ 93,975

See Notes to Condensed Consolidated Financial Statements.

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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 April 29, 2018 and April 30, 2017, the Condensed Consolidated Statements of Earnings, the Condensed Consolidated Statements of Comprehensive Income, and the Condensed Consolidated Statements of Cash Flows for the thirteen 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 weeks then ended. Intercompany transactions and accounts have been eliminated. The balance sheet as of January 28, 2018, 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 28, 2018.

The results of operations for the thirteen weeks ended April 29, 2018 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 28, 2018.

Reclassifications

Certain amounts reported in our Condensed Consolidated Balance Sheets as of January 28, 2018 and April 30, 2017 and our Condensed Consolidated Statement of Cash Flows for the thirteen weeks ended April 30, 2017 have been reclassified in order to conform to the current period presentation. These reclassifications impacted prepaid catalog expenses, prepaid expenses, accounts payable, accrued expenses, gift card and other deferred revenue and other current liabilities. There was no change to total current assets, total current liabilities, or net cash used in operating activities as a result of these reclassifications.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update (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. We adopted the ASU on a modified retrospective basis in the first quarter of fiscal 2018 and applied the guidance therein to all applicable contracts that were not complete as of the date of application. As a result, we recorded an increase to opening retained earnings as of January 29, 2018 of approximately \$17,862,000, net of tax, for the cumulative effect adjustments of adopting the ASU. These adjustments primarily related to the acceleration in the timing of recognizing breakage income related to our unredeemed stored-value cards, the acceleration in the timing of revenue recognition for certain merchandise shipped to our customers, and prepaid catalog advertising costs, which were capitalized and amortized over their expected period of future benefit prior to adoption, and are now expensed as incurred. Prior period balances were not retrospectively adjusted as a result of adopting the ASU. See Note L for further discussion related to the

impact of the adoption of the ASU 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 adopted this ASU in the first quarter of fiscal 2018. The adoption did not have an impact on our financial condition, results of operations or cash flows.

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 us beginning in the first quarter of fiscal 2019. We are currently assessing the impact of this ASU on our Consolidated Financial Statements, but expect that it will result in a substantial increase in our long-term assets and liabilities, however, we do not expect it to materially impact our Consolidated Statement of Earnings.

In October 2016, the FASB issued ASU 2016-16, *Intra-Entity Transfers of Assets Other than Inventory*. The amendments remove the prohibition against the recognition of current and deferred income tax effects of intra-entity transfers of assets other than inventory until the asset has been sold to an outside party. We adopted this ASU in the first quarter of fiscal 2018. The adoption did not have a material impact on our financial condition, results of operations or cash flows.

In August 2017, the FASB issued ASU 2017-12, *Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities (Topic 815)*, which expands and refines hedge accounting for both non-financial and financial risk components and aligns the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. The guidance

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also makes certain targeted improvements to simplify the application of hedge accounting guidance and ease the administrative burden of hedge documentation requirements and assessing hedge effectiveness. This ASU is effective for us in the first quarter of fiscal 2019 and early adoption is permitted. Entities should apply the guidance to existing cash flow and net investment hedge relationships using a modified retrospective approach with a cumulative effect adjustment recorded to opening retained earnings on the date of adoption. The guidance also provides transition relief to make it easier for entities to apply certain amendments to existing hedges where the hedge documentation needs to be modified. We do not expect the adoption of this ASU to have a material impact on our financial condition, results of operations or cash flows.

In February 2018, the FASB issued ASU 2018-02, *Income Statement-Reporting Comprehensive Income (Topic 220)*, which allows a reclassification from accumulated other comprehensive income (loss) to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act of 2017. This ASU is effective for fiscal years and interim periods within those years beginning after December 15, 2018 and early adoption is permitted. We adopted this ASU in the first quarter of fiscal 2018. The adoption did not have an impact on our financial condition, results of operations or cash flows.

NOTE B. BORROWING ARRANGEMENTS*Credit Facility*

We have a credit facility which provides for a \$500,000,000 unsecured revolving line of credit (revolver) and a \$300,000,000 unsecured term loan facility (term loan). The revolver 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 revolver by up to \$250,000,000, at such lenders' option, to provide for a total of \$750,000,000 of unsecured revolving credit. The revolver matures on January 8, 2023, at which time all outstanding borrowings must be repaid and all outstanding letters of credit must be cash collateralized. We may, prior to the first and second anniversaries of the closing date of the amendment of the credit facility, elect to extend the maturity date for an additional year, subject to lender approval.

During the first quarter of fiscal 2018, we had no borrowings under the revolver. During the first quarter of fiscal 2017, we had borrowings of \$45,000,000 under the revolver (at a weighted average interest rate of 2.01%), all of which were outstanding as of April 30, 2017. Additionally, as of April 29, 2018, \$12,772,000 in 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.

As of April 29, 2018, we had \$300,000,000 outstanding under our term loan (at a weighted average interest rate of 2.85%). The term loan matures on January 8, 2021, at which time all outstanding principal and any accrued interest must be repaid.

The interest rates under the credit facility are variable, and may be elected by us as: (i) the London Interbank Offer Rate (LIBOR) plus an applicable margin based on our leverage ratio ranging from 0.91% to 1.775% for a revolver borrowing, and 1.0% to 2.0% for the term loan; or (ii) a base rate as defined in the credit facility plus an applicable margin ranging from 0% to 0.775% for a revolver borrowing, and 0% to 1% for the term loan.

As of April 29, 2018, we are in compliance with our financial covenants under the credit facility and, based on current projections, we expect to remain in compliance throughout the next 12 months.

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 25, 2018. The letter of credit facilities contain covenants that are consistent with our credit facility. Interest on unreimbursed amounts under the letter of credit facilities accrues at a base rate as defined in the credit facility plus an applicable margin based on our leverage ratio. As of April 29, 2018, an aggregate of \$5,900,000 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 22, 2019.

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 April 29, 2018, there were approximately 3,032,000 shares available for future grant. Subsequently, on May 30, 2018, our stockholders approved an amendment and restatement of the Plan to increase the number of shares issuable by 4,260,000 shares. Awards may be granted under the Plan to our 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.

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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 and have a maximum term of seven years. 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, vest three years from the date of grant. Certain stock awards and other agreements contain vesting acceleration clauses resulting from events including, but not limited to, retirement, merger or a similar corporate event. Stock awards granted to non-employee Board members generally vest in one year. Non-employee Board members automatically receive stock awards on the date of their initial election to the Board and annually thereafter on the date of the annual meeting of stockholders (so long as they continue to serve as a non-employee Board member).

Stock-Based Compensation Expense

During the thirteen weeks ended April 29, 2018 and April 30, 2017, we recognized total stock-based compensation expense, as a component of selling, general and administrative expenses, of \$12,889,000 and \$9,817,000, respectively.

Stock-Settled Stock Appreciation Rights

A stock-settled stock appreciation right is an award that allows the recipient to receive common stock equal to the appreciation in the fair market value of our common stock between the grant date and the conversion date for the number of shares converted.

The following table summarizes our stock-settled stock appreciation right activity during the thirteen weeks ended April 29, 2018:

	Shares
Balance at January 28, 2018 (100% vested)	167,737
Granted	
Converted into common stock	(125,787)
Cancelled	(1,290)
Balance at April 29, 2018 (100% vested)	40,660

Restricted Stock Units

The following table summarizes our restricted stock unit activity during the thirteen weeks ended April 29, 2018:

Shares

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Balance at January 28, 2018	2,358,137
Granted	1,306,744
Granted, with vesting subject to performance conditions	256,350
Released	(339,418)