KOHLS Corp
Form 10-Q
December 05, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)

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

For the quarterly period ended November 1, 2014

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 1-11084

KOHL'S CORPORATION
(Exact name of registrant as specified in its charter)

Wisconsin	39-1630919
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
N56 W17000 Ridgewood Drive, Menomonee Falls, Wisconsin	53051
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (262) 703-7000

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 ý 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 ý 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. (Check one):

Large accelerated filer	ý	Accelerated filer	¨
Non-accelerated filer	¨¬ (Do not check if a smaller reporting company)	Smaller reporting company	¨

Indicate by a check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: November 29, 2014 Common Stock, Par Value $0.01 per Share, 202,009,115 shares outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

KOHL'S CORPORATION
CONSOLIDATED BALANCE SHEETS
(In Millions)

Assets	November 1, 2014 (Unaudited)	February 1, 2014 (Audited)	November 2, 2013 (Unaudited)
Current assets:			
Cash and cash equivalents	$ 631	$ 971	$ 598
Merchandise inventories	4,973	3,874	4,959
Income taxes receivable	52	—	—
Deferred income taxes	125	142	147
Other	297	305	283
Total current assets	6,078	5,292	5,987
Property and equipment, net	8,671	8,745	8,925
Other assets	298	341	333
Total assets	$ 15,047	$ 14,378	$ 15,245
Liabilities and Shareholders' Equity			
Current liabilities:			
Accounts payable	$ 2,384	$ 1,365	$ 2,261
Accrued liabilities	1,162	1,138	1,198
Income taxes payable	—	94	41
Current portion of capital lease and financing obligations	109	139	141
Total current liabilities	3,655	2,736	3,641
Long-term debt	2,793	2,792	2,792
Capital lease and financing obligations	1,886	1,930	1,950
Deferred income taxes	336	382	390
Other long-term liabilities	572	560	548
Shareholders' equity:			
Common stock	4	4	4
Paid-in capital	2,719	2,598	2,557
Treasury stock, at cost	(8,615)	(8,052)	(7,802)
Accumulated other comprehensive loss	(21)	(34)	(39)
Retained earnings	11,718	11,462	11,204
Total shareholders' equity	5,805	5,978	5,924
Total liabilities and shareholders' equity	$ 15,047	$ 14,378	$ 15,245

See accompanying Notes to Consolidated Financial Statements

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KOHL'S CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
(In Millions, Except per Share Data)

	Three Months Ended		Nine Months Ended	
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013
Net sales	$4,374	$4,444	$12,686	$12,932
Cost of merchandise sold	2,746	2,778	7,908	8,063
Gross margin	1,628	1,666	4,778	4,869
Operating expenses:				
Selling, general and administrative	1,097	1,073	3,078	3,071
Depreciation and amortization	227	228	665	665
Operating income	304	365	1,035	1,133
Interest expense, net	85	84	255	251
Income before income taxes	219	281	780	882
Provision for income taxes	77	104	282	327
Net income	$142	$177	$498	$555
Net income per share:				
Basic	$0.70	$0.82	$2.44	$2.53
Diluted	$0.70	$0.81	$2.43	$2.51
Dividends declared and paid per share	$0.39	$0.35	$1.17	$1.05

See accompanying Notes to Consolidated Financial Statements

KOHL'S CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(In Millions)

	Three Months Ended		Nine Months Ended	
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013
Net income	$142	$ 177	$498	$ 555
Other comprehensive income, net of tax:				
Unrealized gains on investments	9	—	11	4
Reclassification adjustment for interest expense on interest rate derivative included in net income	1	1	2	2
Other comprehensive income	10	1	13	6
Comprehensive income	$152	$ 178	$511	$ 561

See accompanying Notes to Consolidated Financial Statements

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KOHL’S CORPORATION
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS’ EQUITY
(Unaudited)
(In Millions, Except per Share Data)

	Common Stock		Paid-In	Treasury Stock		Accumulated Other Comprehensive	Retained	
	Shares	Amount	Capital	Shares	Amount	Loss	Earnings	Total
Balance at February 1, 2014	364	$4	$2,598	(153)	$(8,052)	$(34)	$11,462	$5,978
Comprehensive income	—	—	—	—	—	13	498	511
Stock options and awards	3	—	121	(1)	(17)	—	—	104
Dividends paid ($1.17 per common share)	—	—	—	—	3	—	(242)	(239)
Treasury stock purchases	—	—	—	(10)	(549)	—	—	(549)
Balance at November 1, 2014	367	$4	$2,719	(164)	$(8,615)	$(21)	$11,718	$5,805

See accompanying Notes to Consolidated Financial Statements

KOHL'S CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In Millions)

	Nine Months Ended	
	November 1, 2014	November 2, 2013
Operating activities		
Net income	$498	$555
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	665	665
Share-based compensation	38	41
Excess tax benefits from share-based compensation	(2)	(3)
Deferred income taxes	(37)	(1)
Other non-cash revenues and expenses	19	30
Changes in operating assets and liabilities:		
Merchandise inventories	(1,093)	(1,204)
Other current and long-term assets	(1)	11
Accounts payable	1,019	954
Accrued and other long-term liabilities	(1)	79
Income taxes	(175)	(113)
Net cash provided by operating activities	930	1,014
Investing activities		
Acquisition of property and equipment	(561)	(465)
Sales of investments in auction rate securities	59	1
Other	6	13
Net cash used in investing activities	(496)	(451)
Financing activities		
Treasury stock purchases	(549)	(549)
Shares withheld for taxes on vested restricted shares	(17)	(13)
Dividends paid	(239)	(229)
Proceeds from issuance of debt	—	300
Proceeds from financing obligations	5	—
Capital lease and financing obligation payments	(87)	(87)
Proceeds from stock option exercises	111	77
Excess tax benefits from share-based compensation	2	3
Deferred financing costs	—	(4)
Net cash used in financing activities	(774)	(502)
Net increase (decrease) in cash and cash equivalents	(340)	61
Cash and cash equivalents at beginning of period	971	537
Cash and cash equivalents at end of period	$631	$598
Supplemental information:		
Interest paid, net of capitalized interest	$216	$221
Income taxes paid	493	438
Non-Cash Investing and Financing Activities		
Property and equipment acquired through additional liabilities	$40	$119

See accompanying Notes to Consolidated Financial Statements

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KOHL’S CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation
The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for fiscal year end financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. For further information, refer to the financial statements and related footnotes included in our Annual Report on Form 10-K for the fiscal year ended February 1, 2014 (Commission File No. 1-11084) as filed with the Securities and Exchange Commission on March 21, 2014.
Due to the seasonality of our business, results for any quarter are not necessarily indicative of the results that may be achieved for a full fiscal year. In addition, quarterly results of operations may be impacted by the timing and amount of sales and costs associated with the opening of new stores.
We operate as a single business unit.
In May 2014, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which supersedes the revenue recognition requirements in ASC 605, Revenue Recognition. This ASU is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. We are required to adopt the new pronouncement in the first quarter of fiscal 2017 using one of two retrospective application methods. We are evaluating the application method and the impact of this new statement on our financial statements.

2. Debt
Long-term debt consists of the following unsecured senior debt:

Maturity	Effective Rate	Coupon Rate	Outstanding November 1, 2014	February 1, 2014 and November 2, 2013
			(Dollars in Millions)	
2017	6.31 %	6.25 %	$650	$650
2021	4.81 %	4.00 %	650	650
2023	3.25 %	3.25 %	350	350
2023	4.78 %	4.75 %	300	300
2029	7.36 %	7.25 %	200	200
2033	6.05 %	6.00 %	300	300
2037	6.89 %	6.88 %	350	350
	5.54 %		2,800	2,800
Unamortized debt discount			(7)	(8)
Long-term debt			$2,793	$2,792

3. Fair Value Measurements
ASC No. 820, “Fair Value Measurements and Disclosures,” requires fair value measurements be classified and disclosed in one of the following pricing categories:

Level 1: Financial instruments with unadjusted, quoted prices listed on active market exchanges.

Level 2:	Financial instruments lacking unadjusted, quoted prices from active market exchanges, including over-the-counter traded financial instruments. The prices for the financial instruments are determined using prices for recently traded financial instruments with similar underlying terms as well as directly or indirectly observable inputs, such as interest rates and yield curves that are observable at commonly quoted intervals.
Level 3:	Financial instruments that are not actively traded on a market exchange. This category includes situations where there is little, if any, market activity for the financial instrument. The prices are determined using significant unobservable inputs or valuation techniques.

KOHL’S CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table summarizes our financial instruments:

	Pricing Category	November 1, 2014 Cost	November 1, 2014 Fair Value	February 1, 2014 Cost	February 1, 2014 Fair Value	November 2, 2013 Cost	November 2, 2013 Fair Value
		(In Millions)					
Cash and cash equivalents	Level 1	$631	$631	$971	$971	$598	$598
Auction rate securities	Level 3	23	23	82	64	82	57
Debt	Level 1	2,793	3,089	2,792	2,988	2,792	2,960

Our investments in auction rate securities (“ARS”) are included in other long-term assets in our balance sheet. We sold $59 million of ARS at par in 2014. On October 27, 2014, $23 million of ARS were called at par and were subsequently settled on November 6, 2014.

4. Stock-Based Compensation

The following table summarizes stock-based compensation grants:

	Nine Months Ended November 1, 2014	Nine Months Ended November 2, 2013
	(In Thousands)	
Stock options granted	186	549
Restricted shares and units granted, excluding shares earned in lieu of cash dividends	850	873
Total stock-based compensation grants	1,036	1,422
Weighted average fair value at grant date:		
Stock options	$12.23	$10.57
Restricted shares and units	$56.40	$47.97

5. Contingencies

We are subject to certain legal proceedings and claims arising out of the conduct of our business. In the opinion of management, the outcome of these proceedings and litigation will not have a material adverse impact on our consolidated financial statements.

6. Net Income Per Share

The following table summarizes our basic and diluted net income per share calculations:

	Three Months Ended November 1, 2014	Three Months Ended November 2, 2013	Nine Months Ended November 1, 2014	Nine Months Ended November 2, 2013
	(In Millions)			
Numerator—Net income	$142	$177	$498	$555
Denominator—Weighted average shares:				
Basic	202	216	204	219
Impact of dilutive employee stock-based awards	1	2	1	2
Diluted	203	218	205	221
Antidilutive shares	4	8	5	12

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

For purposes of the following discussion, all references to "the quarter" and "the third quarter" are for the 13-week fiscal periods ended November 1, 2014 and November 2, 2013 and all references to "year to date" are for the 39-week fiscal periods ended November 1, 2014 and November 2, 2013.
The following discussion should be read in conjunction with our Consolidated Financial Statements and the related notes included elsewhere in this report, as well as the financial and other information included in our 2013 Annual Report on Form 10-K (our "2013 Form 10-K"). The following discussion may contain forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could materially differ from those discussed in these forward-looking statements. Factors that could cause or contribute to those differences include, but are not limited to, those discussed elsewhere in this report and in our 2013 Form 10-K (particularly in "Risk Factors").

Executive Summary

As of November 1, 2014, we operated 1,163 family-focused, value-oriented department stores and a website (www.Kohls.com) that sell moderately priced exclusive and national brand apparel, footwear, accessories, beauty and home products. Our stores generally carry a consistent merchandise assortment with some differences attributable to regional preferences. Our website includes merchandise which is available in our stores, as well as merchandise which is available only on-line.
The following table summarizes our results.

	Quarter	Year to Date
	(Dollars and shares in Millions)	
Net sales	$4,374	$12,686
Change in:		
Net sales	(1.6)%	(1.9)%
Comparable sales	(1.8)%	(2.2)%
Gross margin as a percent of net sales	37.2%	37.7%
Selling, general and administrative expenses	$1,097	$3,078
Net income	$142	$498
Net earnings per diluted share	$0.70	$2.43
Shares repurchased	2.7	10.1
Treasury stock purchases	$157	$549

For additional details about our financial results, see Results of Operations and Financial Condition and Liquidity.
Our main business objective is to profitably increase sales. In order to increase sales, we believe that we need to increase transactions per store, which is our primary sales driver. In the first quarter of 2014, we introduced a multi-year vision that we believe will increase transactions per store and sales. This vision, which we refer to as "the Greatness Agenda," is built on five pillars - amazing product, incredible savings, easy experience, personalized connections and winning teams.
Amazing product provides a renewed focus on providing the right merchandise mix, being locally relevant, and tailoring products to every customer across every channel. Our new beauty offerings are an example of the new product that customers can find in many of our stores and on-line. We continue to test different beauty department formats. Stores with the new beauty department continue to outperform other stores - both in the beauty department and across the store. We continue to see sales increases of approximately 2 percent in higher sales volume stores with the new beauty department versus a control group of stores without renovated beauty departments. We renovated beauty departments in 178 stores during the third quarter of fiscal 2014 bringing the total number of stores with the new beauty department to 512 as of November 1, 2014. We expect to have the new beauty department in approximately 900 stores by the end of fiscal 2015.

We continue to offer new products to our customers as we believe this creates excitement for our customers and increases customer traffic to our stores and website. In the first quarter, we launched our first Jumping Beans collection featuring Disney characters. New elements around more of the Disney portfolio will be rolled out frequently. In June 2014, we launched the Fitbit brand as part of extending our active and wellness business. In September 2014, we launched both the IZOD brand in Men's and the Juicy Couture brand in Women's. We also further expanded our active and wellness product offerings and

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introduced Gaiam yoga products in our stores during the third quarter. Finally, we expect to launch the Puma brand in the first half of fiscal 2015.

National brands are a key component of the Greatness Agenda as we believe they drive customer traffic and sales increases. In the third quarter of 2014, National brand comparable sales were higher than Private and Exclusive brand comparable sales for the fifth consecutive quarter. Year to date, National brand penetration has increased approximately 150 basis points.

The goal of incredible savings is to help every customer get more from every dollar. In addition to the value offered in our Kohl's Cash and Kohl's-branded credit card, we now offer a loyalty program which allows enrolled customers to earn various rewards based upon the volume of their purchases. Prior to the nationwide launch in October 2014, we had approximately 10 million customers enrolled in the program. By the end of the third quarter of 2014, over 17 million customers had enrolled.

We are also making significant investments to create an easy experience for our customers wherever or however they choose to engage with us. Whether they are shopping in one of our stores, from their mobile devices or from their laptops, we are creating a consistent experience to ensure that our customers can connect with us wherever and however they wish. In 2014, we are focused on improving the tablet and smartphone shopping experience. We launched buy on-line and pick up in store in approximately 100 stores during the third quarter. We expect to offer this shopping option in all of our stores by the second quarter of 2015.

Personalized connections is about building lasting relationships with our customers. To build personalized connections during the shopping experience, we are focused on localizing and tailoring what we sell and how we communicate our product to ensure that our product and offers are personally relevant to each and every customer. At the same time, personalized connections is about contributing to causes such as children's health and education or the environment, so our customers know we are sensitive to the issues that are important to them.

The final pillar is winning teams, which is focused on building teams of engaged, talented, empowered and results-oriented management and associates.

We remain committed to meeting the changing shopping needs of our customer, to strengthening our omni-channel experience and to investing in our future in a strategic and profitable manner. We are pleased with the progress we have made in these areas, but believe that we have additional opportunities to improve.

Results of Operations

Net sales.

Net sales decreased $70 million, or 1.6%, to $4.4 billion for the third quarter of 2014. Year to date, net sales decreased $246 million, or 1.9%, to $12.7 billion. Comparable sales decreased 1.8% for the third quarter and decreased 2.2% year to date. Comparable sales include sales for stores (including relocated or remodeled stores) which were open during both the current and prior year periods. We also include E-Commerce sales in our comparable sales. E-Commerce includes sales which originated on-line and are shipped from our E-Commerce fulfillment centers, shipped from our stores, picked up in our stores, or shipped directly from third-party vendors to our customers. Merchandise returns reduce sales at the location of the return. As a result, store sales are reduced by merchandise purchased on-line, but returned to a store.

The following table summarizes changes in net sales for the quarter and year to date:

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	Quarter		Year to Date	
	$	%	$	%
	(Dollars In Millions)			
Net Sales - 2013	$4,444		$12,932	
Comparable sales:				
Stores	(187)	(4.0)%	(481)	(3.7)%
E-Commerce	107	31.1	205	21.1
Total	(80)	(1.8)	(276)	(2.2)
New stores and other revenues	10	—	30	—
Total decrease in net sales	(70)	(1.6)%	(246)	(1.9)%
Net Sales - 2014	$4,374		$12,686	

We replatformed our E-Commerce website in the second and third quarters of 2013, which temporarily decelerated growth. The increase in E-Commerce sales in the quarter was partially driven by the anniversary of the website replatform, as we continue to return to historical growth trends more similar to those experienced before the replatform.

Drivers of the changes in comparable sales were as follows:

	Quarter	Year to Date
Selling price per unit	2.6 %	2.7 %
Units per transaction	(1.8)	(1.5)
Average transaction value	0.8	1.2
Number of transactions	(2.6)	(3.4)
Comparable sales	(1.8)%	(2.2)%

The increases in selling price per unit were primarily due to increases in National brand merchandise penetration. Units per transaction decreased as customers purchased fewer items in response to the higher prices. Increases in the number of E-Commerce transactions were more than offset by decreases in our stores in both periods. Year-to-date transactions in our stores were negatively impacted by unfavorable weather trends which reduced customer visits.

The Midwest and Northeast regions outperformed the store average for the quarter. The Mid-Atlantic, Southeast, South Central, and West regions underperformed the store average for the quarter. Year to date, the West region reported the lowest decrease in comparable sales. The South Central region reported the largest sales decrease in the first nine months of 2014.

For the quarter, Children's was the best performing and only line of business to report higher sales. All Children's categories, except boys, reported sales increases. Accessories, Footwear and Men's sales were all slightly lower than last year, but better than the Company average. Accessories was led by sales increases in beauty and handbags. In Footwear, athletic shoes and men's dress and casual shoes were the strongest categories. Men's was led by sales increases in active and young men's. Home and Women's both underperformed the Company average. Women’s was led by the active and classic sportswear categories.

Year to date, Children's was the best performing and only line of business to report higher sales. All Children's categories, except boys, reported sales increases. Footwear and Men's also outperformed the Company average. These lines of business were led by sales increases in athletic and mens dress and casual categories within Footwear and young men's and active categories within Men's. Accessories, Home, and Women's all underperformed the Company average.

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Gross margin.

	Quarter				Year to Date			
			Decrease				Decrease	
	2014	2013	$	%	2014	2013	$	%
	(Dollars in Millions)							
Gross margin	$1,628	$1,666	$(38)	(2.3)%	$4,778	$4,869	$(91)	(1.9)%
As a percent of net sales	37.2%	37.5%		(0.3)%	37.7 %	37.7 %		—%

Gross margin includes the total cost of products sold, including product development costs, net of vendor payments other than reimbursement of specific, incremental and identifiable costs; inventory shrink; markdowns; freight expenses associated with moving merchandise from our vendors to our distribution centers; shipping and handling expenses of on-line sales; and terms cash discount. Our gross margin may not be comparable with that of other retailers because we include distribution center costs in selling, general and administrative expenses while other retailers may include these expenses in cost of merchandise sold.

For the quarter, gross margin as a percentage of sales decreased approximately 30 basis points from 2013. The decrease for the quarter can be attributed to a higher mix of lower margin National brand sales and higher markdowns. Year to date, gross margin as a percentage of sales was consistent with 2013.

Selling, general and administrative expenses.

	Quarter				Year to Date			
			Increase				Increase	
	2014	2013	$	%	2014	2013	$	%
	(Dollars in Millions)							
Selling, general and administrative expenses	$1,097	$1,073	$24	2.2 %	$3,078	$3,071	$7	— %
As a percent of net sales	25.1 %	24.1 %		1.0 %	24.3 %	23.7 %		0.6 %

Selling, general and administrative expenses (“SG&A”) include compensation and benefit costs (including stores, headquarters, buying and merchandising, and distribution centers); occupancy and operating costs of our retail, distribution and corporate facilities; freight expenses associated with moving merchandise from our distribution centers to our retail stores and among distribution and retail facilities; marketing expenses, offset by vendor payments for reimbursement of specific, incremental and identifiable costs; net revenues from our Kohl’s credit card operations; and other administrative revenues and expenses. We do not include depreciation and amortization in SG&A. The classification of these expenses varies across the retail industry.

The following table summarizes the changes in SG&A by expense type:

	Quarter	Year to Date
	(In Millions)	
Net revenues from credit card operations	$(7)	$(24)
Store expenses	(5)	(10)
Marketing costs, excluding credit card operations	6	4
Corporate expenses	28	30
Distribution costs	2	7
Increase in SG&A	$24	$7

Many of our expenses, including store payroll and distribution costs, are variable in nature. These costs generally increase as sales increase and decrease as sales decrease. We measure both the change in these variable expenses and the expense as a percent of sales. If the expense as a percent of sales decreased from the prior year, the expense “leveraged” and indicates that the expense was well-managed or effectively generated additional sales. If the expense as a percent of sales increased over the prior year, the expense "deleveraged" and indicates that sales growth was less than expense growth. SG&A as a percent of sales increased, or "deleveraged," by approximately 100 basis points for the quarter and approximately 60 basis points year to date.

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The increases in net revenues from credit card operations are the result of higher finance charge revenues and late fees due to growth in the portfolio. Partially offsetting these increases were higher bad debt expenses and operational costs. Store expenses reflect lower store payroll and lower operating expenses such as utilities, repairs and maintenance, cleaning, and insurance. Marketing costs increased in the quarter and year to date, as we launched our loyalty program nationwide in the third quarter. Corporate costs increased for the quarter and year to date due to a change in our incentive compensation estimated payout in the third quarter of 2013, which resulted in an incentive compensation reversal for the quarter. Corporate costs also increased for the quarter and year to date, as we continue to invest in technology. Store distribution costs decreased, but were offset by higher E-Commerce fulfillment costs in both periods.

Other Expenses.

	Quarter				Year to Date			
			Increase/ (Decrease)				Increase/ (Decrease)	
	2014	2013	$	%	2014	2013	$	%
	(Dollars in Millions)							
Depreciation and amortization	$227	$228	$(1)	—%	$665	$665	$—	—%
Interest expense, net	85	84	1	1%	255	251	4	2%
Provision for income taxes	77	104	(27)	(26)%	282	327	(45)	(14)%
Effective tax rate	35.3%	37.0%			36.1%	37.0%		

Depreciation and amortization expense was consistent with 2013. The increase in year-to-date interest expense is primarily due to higher outstanding long-term debt following the September 2013 debt issuance. The decreases in the provision for income taxes are due to lower income before taxes, primarily driven by lower sales, and lower effective tax rates. The decreases in the effective tax rates were primarily due to favorable state audit settlements throughout 2014.

Seasonality and Inflation

Our business, like that of most retailers, is subject to seasonal influences, with the major portion of sales and income typically realized during the second half of each fiscal year, which includes the back-to-school and holiday seasons. Approximately 15% of annual sales typically occur during the back-to-school season and 30% during the holiday season. Because of the seasonality of our business, results for any quarter are not necessarily indicative of the results that may be achieved for a full fiscal year. Revenues and expenses associated with the opening of new stores may also affect our quarterly results.

Although we expect that our operations will be influenced by general economic conditions, including rising food, fuel and energy prices, we do not believe that inflation has had a material effect on our results of operations. However, there can be no assurance that our business will not be impacted by such factors in the future.

Financial Condition and Liquidity

Our primary ongoing cash requirements are for capital expenditures for new stores, remodels and IT spending and for seasonal and new store inventory purchases. Share repurchases and dividend payments to shareholders are currently other significant usages of cash. These payments are discretionary and can be discontinued at any time should we require cash for other uses. Our primary source of funds is cash flow provided by operations. Short-term trade credit, in the form of extended payment terms for inventory purchases, often represents a significant source of financing for merchandise inventories. We also have a line of credit available under our revolving credit facility which could be used to meet cash needs. Our working capital and inventory levels typically build throughout the fall, peaking during the November and December holiday selling season.

			Decrease in Cash	
	2014	2013	$	%
Net cash provided by (used in):	(Dollars in Millions)			
Operating activities	$930	$1,014	$(84)	(8)%

Investing activities	(496)	(451)	(45)	(10)%
Financing activities	(774)	(502)	(272)	(54)%

Operating Activities. Operating activities generated $930 million of cash in the first three quarters of 2014, compared to $1,014 million in the first three quarters of 2013.

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Merchandise inventory increased $14 million over November 2, 2013 to $5.0 billion at November 1, 2014. Inventory per store was consistent with 2013, but units per store were 3 percent lower. Accounts payable as a percent of inventory was 47.9% at November 1, 2014, compared to 45.6% at November 2, 2013. The increase was primarily due to timing of overseas inventory shipment receipts and timing of payments to some of our vendors.

Investing Activities. The increase in net cash used in investing activities reflects a $96 million increase in capital spending primarily due to the purchase and build out of a call center in Texas, increased IT spending, increased remodel spending and the expansion of our corporate campus. The increase was partially offset by $59 million of sales at par of auction rate securities in 2014.

Financing Activities. Financing activities used cash of $774 million in the first three quarters of 2014 and $502 million in the first three quarters of 2013.

We paid cash for treasury stock purchases of $549 million in both 2014 and 2013. Share repurchases are discretionary in nature. The timing and amount of repurchases is based upon available cash balances, our stock price and other factors.

We paid cash dividends of $239 million ($1.17 per share) in 2014 and $229 million ($1.05 per share) in 2013. On November 12, 2014, our board of directors declared a quarterly cash dividend of $0.39 per common share. The dividend is payable on December 24, 2014 to shareholders of record at the close of business on December 10, 2014.

In September 2013, we issued $300 million of 4.75% notes with semi-annual interest payments beginning in December 2013.

We received proceeds from stock options exercises of $111 million in 2014 and $77 million in 2013. The increase is due to higher stock prices, primarily in the third quarter of 2014.

Free Cash Flow. We generated free cash flow of $287 million in 2014 compared to $462 million in 2013. Free cash flow is a non-GAAP financial measure which we define as net cash provided by operating activities and proceeds from financing obligation payments (which generally represent landlord reimbursements of construction costs) less capital expenditures and capital lease and financing obligations. Free cash flow should be evaluated in addition to, and not considered a substitute for, other financial measures such as net income and cash flow provided by operations.

The following table reconciles net cash provided by operating activities (a GAAP measure) to free cash flow (a non-GAAP measure).

	2014	2013	Increase/(Decrease) in Free Cash Flow
	(In Millions)		
Net cash provided by operating activities	$930	$1,014	$ (84)
Acquisition of property & equipment	(561)	(465)	(96)
Capital lease & financing obligation payments	(87)	(87)	—
Proceeds from financing obligations	5	—	5
Free cash flow	$287	$462	$ (175)

Key financial ratios. Key financial ratios that provide certain measures of our liquidity are as follows:

	November 1, 2014	November 2, 2013
Working capital (In Millions)	$2,423	$2,346
Current ratio	1.66	1.64
Debt/capitalization	45.2%	45.2%

The increases in working capital and the current ratio are primarily due to higher cash balances and lower income tax payable balances. The debt/capitalization ratio was consistent, as decreases in our capital lease and financing obligations from annual rent payments were completely offset by lower capitalization, primarily due to share repurchases.

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Debt Covenant Compliance. As of November 1, 2014, we were in compliance with all debt covenants and expect to remain in compliance during fiscal 2014.

	(Dollars in Millions)
Included Indebtedness	
Total debt	$ 4,795
Permitted exclusions	(7)
Subtotal	4,788
Rent x 8	2,192
Included Indebtedness	$ 6,980
Rolling 12-month Adjusted Debt Compliance EBITDAR	
Net income	$ 832
Rent expense	274
Depreciation and amortization	889
Net interest	342
Provision for income taxes	470
EBITDAR	2,807
Stock based compensation	51
Other non-cash revenues and expenses	13
Rolling 12-month Adjusted Debt Compliance EBITDAR	$ 2,871
Debt Ratio (a)	2.43
Maximum permitted Debt Ratio	3.75

(a) Included Indebtedness divided by Adjusted Debt Compliance EBITDAR

Contractual Obligations

There have been no significant changes in the contractual obligations disclosed in our 2013 Form 10-K.

Off-Balance Sheet Arrangements

We have not provided any financial guarantees as of November 1, 2014. We have not created, and are not party to, any special-purpose or off-balance sheet entities for the purpose of raising capital, incurring debt or operating our business. We do not have any arrangements or relationships with entities that are not consolidated into our financial statements that are reasonably likely to materially affect our liquidity or the availability of capital resources.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect reported amounts. Management has discussed the development, selection and disclosure of its estimates and assumptions with the Audit Committee of our Board of Directors. There have been no significant changes in the critical accounting policies and estimates discussed in our 2013 Form 10-K.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no significant changes in the market risks described in our 2013 Form 10-K.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

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 the design and operation of our disclosure controls and procedures (the “Evaluation”) at a reasonable assurance level as of the last day of the period covered by this report.

Based upon the Evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective at the reasonable assurance level. Disclosure controls and procedures are defined by Rule

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13a-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act") as controls and other procedures that are designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures.

It should be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving our stated goals under all potential future conditions, regardless of how remote.

(b) Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended November 1, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1A. Risk Factors

There have been no significant changes in our risk factors from those described in our 2013 Form 10-K.

Forward-looking Statements

This report contains statements that may constitute forward-looking statements within the meaning of the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. Those statements relate to developments, results, conditions or other events we expect or anticipate will occur in the future. Words such as “believes,” “anticipates,” “plans,” “expects” and similar expressions are intended to identify forward-looking statements. Without limiting the foregoing, these statements may relate to future outlook, revenues, earnings, store openings, planned capital expenditures, market conditions, new strategies and the competitive environment. Forward-looking statements are based on our management’s then current views and assumptions and, as a result, are subject to certain risks and uncertainties that could cause actual results to differ materially from those projected. Any such forward-looking statements are qualified by the important risk factors, described in Item 1A of our 2013 Form 10-K, that could cause actual results to differ materially from those predicted by the forward-looking statements. Forward-looking statements relate to the date initially made, and we undertake no obligation to update them. An investment in our common stock or other securities carries certain risks. Investors should carefully consider the risks as stated in our 2013 Form 10-K and other risks which may be disclosed from time to time in our filings with the SEC before investing in our securities.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

We did not sell any securities during the quarter ended November 1, 2014 which were not registered under the Securities Act.

The following table contains information for shares repurchased and shares acquired from employees in lieu of amounts required to satisfy minimum tax withholding requirements upon the vesting of the employees’ restricted stock during the three fiscal months ended November 1, 2014:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
				(In Millions)

August 3 – August 30, 2014	325,905	$54.71	325,100	$ 1,912
August 31 – October 4, 2014	1,111,727	60.89	1,108,500	1,844
October 5 – November 1, 2014	1,257,414	57.01	1,248,000	1,773
Total	2,695,046	$58.33	2,681,600	$ 1,773

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Item 6. Exhibits

Exhibit Number	Description
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the 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 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.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

SIGNATURES

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

Kohl’s Corporation
(Registrant)

Date: December 5, 2014

/s/ Wesley S. McDonald
Wesley S. McDonald
On behalf of the Registrant and as Senior Executive Vice President and Chief Financial Officer
(Principal Financial and Chief Accounting Officer)