FOOT LOCKER, INC.
Form 10-K
April 02, 2019
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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 EXCHANGE ACT OF 1934

For the fiscal year ended February 2, 2019

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 No. 1 10299

(Exact name of registrant as specified in its charter)

New York	13 3513936
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
330 West 34th Street, New York, New York	10001
(Address of principal executive offices)	(Zip Code)

Registrant’s telephone number, including area code: (212) 720 3700

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value $0.01	New York Stock Exchange

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 every Interactive Data File required to be submitted 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 such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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, 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 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 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 Act). Yes No

The number of shares of the registrant's Common Stock, par value $0.01 per share, outstanding as of March 25, 2019:	112,310,616
The aggregate market value of voting stock held by non-affiliates of the registrant computed by reference to the closing price as of the last business day of the Registrant's most recently completed second fiscal quarter, August 4, 2018, was approximately:	$4,021,122,206*

* For purposes of this calculation only (a) all directors plus three executive officers and owners of five percent or more of the registrant are deemed to be affiliates of the registrant and (b) shares deemed to be “held” by such persons include only outstanding shares of the registrant’s voting stock with respect to which such persons had, on such date, voting or investment power.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant’s definitive Proxy Statement (the “Proxy Statement”) to be filed in connection with the Annual Meeting of Shareholders to be held on May 22, 2019: Parts III and IV.

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PART I

Item 1. Business

General

Foot Locker, Inc., incorporated under the laws of the State of New York in 1989, is a leading global retailer of athletically inspired shoes and apparel. As of February 2, 2019, the Company operated 3,221 primarily mall-based stores, as well as stores in high-traffic urban retail areas and high streets, in the United States, Canada, Europe, Australia, New Zealand, and Asia. Foot Locker, Inc. and its subsidiaries hereafter are referred to as the “Registrant,” “Company,” “we,” “our,” or “us.” Information regarding the business is contained under the “Business Overview” section in “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

The Company maintains a website on the internet at www.footlocker-inc.com. The Company’s filings with the U.S. Securities and Exchange Commission (the “SEC”), including its annual reports on Form 10 K, quarterly reports on Form 10 Q, current reports on Form 8 K, and all amendments to those reports are available free of charge through this website as soon as reasonably practicable after they are filed with or furnished to the SEC by clicking on the “SEC Filings” link. The Corporate Governance section of the Company’s corporate website contains the Company’s Corporate Governance Guidelines, Committee Charters, and the Company’s Code of Business Conduct for directors, officers and employees, including the Chief Executive Officer, Chief Financial Officer, and Chief Accounting Officer. Copies of these documents may also be obtained free of charge upon written request to the Company’s Corporate Secretary at 330 West 34th Street, New York, N.Y. 10001.

Information Regarding Business Segments and Geographic Areas

The financial information concerning business segments, divisions, and geographic areas is contained under the “Business Overview” and “Segment Information” sections in “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Information regarding sales, operating results, and identifiable assets of the Company by business segment and by geographic area is contained under the Segment Information note in “Item 8. Consolidated Financial Statements and Supplementary Data.”

The service marks, trade names, and trademarks appearing in this report (except for Nike, Jordan, adidas, and Puma) are owned by Foot Locker, Inc. or its subsidiaries.

Employees

The Company and its consolidated subsidiaries had 15,470 full-time and 33,861 part-time employees as of February 2, 2019. The Company considers employee relations to be satisfactory.

Competition

Financial information concerning competition is contained under the “Business Risk” section in the Financial Instruments and Risk Management note in “Item 8. Consolidated Financial Statements and Supplementary Data.”

Merchandise Purchases

Financial information concerning merchandise purchases is contained under the “Liquidity” section in “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” and under the “Business Risk” section in the Financial Instruments and Risk Management note in “Item 8. Consolidated Financial Statements and

Supplementary Data."

Item 1A. Risk Factors

The statements contained in this Annual Report on Form 10 K ("Annual Report") that are not historical facts, including, but not limited to, statements regarding our expected financial position, business and financing plans found in "Item 1. Business" and "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations," constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995.

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Please also see “Disclosure Regarding Forward-Looking Statements.” Our actual results may differ materially due to the risks and uncertainties discussed in this Annual Report, including those discussed below. Additional risks and uncertainties that we do not presently know about or that we currently consider to be insignificant may also affect our business operations and financial performance.

Our inability to implement our long-range strategic plan may adversely affect our future results.

Our ability to successfully implement and execute our long-range plan is dependent on many factors. Our strategies may require significant capital investment and management attention. Additionally, any new initiative is subject to certain risks including customer acceptance of our products and renovated store designs, competition, product differentiation, the ability to attract and retain qualified personnel, and our ability to successfully implement technological initiatives. If we cannot successfully execute our strategic growth initiatives or if the long-range plan does not adequately address the challenges or opportunities we face, our financial condition and results of operations may be adversely affected. Additionally, failure to meet shareholder expectations, particularly with respect to sales, operating margins, and earnings per share, would likely result in volatility in the market value of our stock.

The retail athletic footwear and apparel business is highly competitive.

Our athletic footwear and apparel operations compete primarily with athletic footwear specialty stores, sporting goods stores, department stores, traditional shoe stores, mass merchandisers, and internet retailers, many of which are units of national or regional chains that have significant financial and marketing resources. The principal competitive factors in our markets are selection of merchandise, customer experience, reputation, store location, advertising, and price. We cannot assure that we will continue to be able to compete successfully against existing or future competitors. Our expansion into markets served by our competitors, and entry of new competitors or expansion of existing competitors into our markets, could have a material adverse effect on our business, financial condition, and results of operations.

Although we sell an increasing proportion of our merchandise via the internet, a significantly faster shift in customer buying patterns to purchasing athletic footwear, athletic apparel, and sporting goods via the internet could have a material adverse effect on our business results. In addition, all of our significant suppliers operate retail stores and distribute products directly through the internet and others may follow. Should this continue to occur or accelerate, and if our customers decide to purchase directly from our suppliers, it could have a material adverse effect on our business, financial condition, and results of operations.

The industry in which we operate is dependent upon fashion trends, customer preferences, product innovations, and other fashion-related factors.

The athletic footwear and apparel industry, especially at the premium end of the price spectrum, is subject to changing fashion trends and customer preferences. In addition, retailers in the athletic industry rely on their suppliers to maintain innovation in the products they develop. We cannot guarantee that our merchandise selection will accurately reflect customer preferences when it is offered for sale or that we will be able to identify and respond quickly to fashion changes, particularly given the long lead times for ordering much of our merchandise from suppliers. A substantial portion of our highest margin sales are to young males (ages 12–25), many of whom we believe purchase athletic footwear and athletic apparel as a fashion statement and are frequent purchasers. Our failure to anticipate, identify or react appropriately in a timely manner to changes in fashion trends that would make athletic footwear or athletic apparel less attractive to our customers could have a material adverse effect on our business, financial condition, and results of operations.

If we do not successfully manage our inventory levels, our operating results will be adversely affected.

We must maintain sufficient inventory levels to operate our business successfully. However, we also must guard against accumulating excess inventory. For example, we order most of our athletic footwear four to six months prior to delivery to our stores. If we fail to anticipate accurately either the market for the merchandise in our stores or our customers' purchasing habits, we may be forced to rely on markdowns or promotional sales to dispose of excess or slow moving inventory, which could have a material adverse effect on our business, financial condition, and results of operations.

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A change in the relationship with any of our key suppliers or the unavailability of key products at competitive prices could affect our financial health.

Our business is dependent to a significant degree upon our ability to obtain premium product and the ability to purchase brand-name merchandise at competitive prices from a limited number of suppliers. In addition, we have negotiated volume discounts, cooperative advertising, and markdown allowances with our suppliers, as well as the ability to cancel orders and return excess or unneeded merchandise. We cannot be certain that such terms with our suppliers will continue in the future.

We purchased approximately 90 percent of our merchandise in 2018 from our top five suppliers and we expect to continue to obtain a significant percentage of our athletic product from these suppliers in future periods. Approximately 66 percent of all merchandise purchased in 2018 was purchased from one supplier — Nike, Inc. ("Nike"). Each of our operating divisions is highly dependent on Nike. Individually they purchased between 38 to 74 percent of their merchandise from Nike during the year. Merchandise that is high profile and in high demand is allocated by our suppliers based upon their internal criteria. Although we have generally been able to purchase sufficient quantities of this merchandise in the past, we cannot be certain that our suppliers will continue to allocate sufficient amounts to us in the future. Our inability to obtain merchandise in a timely manner from major suppliers as a result of business decisions by our suppliers, or any disruption in the supply chain, could have a material adverse effect on our business, financial condition, and results of operations. Because of the high proportion of purchases from Nike, any adverse development in Nike's reputation, financial condition or results of operations or the inability of Nike to develop and manufacture products that appeal to our target customers could also have an adverse effect on our business, financial condition, and results of operations. We cannot be certain that we will be able to acquire merchandise at competitive prices or on competitive terms in the future. These risks could have a material adverse effect on our business, financial condition, and results of operations.

We are affected by mall traffic and our ability to secure suitable store locations.

Many of our stores, especially in North America, are located primarily in enclosed regional and neighborhood malls. Our sales are affected, in part, by the volume of mall traffic. Mall traffic may be adversely affected by, among other factors, economic downturns, the closing or continued decline of anchor department stores and/or specialty stores, and a decline in the popularity of mall shopping among our target customers. Further, any terrorist act, natural disaster, public health or safety concern that decreases the level of mall traffic, or that affects our ability to open and operate stores in such locations, could have a material adverse effect on our business.

To take advantage of customer traffic and the shopping preferences of our customers, we need to maintain or acquire stores in desirable locations such as in regional and neighborhood malls, as well as high-traffic urban retail areas and high streets. We cannot be certain that desirable locations will continue to be available at favorable rates. Some traditional enclosed malls are experiencing significantly lower levels of customer traffic, driven by economic conditions, the closure of certain mall anchor tenants, and changes in customer shopping preferences, such as shopping online.

Several large landlords dominate the ownership of prime malls and because of our dependence upon these landlords for a substantial number of our locations, any significant erosion of their financial condition or our relationships with them could negatively affect our ability to obtain and retain store locations. Additionally, further landlord consolidation may negatively affect our ability to negotiate favorable lease terms.

We may experience fluctuations in, and cyclicality of, our comparable-store sales results.

Our comparable-store sales have fluctuated significantly in the past, on both an annual and a quarterly basis, and we expect them to continue to fluctuate in the future. A variety of factors affect our comparable-store sales results, including, among others, fashion trends, product innovation, promotional events, the highly competitive retail sales environment, economic conditions, timing of income tax refunds, changes in our merchandise mix, calendar shifts of holiday periods, supply chain disruptions, and weather conditions. Many of our products represent discretionary purchases. Accordingly, customer demand for these products could decline in an economic downturn or if our customers develop other priorities for their discretionary spending. These risks could have a material adverse effect on our business, financial condition, and results of operations.

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Economic or political conditions in other countries, including fluctuations in foreign currency exchange rates and tax rates may adversely affect our operations.

A significant portion of our sales and operating income for 2018 was attributable to our operations in Europe, Canada, Australia, and New Zealand. As a result, our business is subject to the risks associated with doing business outside of the United States such as local customer product preferences, political unrest, disruptions or delays in shipments, changes in economic conditions in countries in which we operate, foreign currency fluctuations, real estate costs, and labor and employment practices in non-U.S. jurisdictions that may differ significantly from those that prevail in the United States. In addition, because our suppliers manufacture a substantial amount of our products in foreign countries, our ability to obtain sufficient quantities of merchandise on favorable terms may be affected by governmental regulations, trade restrictions, labor, and other conditions in the countries from which our suppliers obtain their product.

Fluctuations in the value of the euro and the British Pound may affect the value of our European earnings when translated into U.S. dollars. Similarly, our earnings in Canada, Australia, and New Zealand may be affected by the value of currencies when translated into U.S. dollars. Except for our business in the United Kingdom (the “U.K”), our international subsidiaries conduct most of their business in their local currency. Inventory purchases for our U.K. business are denominated in euros, which could result in foreign currency transaction gains or losses.

Our products are subject to import and excise duties and/or sales or value-added taxes in many jurisdictions. Fluctuations in tax rates and duties and changes in tax legislation or regulation could have a material adverse effect on our results of operations and financial condition.

Significant developments stemming from the U.K.’s decision to withdraw from the European Union could have a material adverse effect on the Company.

The U.K. has voted in favor of leaving the European Union (“E.U.”), which is commonly referred to as “Brexit.” E.U. rules provide for a two-year negotiation period, currently set to expire on April 12, 2019, unless another extension is agreed to by the parties. Significant uncertainty remains about the future relationship between the U.K. and the E.U., including the possibility of the U.K. leaving the E.U. without a negotiated and bilaterally approved withdrawal plan. We have significant operations in both the U.K. and the E.U., and we are highly dependent on the free flow of labor and goods in those regions. Uncertainty surrounding Brexit could cause a slowdown in economic activity in the U.K., Europe or globally, which could adversely affect the Company’s operating results and growth prospects. In addition, Brexit could lead to legal uncertainty and potentially divergent national laws and regulations as the U.K. determines which E.U. laws to replace or replicate. Compliance with any new laws and regulations may be cumbersome, difficult or costly. These possible effects of Brexit, among others, could adversely affect our business, results of operations, and financial condition. The ultimate effects of Brexit on our business will depend on the specific terms of the agreement, if any, the U.K. and the E.U. reach to provide access to each other’s markets.

Imposition of tariffs and export controls on the products we buy may have a material adverse effect on our business.

A significant portion of the products that we purchase, including the portion purchased from domestic suppliers, as well as most of our private brand merchandise, is manufactured abroad. We may be affected by potential changes in international trade agreements or tariffs, such as new tariffs imposed on certain Chinese-made goods imported into the U.S. Furthermore, China or other countries may institute retaliatory trade measures in response to existing or future tariffs imposed by the U.S. that could have a negative effect on our business. If any of these events occur as described, we may be obligated to seek alternative suppliers for our private brand merchandise, raise prices, or make changes to our operations, any of which could have a material adverse effect on our sales and profitability, results of operations and financial condition.

Macroeconomic developments may adversely affect our business.

Our performance is subject to global economic conditions and the related effects on consumer spending levels. Continued uncertainty about global economic conditions poses a risk as consumers and businesses may postpone spending in response to tighter credit, unemployment, negative financial news, and/or declines in income or asset values, which could have a material negative effect on demand for our products.

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As a retailer that is dependent upon consumer discretionary spending, our results of operations are sensitive to changes in macroeconomic conditions. Our customers may have less money for discretionary purchases as a result of job losses, foreclosures, bankruptcies, increased fuel and energy costs, higher interest rates, higher taxes, reduced access to credit, and lower home values. These and other economic factors could adversely affect demand for our products, which could adversely affect our financial condition and operating results.

Instability in the financial markets may adversely affect our business.

Instability in the global financial markets could reduce availability of credit to our business. Although we currently have a revolving credit agreement in place until May 19, 2021, tightening of credit markets could make it more difficult for us to access funds, refinance our existing indebtedness, enter into agreements for new indebtedness, or obtain funding through the issuance of the Company's securities. In 2017, the U.K.'s Financial Conduct Authority, which regulates LIBOR, announced its intention to phase out LIBOR by the end of 2021. It is unclear if LIBOR will cease to exist at that time or if new methods of calculating LIBOR will be established such that it continues to exist after 2021. If LIBOR ceases to exist, we will need to renegotiate our credit facility. This could have an adverse effect on our financing costs. Other than insignificant amounts used for standby letters of credit, we do not have any borrowings under our credit facility.

We rely on a few key suppliers for a majority of our merchandise purchases (including a significant portion from one key supplier). The inability of these key suppliers to access liquidity, or the insolvency of key suppliers, could lead to their failure to deliver merchandise to us. Our inability to obtain merchandise in a timely manner from major suppliers could have a material adverse effect on our business, financial condition, and results of operations.

Material changes in the market value of the securities we hold may adversely affect our results of operations and financial condition.

At February 2, 2019, our cash and cash equivalents totaled $891 million. The majority of our investments were short-term deposits in highly-rated banking institutions. We regularly monitor our counterparty credit risk and mitigate our exposure by making short-term investments only in highly-rated institutions and by limiting the amount we invest in any one institution. We continually monitor the creditworthiness of our counterparties. At February 2, 2019, all investments were in investment grade institutions. Despite an investment grade rating, it is possible that the value or liquidity of our investments may decline due to any number of factors, including general market conditions and bank-specific credit issues.

Our U.S. pension plan trust holds assets totaling $593 million at February 2, 2019. The fair values of these assets held in the trust are compared to the plan's projected benefit obligation to determine the pension funding liability. We attempt to mitigate funding risk through asset diversification, and we regularly monitor investment risk of our portfolio through quarterly investment portfolio reviews and periodic asset and liability studies. Despite these measures, it is possible that the value of our portfolio may decline in the future due to any number of factors, including general market conditions and credit issues. Such declines could affect the funded status of our pension plan and future funding requirements.

If our long-lived assets or goodwill become impaired, we may need to record significant non-cash impairment charges.

We review our long-lived assets and goodwill when events indicate that the carrying value of such assets may be impaired. Goodwill is reviewed for impairment if impairment indicators arise and, at a minimum, annually. Goodwill is not amortized but is subject to an impairment test, which consists of either a qualitative assessment on a reporting unit level, or a two-step impairment test, if necessary. The determination of impairment charges is significantly affected by estimates of future operating cash flows and estimates of fair value. Our estimates of future operating cash flows are identified from our long-range strategic plans, which are based upon our experience, knowledge, and expectations; however, these estimates can be affected by factors such as our future operating results, future store profitability, and future economic conditions, all of which are difficult to predict accurately. Any significant deterioration in macroeconomic conditions could affect the fair value of our long-lived assets and goodwill and could result in future impairment charges, which would adversely affect our results of operations.

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We do not have the ability to exert control over our minority investments, and therefore, we are dependent on others in order to realize their potential benefits.

We currently hold $104 million of non-controlling minority investments in various entities and we may make additional strategic minority investments in the future. Such minority investments inherently involve a lesser degree of control over business operations, thereby potentially increasing the financial, legal, operational, and compliance risks associated with the investments. Other investors in these entities may have business goals and interests that are not aligned with ours or may exercise their rights in a manner in which we do not approve. These circumstances could lead to delayed decisions or disputes and litigation with those other investors, all of which could have a material adverse impact on our reputation, business, financial condition, and results of operations.

If our investees seek additional financing to fund their growth strategies, these financing transactions may result in further dilution of our ownership stakes and these transactions may occur at lower valuations than the investment transactions through which we acquired such interests, which could significantly decrease the fair values of our investments in those entities. Additionally, if our investees are unable to obtain any financing, those entities could need to significantly reduce their spending in order to fund their operations. These actions likely would result in reduced growth forecasts, which also could significantly decrease the fair values of our investments in those entities.

Our financial results may be adversely affected by tax rates or exposure to additional tax liabilities.

We are a U.S.-based multinational company subject to tax in multiple U.S. and foreign tax jurisdictions. Our provision for income taxes is based on a jurisdictional mix of earnings, statutory rates, and enacted tax rules, including transfer pricing. Significant judgment is required in determining our provision for income taxes and in evaluating our tax positions on a worldwide basis. Our effective tax rate could be adversely affected by a number of factors, including shifts in the mix of pretax results by tax jurisdiction, changes in tax laws or related interpretations in the jurisdictions in which we operate, and tax assessments and related interest and penalties resulting from income tax audits.

The effects of natural disasters, terrorism, acts of war, and public health issues may adversely affect our business.

Natural disasters, including earthquakes, hurricanes, floods, and tornadoes may affect store and distribution center operations. In addition, acts of terrorism, acts of war, and military action both in the United States and abroad can have a significant effect on economic conditions and may negatively affect our ability to purchase merchandise from suppliers for sale to our customers. Public health issues, such as flu or other pandemics, whether occurring in the United States or abroad, could disrupt our operations and result in a significant part of our workforce being unable to operate or maintain our infrastructure or perform other tasks necessary to conduct our business. Additionally, public health issues may disrupt, or have an adverse effect on, our suppliers' operations, our operations, our customers, or customer demand. Our ability to mitigate the adverse effect of these events depends, in part, upon the effectiveness of our disaster preparedness and response planning as well as business continuity planning. However, we cannot be certain that our plans will be adequate or implemented properly in the event of an actual disaster. We may be required to suspend operations in some or all of our locations, which could have a material adverse effect on our business, financial condition, and results of operations. Any significant declines in public safety or uncertainties regarding future economic prospects that affect customer spending habits could have a material adverse effect on customer purchases of our products.

Manufacturer compliance with our social compliance program requirements.

We require our independent manufacturers to comply with our policies and procedures, which cover many areas including labor, health and safety, and environmental standards. We monitor compliance with our policies and procedures using internal resources, as well as third-party monitoring firms. Although we monitor their compliance with these policies and procedures, we do not control the manufacturers or their practices. Any failure of our independent manufacturers to comply with our policies and procedures or local laws in the country of manufacture could disrupt the shipment of merchandise to us, force us to locate alternate manufacturing sources, reduce demand for our merchandise, or damage our reputation.

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Complications in our distribution centers and other factors affecting the distribution of merchandise may affect our business.

We operate multiple distribution centers worldwide to support our businesses. In addition to the distribution centers that we operate, we have third-party arrangements to support our operations in the United States, Canada, Australia, and New Zealand. If complications arise with any facility or if any facility is severely damaged or destroyed, our other distribution centers may be unable to support the resulting additional distribution demands. We also may be affected by disruptions in the global transportation network such as port strikes, weather conditions, work stoppages, or other labor unrest. These factors may adversely affect our ability to deliver inventory on a timely basis. We depend upon third-party carriers for shipment of merchandise. Any interruption in service by these carriers for any reason could cause disruptions in our business, a loss of sales and profits, and other material adverse effects.

We are subject to technology risks including failures, security breaches, and cybersecurity risks that could harm our business, damage our reputation, and increase our costs in an effort to protect against these risks.

Information technology is a critically important part of our business operations. We depend on information systems to process transactions, make operational decisions, manage inventory, operate our websites, purchase, sell and ship goods on a timely basis, and maintain cost-efficient operations. There is a risk that we could experience a business interruption, theft of information, or reputational damage as a result of a cyber-attack, such as an infiltration of a data center or data leakage of confidential information, either internally or at our third-party providers. We may experience operational problems with our information systems as a result of system failures, system implementation issues, viruses, malicious hackers, sabotage, or other causes.

We invest in security technology to protect the data stored by us, including our data and business processes, against the risk of data security breaches and cyber-attacks. Our data security management program includes enforcement of standard data protection policies such as Payment Card Industry compliance. Additionally, we certify our major technology suppliers and any outsourced services through accepted security certification measures. We maintain and routinely test backup systems and disaster recovery, along with external network security penetration testing by an independent third party as part of our business continuity preparedness.

While we believe that our security technology and processes follow leading practices in the prevention of security breaches and the mitigation of cybersecurity risks, given the ever-increasing abilities of those intent on breaching cybersecurity measures and given the necessity of our reliance on the security procedures of third-party vendors, the total security effort at any point in time may not be completely effective. Any security breaches and cyber incidents could adversely affect our business. Failure of our systems, including failures due to cyber-attacks that would prevent the ability of systems to function as intended, could cause transaction errors, loss of customers and sales, and negative consequences to us, our employees, and those with whom we do business. Any security breach involving the misappropriation, loss, or other unauthorized disclosure of confidential information by us could also severely damage our reputation, expose us to the risks of litigation and liability, increase operating costs associated with remediation, and harm our business. While we carry insurance that would mitigate the losses, insurance may be insufficient to compensate us fully for potentially significant losses.

Risks associated with digital operations.

Our digital operations are subject to numerous risks, including risks related to the failure of the computer systems that operate our websites, mobile sites, and apps and their related support systems, computer viruses, cybersecurity risks, telecommunications failures, denial of service attacks, bot attacks, and similar disruptions. Also, we will require additional capital in the future to sustain or grow our digital commerce business. Risks related to digital commerce include those associated with credit card fraud, the need to keep pace with rapid technological change, governmental regulation, and legal uncertainties with respect to internet regulatory compliance. If any of these risks materialize, it could have a material adverse effect on our business.

Privacy and data security concerns and regulation could result in additional costs and liabilities.

The protection of customer, employee, and Company data is critical. The regulatory environment surrounding information security and privacy is demanding, with the frequent imposition of new and changing requirements. In addition, customers have a high expectation that we will adequately protect their personal information.

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Any actual or perceived misappropriation or breach involving this data could attract negative media attention, cause harm to our reputation or result in liability (including but not limited to fines, penalties or lawsuits), any of which could have a material adverse effect on our business, operational results, financial position, and cash flows. Additionally, the E.U. adopted a comprehensive General Data Privacy Regulation (the “GDPR”), which became effective in May 2018. GDPR requires companies to satisfy new requirements regarding the handling of personal and sensitive data, including its use, protection, and the ability of persons whose data is stored to correct or delete data about themselves. Failure to comply with GDPR requirements could result in penalties of up to 4 percent of worldwide revenue. In addition, the State of California adopted the California Consumer Protection Act of 2018 ("CCPA"), which will become effective in 2020 and will regulate the collection and use of consumers' data. GDPR, CCPA and other similar laws and regulations, as well as any associated inquiries or investigations or any other government actions, may be costly to comply with, result in negative publicity, increase our operating costs, require significant management time and attention, and subject us to remedies that may harm our business, including fines or demands or orders that we modify or cease existing business practices.

The technology enablement of omni-channel in our business is complex and involves the development of a new digital platform and a new order management system designed to enhance the complete customer experience.

We continue to invest in initiatives designed to deliver a high-quality, coordinated shopping experience online, in stores, and on mobile devices, which requires substantial investment in technology, information systems, and employee training, as well as significant management time and resources. Our omni-channel retailing efforts include the integration and implementation of new technology, software, and processes to be able to fulfill orders from any point within our system of stores and distribution centers, which is extremely complex and may not meet customer expectations for timely and accurate deliveries. These efforts involve substantial risk, including risk of implementation delays, cost overruns, technology interruptions, supply and distribution delays, and other issues that can affect the successful implementation and operation of our omni-channel initiatives.

If our omni-channel initiatives are not successful, or we do not realize the return on our omni-channel investments that we anticipate, our financial performance and future growth could be materially adversely affected.

Our reliance on key management.

Future performance will depend upon our ability to attract, retain, and motivate our executive and senior management teams. Our executive and senior management teams have substantial experience and expertise in our business and have made significant contributions to our success. Our future performance depends to a significant extent both upon the continued services of our current executive and senior management teams, as well as our ability to attract, hire, motivate, and retain additional qualified management in the future. While we believe that we have adequate succession planning and executive development programs, competition for key executives in the retail industry is intense, and our operations could be adversely affected if we cannot retain and attract qualified executives.

Risks associated with attracting and retaining store and field associates.

Our success depends, in part, upon our ability to attract, develop, and retain a sufficient number of qualified store and field associates. The turnover rate in the retail industry is generally high. If we are unable to attract and retain quality associates, our ability to meet our growth goals or to sustain expected levels of profitability may be compromised. Our ability to meet our labor needs while controlling costs is subject to external factors such as unemployment levels, prevailing wage rates, minimum wage legislation, and overtime regulations.

Changes in employment laws or regulation could harm our performance.

Various foreign and domestic labor laws govern our relationship with our employees and affect our operating costs. These laws include minimum wage requirements, overtime and sick pay, paid time off, work scheduling, healthcare reform and the Patient Protection and Affordable Care Act, unemployment tax rates, workers' compensation rates, European works council requirements, and union organization. A number of factors could adversely affect our operating results, including additional government-imposed increases in minimum wages, overtime and sick pay, paid leaves of absence, mandated health benefits, and changing regulations from the National Labor Relations Board or other agencies. Complying with any new legislation or reversing changes implemented under existing law could be time-intensive and expensive and may affect our business.

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Legislative or regulatory initiatives related to climate change concerns may negatively affect our business.

Greenhouse gases may have an adverse effect on global temperatures, weather patterns, and the frequency and severity of extreme weather and natural disasters. Concern over climate change may result in new or additional legal, legislative, and regulatory requirements to reduce or mitigate the effects of climate change on the environment, which could result in future tax, transportation, and utility increases, which could adversely affect our business. There is also increased focus, including by investors, customers, and other stakeholders on these and other sustainability matters, including the use of plastic, energy, waste, and worker safety. Our reputation could be damaged if we do not (or are perceived not to) act responsibly with respect to sustainability matters, which could adversely affect our business, results of operations, cash flows, and financial condition.

We may be adversely affected by regulatory and litigation developments.

We are exposed to the risk that federal or state legislation may negatively affect our operations. Changes in federal or state wage requirements, employee rights, health care, social welfare or entitlement programs, including health insurance, paid leave programs, or other changes in workplace regulation could increase our cost of doing business or otherwise adversely affect our operations. Additionally, we are regularly involved in litigation, including class actions, that arises in the ordinary course of our business. Litigation or regulatory developments could adversely affect our business operations and financial performance.

We operate in many different jurisdictions and we could be adversely affected by violations of the U.S. Foreign Corrupt Practices Act and similar worldwide anti-corruption laws.

The U.S. Foreign Corrupt Practices Act ("FCPA") and similar worldwide anti-corruption laws, including the U.K. Bribery Act of 2010, which is broader in scope than the FCPA, generally prohibit companies and their intermediaries from making improper payments to government officials for the purpose of obtaining or retaining business. Our internal policies mandate compliance with these anti-corruption laws. Despite our training and compliance programs, we cannot be assured that our internal control policies and procedures will always protect us from reckless or criminal acts committed by our employees or agents. Our continued expansion outside the United States, including in developing countries, could increase the risk of FCPA violations in the future. Violations of these laws, or allegations of such violations, could have a material adverse effect on our results of operations or financial condition.

Failure to fully comply with Section 404 of the Sarbanes-Oxley Act of 2002 could negatively affect our business, market confidence in our reported financial information, and the price of our common stock.

We continue to document, test, and monitor our internal control over financial reporting in order to satisfy the requirements of Section 404 of the Sarbanes-Oxley Act of 2002. However, we cannot be assured that our disclosure controls and procedures and our internal control over financial reporting will prove to be completely adequate in the future. Failure to fully comply with Section 404 of the Sarbanes-Oxley Act of 2002 could negatively affect our business, market confidence in our reported financial information, and the price of our common stock.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The properties of the Company and its consolidated subsidiaries consist of land, leased stores, administrative facilities, and distribution centers. Gross square footage and total selling area for our store locations at the end of 2018 were approximately 13.24 and 7.63 million square feet, respectively. These properties, which are primarily leased, are located in the United States and its territories, Canada, various European countries, Asia, Australia, and New Zealand. We currently operate five distribution centers, of which two are owned and three are leased, occupying an aggregate of 3.0 million square feet. Three distribution centers are located in the United States, one in Germany, and one in the Netherlands. The location in Germany serves as the central warehouse distribution center for the Runners Point and Sidestep stores and their related e-commerce business. The lease for our distribution center in Germany expires at the end of 2019. We also own a cross-dock and manufacturing facility, and operate a leased warehouse in the United States, both of which support our Team Edition apparel business. We believe that all leases of properties that are material to our operations may be renewed, or that alternative properties are available, on terms not materially less favorable to us than existing leases.

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Item 3. Legal Proceedings

Information regarding the Company's legal proceedings is contained in the Legal Proceedings note under "Item 8. Consolidated Financial Statements and Supplementary Data."

Item 4. Mine Safety Disclosures

Not applicable.

Item 4A. Executive Officers of the Registrant

The following table provides information with respect to all persons serving as executive officers as of April 2, 2019, including business experience for the last five years.

Chairman, President and Chief Executive Officer	Richard A. Johnson
Executive Vice President and Chief Executive Officer — North America	Stephen D. Jacobs
Executive Vice President and Chief Executive Officer — Asia Pacific	Lewis P. Kimble
Executive Vice President and Chief Financial Officer	Lauren B. Peters
Executive Vice President and Chief Executive Officer — EMEA	Vijay Talwar
Executive Vice President and Chief Information and Customer Connectivity Officer	Pawan Verma
Senior Vice President and Chief Accounting Officer	Giovanna Cipriano
Senior Vice President, General Counsel and Secretary	Sheilagh M. Clarke
Senior Vice President — Global Supply Chain	Todd Greener
Senior Vice President, Chief Strategy and Development Officer	W. Scott Martin
Senior Vice President and Chief Human Resources Officer	Elizabeth S. Norberg
Vice President, Treasurer	John A. Maurer

Richard A. Johnson, age 61, has served as Chairman of the Board since May 2016 and President and Chief Executive Officer since December 2014. Mr. Johnson previously served as Executive Vice President and Chief Operating Officer from May 2012 through November 2014. He served as Executive Vice President and Group President from July 2011 to May 2012; President and Chief Executive Officer of Foot Locker U.S., Lady Foot Locker, Kids Foot Locker, and Footaction from January 2010 to July 2011; President and Chief Executive Officer of Foot Locker Europe from August 2007 to January 2010; and President and Chief Executive Officer of Footlocker.com/Eastbay from April 2003 to August 2007.

Stephen D. Jacobs, age 56, has served as Executive Vice President and Chief Executive Officer-North America since February 2016. He previously served as Executive Vice President and Chief Executive Officer Foot Locker North America from December 2014 through February 2016 and President and Chief Executive Officer of Foot Locker U.S., Lady Foot Locker, Kids Foot Locker, and Footaction from July 2011 to November 2014.

Lewis P. Kimble, age 60, has served as Executive Vice President and Chief Executive Officer-Asia Pacific since February 2019. Mr. Kimble previously served as Executive Vice President and Chief Executive Officer-International from February 2016 to February 2019 and President and Chief Executive Officer of Foot Locker Europe from February 2010 to February 2016.

Lauren B. Peters, age 57, has served as Executive Vice President and Chief Financial Officer since July 2011.

Vijay Talwar, age 47, has served as Executive Vice President and Chief Executive Officer – EMEA since February 2019. Mr. Talwar previously served as President – Digital from March 2018 to February 2019 and President – Digital/Footlocker.com/Eastbay from September 2016 to March 2018. Mr. Talwar served as President, Gifts and Special Occasions at Sears Holdings Corporation from 2014 to September 2016 and in various executive leadership roles at Blue Nile, Inc. from 2010 to 2014, including Chief Executive Officer, Chief Financial Officer and President, International / Global Customer Care.

Pawan Verma, age 42, has served as Executive Vice President, Chief Information and Customer Connectivity Officer since October 2017 and as Senior Vice President and Chief Information Officer from August 2015 to September 2017. From February 2013 to July 2015, Mr. Verma served in various technology leadership roles at Target Corporation ranging from enterprise architecture, e-commerce, mobile and digital, with his most recent role at Target as Vice President - Digital Technology and API Platforms.

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Giovanna Cipriano, age 49, has served as Senior Vice President and Chief Accounting Officer since May 2009.

Sheilagh M. Clarke, age 59, has served as Senior Vice President, General Counsel and Secretary since June 2014. She previously served as Vice President, Associate General Counsel and Assistant Secretary from May 2007 to May 2014.

Todd Greener, age 48, has served as Senior Vice President—Global Supply Chain since October 2018. Mr. Greener previously served as Senior Vice President—Supply Chain at Advance Auto Parts from March 2015 to October 2018 and General Manager—Appliance Distribution Operations at General Electric Company from September 2012 to February 2015.

W. Scott Martin, age 51, has served as Senior Vice President, Chief Strategy and Development Officer since March 27, 2019. Previously he served as Senior Vice President - Strategy and Store Development from October 2017 to March 26, 2019 and as Senior Vice President — Real Estate from June 2016 to September 2017. Mr. Martin previously served as Vice President, Store Development – Asia Pacific with Gap Inc. from June 2014 to June 2016. Prior to that role, he served in various roles at Starbucks Coffee Company: Director, Strategy Development, China, Asia Pacific and Emerging Brands (July 2013 to July 2014); Director, Global Store Development (June 2007 to July 2013).

Elizabeth S. Norberg, age 52, has served as Senior Vice President and Chief Human Resources Officer since September 2018. Ms. Norberg previously served as Executive Vice President, Chief Human Resources Officer at Loews Hotels & Co. (a subsidiary of Loews Corporation) from August 2017 to September 2018, Executive Vice President, Chief Human Resources Officer at Red Lion Hotels Corporation from June 2016 to August 2017, Vice President and Chief of Human Resources Operations, Health System at Northwell Health from 2015 to 2016 and Vice President and Chief Human Resources Officer, Central Region at Northwell Health from 2013 to 2015.

John A. Maurer, age 59, has served as Vice President, Treasurer since September 2006. In addition to this role, he also served as the Vice President of Investor Relations from February 2011 through March 2018.

There are no family relationships among the executive officers or directors of the Company.

PART II

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

Foot Locker, Inc. common stock (ticker symbol “FL”) is listed on The New York Stock Exchange as well as on the Börse Stuttgart stock exchange in Germany. As of February 2, 2019, the Company had 12,690 shareholders of record owning 112,221,581 common shares.

During each of the quarters of 2018, the Company declared a dividend of $0.345 per share. The Board of Directors reviews the dividend policy and rate, taking into consideration the overall financial and strategic outlook for our earnings, liquidity, and cash flow. On February 20, 2019, the Board of Directors declared a quarterly dividend of $0.38 per share to be paid on May 3, 2019. This dividend represents a 10 percent increase over the previous quarterly per share amount.

The following table is a summary of our fourth quarter share repurchases:

Date Purchased	Total Number of Shares Purchased (1)	Average Price Paid Per Share (1)	Total Number of Shares Purchased as Part of Publicly Announced Program (2)	Approximate Dollar Value of Shares that may yet be Purchased Under the Program (2)
Nov. 4 - Dec. 1, 2018	547,424	$ 51.12	547,200	$ 417,236,248
Dec. 2 - Jan. 5, 2019	483,300	50.43	483,300	392,863,811
Jan. 6 - Feb. 2, 2019	167,500	56.73	167,500	383,360,707
	1,198,224	$ 51.63	1,198,000	

(1) These columns also reflect shares acquired in satisfaction of the tax withholding obligation of holders of restricted stock awards which vested during the quarter and shares repurchased pursuant to Rule 10b5 1 under the Securities Exchange Act of 1934. The calculation of the average price paid per share includes all fees, commissions, and other costs associated with the repurchase of such shares.

(2) On February 20, 2019, the Board of Directors approved a new 3 year, $1.2 billion share repurchase program extending through January 2022, replacing the previous $1.2 billion program.

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Performance Graph

The graph below compares the cumulative five-year total return to shareholders (common stock price appreciation plus dividends, on a reinvested basis) on Foot Locker, Inc.'s common stock relative to the total returns of the S&P 500 Specialty Retailing Index and the S&P 500 Index.

The following Performance Graph and related information shall not be deemed "soliciting material" or deemed to be filed with the SEC, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933 or Securities Exchange Act of 1934, each as amended, except to the extent that we specifically incorporate it by reference into such filing.

	2/1/2014	1/31/2015	1/30/2016	1/28/2017	2/3/2018	2/2/2019
Foot Locker, Inc.	$ 100.00	$ 140.34	$ 180.92	$ 185.25	$ 135.37	$ 158.39
S&P 500 Index	$ 100.00	$ 114.22	$ 113.45	$ 137.11	$ 168.40	$ 168.30
S&P 500 Specialty Retailing Index	$ 100.00	$ 133.45	$ 144.54	$ 155.49	$ 191.43	$ 198.35

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Item 6. Selected Financial Data

FIVE-YEAR SUMMARY OF SELECTED FINANCIAL DATA

The selected financial data below should be read in conjunction with the Consolidated Financial Statements and the Notes thereto and other information contained elsewhere in this report.

	2018		2017 (1)	2016	2015	2014
	(in millions, except per share amounts)					
Summary of Operations						
Sales	$ 7,939		7,782	7,766	7,412	7,151
Gross margin	2,528		2,456	2,636	2,505	2,374
Selling, general and administrative expenses	1,614		1,501	1,472	1,415	1,426
Depreciation and amortization	178		173	158	148	139
Litigation and other charges	37		211	6	105	4
Interest (income) / expense, net	(9)		(2)	2	4	5
Other income	(5)		(5)	(6)	(4)	(9)
Net income	541		284	664	541	520
Per Common Share Data						
Basic earnings	4.68		2.23	4.95	3.89	3.61
Diluted earnings	4.66		2.22	4.91	3.84	3.56
Common stock dividends declared per share	1.38		1.24	1.10	1.00	0.88
Weighted-average Common Shares Outstanding						
Basic earnings	115.6		127.2	134.0	139.1	143.9
Diluted earnings	116.1		127.9	135.1	140.8	146.0
Financial Condition						
Cash, cash equivalents, and short-term investments	$ 891		849	1,046	1,021	967
Merchandise inventories	1,269		1,278	1,307	1,285	1,250
Property and equipment, net	836		866	765	661	620
Total assets	3,820		3,961	3,840	3,775	3,577
Long-term debt and obligations under capital leases	124		125	127	130	134
Total shareholders' equity	2,506		2,519	2,710	2,553	2,496
Financial Ratios						
Sales per average gross square foot (2)	$ 504		495	515	504	490
SG&A as a percentage of sales	20.3	%	19.3	19.0	19.1	19.9
Net income margin	6.8	%	3.6	8.6	7.3	7.3
Adjusted net income margin (3)	6.9	%	6.6	8.4	8.2	7.3
Earnings before interest and taxes (EBIT) (3)	$ 704		576	1,006	841	814
EBIT margin (3)	8.9	%	7.4	13.0	11.3	11.4
Adjusted EBIT (3)	$ 741		762	1,012	946	816
Adjusted EBIT margin (3)	9.3	%	9.9	13.0	12.8	11.4
Return on assets (ROA)	13.9	%	7.3	17.4	14.7	14.7
Return on invested capital (ROIC) (3)	12.0	%	11.0	15.1	15.8	15.0
Net debt capitalization percent (3), (4)	51.7	%	54.4	48.5	47.4	43.4
Current ratio	3.3		4.1	4.3	3.7	3.5
Other Data						
Capital expenditures	$ 187		274	266	228	190
Number of stores at year end	3,221		3,310	3,363	3,383	3,423

Total selling square footage at year end (in millions)	7.63	7.71	7.63	7.58	7.48
Total gross square footage at year end (in millions)	13.24	13.30	13.12	12.92	12.73

(1) 2017 represents the 53 weeks ended February 3, 2018.
(2) Calculated as store sales divided by the average monthly ending gross square footage of the last thirteen months. The computation for each of the years presented reflects the foreign exchange rate in effect for such year. The 2017 amount has been calculated excluding the sales of the 53rd week.
(3) These represent non-GAAP measures, see Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" for additional information and calculation.
(4) Represents total debt and obligations under capital leases, net of cash, cash equivalents, and short-term investments. This calculation includes the present value of operating leases and therefore is considered a non-GAAP measure.

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

Disclosure Regarding Forward-Looking Statements

This report contains forward-looking statements within the meaning of the federal securities laws. Other than statements of historical facts, all statements which address activities, events, or developments that the Company anticipates will or may occur in the future, including, but not limited to, such things as future capital expenditures, expansion, strategic plans, financial objectives, dividend payments, stock repurchases, growth of the Company’s business and operations, including future cash flows, revenues, and earnings, and other such matters, are forward-looking statements. These forward-looking statements are based on many assumptions and factors which are detailed in the Company’s filings with the U.S. Securities and Exchange Commission.

These forward-looking statements are based largely on our expectations and judgments and are subject to a number of risks and uncertainties, many of which are unforeseeable and beyond our control. For additional discussion on risks and uncertainties that may affect forward-looking statements, see “Risk Factors” in Part I, Item 1A. Any changes in such assumptions or factors could produce significantly different results. The Company undertakes no obligation to update forward-looking statements, whether as a result of new information, future events, or otherwise.

Business Overview

Foot Locker, Inc., through its subsidiaries, is one of the largest athletic footwear and apparel retailers in the world, operating 3,221 stores in 27 countries. The Foot Locker brand is one of the most widely recognized names in the markets in which we operate, epitomizing premium quality for the active lifestyle customer. We operate websites and mobile apps, aligned with the brand names of our store banners (including footlocker.com, ladyfootlocker.com, six02.com, kidsfootlocker.com, champssports.com, footaction.com, footlocker.ca, footlocker.eu, footlocker.com.au, runnerspoint.com, sidestep-shoes.com, footlocker.hk, footlocker.sg, and footlocker.my). These sites offer some of the largest online selections of athletically inspired shoes and apparel, while providing a seamless link between e-commerce and physical stores. We also operate the websites for eastbay.com, final-score.com, and eastbayteamsales.com.

With its various marketing channels and experiences across North America, Europe, Asia, Australia, and New Zealand, the Company's purpose is to inspire and empower youth culture around the world, by fueling a shared passion for self-expression and creating unrivaled experiences at the heart of the sport and sneaker communities.

Segment Reporting

We identify our operating segments according to how our business activities are managed and evaluated by our chief operating decision maker, our CEO. Prior to 2018, we had two reportable segments, Athletic Stores and Direct-to-Customers. Beginning in 2018, the Company has changed its organizational and internal reporting structure in order to execute our omni-channel strategy. This change resulted in the combination of our stores and direct-to-customer financial results.

The Company has determined that it has two operating segments, North America and International. Our North America operating segment includes the results of the following banners operating in the U.S. and Canada: Foot Locker, Kids Foot Locker, Lady Foot Locker, Champs Sports, Footaction, and SIX:02, including each of their related e-commerce businesses, as well as our Eastbay business that includes internet, catalog, and team sales. Our International operating segment includes the results of the following banners operating in Europe, Asia, Australia, and

New Zealand: Foot Locker, Runners Point, Sidestep, and Kids Foot Locker, including each of their related e-commerce businesses. We have further aggregated these operating segments into one reportable segment based upon their shared customer base and similar economic characteristics.

During 2018, the Company expanded into Asia, we have opened five stores and launched our digital channels across Singapore, Hong Kong, and Malaysia. In addition, we entered China through a limited offering in partnership with Tmall (a Chinese-language platform for business-to-consumer online retail). During the first quarter of 2019, we updated our organizational structure to support an accelerated growth strategy for the region. We opened an Asian headquarters in Singapore and realigned our organization into three distinct geographic regions: Europe, Middle East and Africa (EMEA), Asia Pacific, and North America. The Company will reevaluate during the first quarter of 2019 our operating segments and reporting units as a result of this change.

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Store and Operations Profile

	February 3, 2018	Opened	Closed	February 2, 2019	Relocations/ Remodels	Square Footage (in thousands) Selling	Gross
Foot Locker U.S.	910	2	26	886	33	2,404	4,184
Foot Locker Europe	636	18	12	642	37	1,002	2,158
Foot Locker Canada	111	—	4	107	7	263	426
Foot Locker Pacific	98	2	6	94	7	139	230
Foot Locker Asia	—	5	—	5	—	19	34
Kids Foot Locker	436	3	11	428	7	738	1,267
Lady Foot Locker	85	—	28	57	—	79	133
Champs Sports	541	3	9	535	17	1,913	2,974
Footaction	260	5	15	250	8	799	1,360
Runners Point	118	3	14	107	1	138	238
Sidestep	83	4	7	80	5	74	133
SIX:02	32	—	2	30	—	60	102
Total	3,310	45	134	3,221	122	7,628	13,239

We operated 3,221 stores as of the end of 2018. The following is a brief description of each of our banners:

Foot Locker — Foot Locker is a leading global youth culture brand that connects the sneaker obsessed consumer with the most innovative and culturally relevant sneakers and apparel. Across all our consumer touchpoints, Foot Locker enables consumers to fulfill their desire to be part of sneaker and youth culture. We curate special product assortments and marketing content that supports our premium position – from leading global brands such as Nike, Jordan, adidas, and Puma, as well as new and emerging brands in the athletic and lifestyle space. We connect emotionally with our consumers through a combination of global brand events and highly targeted and personalized experiences in local markets. Foot Locker's 1,734 stores are located in 27 countries including 886 in the United States, Puerto Rico, U.S. Virgin Islands, and Guam, 107 in Canada, 642 in Europe, a combined 94 in Australia and New Zealand, and 5 in Asia. Our domestic stores have an average of 2,700 selling square feet and our international stores have an average of 1,700 selling square feet.

Kids Foot Locker — Kids Foot Locker offers the largest selection of brand-name athletic footwear, apparel and accessories for children. We feature products, content and experiences geared toward youth sneaker culture. Of our 428 stores, 369 are located in the United States, Puerto Rico, and the U.S. Virgin Islands, 38 in Europe, 19 in Canada, and a combined 2 in Australia and New Zealand. These stores have an average of 1,700 selling square feet.

Lady Foot Locker — Lady Foot Locker is a U.S. retailer of athletic footwear, apparel, and accessories dedicated to sneaker-obsessed young women. Our stores provide premium sneakers and apparel, carefully selected to reflect the latest styles. Lady Foot Locker operates 57 stores that are located in the United States and Puerto Rico. These stores have an average of 1,400 selling square feet.

Champs Sports — Champs Sports is one of the largest mall-based specialty athletic footwear and apparel retailers in North America. With a focus on the lifestyle expression of sport, Champs Sports' product categories include athletic footwear and apparel, and sport-lifestyle inspired accessories. This assortment allows Champs Sports to offer the best head-to-toe fashion stories representing the most powerful athletic brands, sports teams, and athletes in North America. Of our 535 stores, 504 are located in the United States, Puerto Rico, and the U.S. Virgin Islands and 31 in

Canada. The Champs Sports stores have an average of 3,600 selling square feet.

Footaction — Footaction is a North American athletic footwear and apparel retailer that offers the freshest, best edited selection of athletic lifestyle brands and looks. This banner is uniquely positioned at the intersection of sport and style, with a focus on authentic, premium product. The primary consumer is a style-obsessed, confident, influential young male who is always dressed to impress. Of our 250 stores, 246 are located in the United States and Puerto Rico and 4 are in Canada. The Footaction stores have an average of 3,200 selling square feet.

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Runners Point — Runners Point specializes in running footwear, apparel, and equipment for both performance and lifestyle purposes. This banner offers athletically inspired premium products and personalized service. Runners Point also caters to local running communities providing technical products, training tips and access to local running and group events, while also serving their lifestyle running needs. Our 107 stores are located in Germany, Austria, and Switzerland. Runners Point stores have an average of 1,300 selling square feet.

Sidestep — Sidestep is a predominantly athletic fashion footwear banner. Our 80 stores are located in Germany, Austria, Netherlands, and Switzerland. Sidestep caters to a more discerning, fashion forward consumer. Sidestep stores have an average of 900 selling square feet.

SIX:02 — SIX:02 operates 30 stores in the United States and have an average of 2,000 selling square feet. The Company has decided to close the SIX:02 banner during the early part of 2019 and will focus on its women's business through our other banners.

Eastbay

Eastbay is a sporting goods direct marketer operating in the United States, providing serious high school and other athletes with a complete sports solution including athletic footwear, apparel, equipment, and team licensed merchandise for a broad range of sports. With 150 sales professionals serving the United States, Eastbay Team Sales connects directly with thousands of high school coaches and athletic directors in offering the best performance product and premium level of service.

Franchise Operations

The Company operates franchised Foot Locker stores located within the Middle East, as well as franchised stores in Germany under the Runners Point banner. In addition, we entered into a franchise agreement during 2017 with Fox-Wizel Ltd for franchised stores operating in Israel.

A total of 122 franchised stores were operating as of February 2, 2019, 10 in Germany and 112 in the Middle East, of which 41 are in Israel.

Reconciliation of Non-GAAP Measures

In addition to reporting the Company's financial results in accordance with GAAP, the Company reports certain financial results that differ from what is reported under GAAP. In the following tables, we have presented certain financial measures and ratios identified as non-GAAP such as sales excluding 53rd week, Earnings Before Interest and Taxes ("EBIT"), adjusted EBIT, adjusted EBIT margin, adjusted income before income taxes, adjusted net income, adjusted net income margin, adjusted diluted earnings per share, Return on Invested Capital ("ROIC"), free cash flow, and net debt capitalization. We present these non-GAAP measures because we believe they assist investors in comparing our performance across reporting periods on a consistent basis by excluding items that are not indicative of our core business or which affect comparability. In addition, these non-GAAP measures are useful in assessing our progress in achieving our long-term financial objectives.

Additionally, we present certain amounts as excluding the effects of foreign currency fluctuations, which are also considered non-GAAP measures. Throughout the following discussions, where amounts are expressed as excluding the effects of foreign currency fluctuations, such changes are determined by translating all amounts in both years using the prior-year average foreign exchange rates. Presenting amounts on a constant currency basis is useful to investors because it enables them to better understand the changes in our businesses that are not related to currency movements.

Fiscal year 2017 represented the fifty-three weeks ended February 3, 2018. Accordingly, certain non-GAAP results have also been adjusted to exclude the effects of the 53rd week to assist in comparability.

We estimate the tax effect of the non-GAAP adjustments by applying a marginal rate to each of the respective items. The income tax items represent the discrete amount that affected the period. The non-GAAP financial information is provided in addition to, and not as an alternative to, our reported results prepared in accordance with GAAP. Presented below is a reconciliation of GAAP and non-GAAP results discussed throughout this Annual Report on Form 10-K. Please see the non-GAAP reconciliations for free cash flow and net debt capitalization in the "Liquidity and Capital Resources" section.

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Reconciliation:

	2018		2017		2016	
	($ in millions)					
Sales	$ 7,939		$ 7,782		$ 7,766	
53rd week	—		95		—	
Sales excluding 53rd week (non-GAAP)	$ 7,939		$ 7,687		$ 7,766	
Pre-tax income:						
Income before income taxes	$ 713		$ 578		$ 1,004	
Pre-tax adjustments excluded from GAAP:						
Litigation and other charges (1)	37		211		6	
53rd week	—		(25)		—	
Adjusted income before income taxes (non-GAAP)	$ 750		$ 764		$ 1,010	
Calculation of Earnings Before Interest and Taxes (EBIT):						
Income before income taxes	$ 713		$ 578		$ 1,004	
Interest (income) / expense, net	(9)		(2)		2	
EBIT	$ 704		$ 576		$ 1,006	
Adjusted income before income taxes	$ 750		$ 764		$ 1,010	
Interest (income) / expense, net	(9)		(2)		2	
Adjusted EBIT	$ 741		$ 762		$ 1,012	
EBIT margin %	8.9	%	7.4	%	13.0	%
Adjusted EBIT margin %	9.3	%	9.9	%	13.0	%
After-tax income:						
Net income	$ 541		$ 284		$ 664	
After-tax adjustments excluded from GAAP:						
Litigation and other charges, net of income tax benefit of $6, $78, and $1 million, respectively (1)	31		133		5	
U.S. tax reform (2)	(28)		99		—	
Tax expense related to Dutch and French tax rate change (3)	4		2		2	
Tax benefit related to enacted change in foreign branch currency regulations (4)	(1)		—		(9)	
Income tax valuation allowances (5)	—		8		—	
Tax benefit related to intellectual property reassessment (6)	—		—		(10)	
53rd week, net of income tax expense of $9 million	—		(16)		—	
Adjusted net income (non-GAAP)	$ 547		$ 510		$ 652	
Earnings per share:						
Diluted EPS	$ 4.66		$ 2.22		$ 4.91	
Diluted EPS amounts excluded from GAAP:						
Litigation and other charges (1)	0.27		1.02		0.03	
U.S. tax reform (2)	(0.25)		0.78		—	
Tax expense related to Dutch and French tax rate change (3)	0.04		0.02		0.02	
	(0.01)		—		(0.07)	

Tax benefit related to enacted change in foreign branch currency regulations (4)						
Income tax valuation allowances (5)	—		0.07		—	
Tax benefit related to intellectual property reassessment (6)	—		—		(0.07)	
53rd week	—		(0.12)		—	
Adjusted diluted EPS (non-GAAP)	$ 4.71		$ 3.99		$ 4.82	
Net income margin %	6.8	%	3.6	%	8.6	%
Adjusted net income margin %	6.9	%	6.6	%	8.4	%

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Notes on Non-GAAP Adjustments:

(1) Litigation and other charges for 2018 includes pension-related litigation charges ($18 million, or $13 million after-tax) and impairment charges ($19 million, or $18 million after-tax). The 2017 amount represented pension-related litigation charges ($178 million, or $111 million after-tax), impairment charges ($20 million, or $14 million after-tax), and severance and related costs ($13 million, or $8 million after-tax). The 2016 amount represented impairment charges of $6 million, or $5 million after-tax.

Pension litigation - The Company recorded pre-tax charges $18 million during 2018, in connection with its U.S. retirement plan litigation and required plan reformation. The charge reflected $13 million of adjustments to the estimated cost of the reformation and interest. Additionally, professional fees of $5 million were incurred during 2018 in connection with the plan reformation.

Impairment charges – The Company recognized pre-tax impairment charges totaling $19 million, $20 million, and $6 million during the fourth quarters of 2018, 2017, and 2016, respectively. These charges were associated with our SIX:02, Runners Point, and Sidestep businesses and primarily represented the write-down of the Runners Point tradename, store fixtures, and leasehold improvements.

Severance and related costs – During the third quarter of 2017, the Company recorded a pre-tax charge of $13 million associated with the reorganization and the reduction of staff taken to improve efficiency.

(2) On December 22, 2017, the United States enacted tax reform legislation that included a broad range of business tax provisions. During the fourth quarter of 2017, the Company recognized a $99 million provisional charge for the mandatory deemed repatriation of foreign sourced net earnings and a corresponding change in our permanent reinvestment assertion under ASC 740-30. During 2018, the Company reduced the provisional amounts by $28 million. This adjustment represented a $21 million reduction in the deemed repatriation tax and a $7 million benefit related to IRS accounting method changes and timing difference adjustments.

We exclude the discrete U.S. tax reform effect from our Adjusted diluted EPS as it does not reflect our ongoing tax obligations under U.S. tax reform.

(3) During the fourth quarters of 2018 and 2017, the Company recognized tax expense of $4 million and $2 million, respectively, in connection to separate tax rate reductions in the Netherlands and France, respectively, to write down the value of deferred tax assets. During 2016, the Company recognized tax expense of $2 million related to a separate tax rate reduction in France.

(4) During the second quarter of 2018, the U.S. Treasury issued a notice that delayed the effective date of regulations under Internal Revenue Code Section 987. These regulations, which were promulgated in December 2016, changed our method for determining the tax effects of foreign currency translation gains and losses for our foreign businesses that are operated as branches and are reported in a currency other than the currency of their parent. As a result of the delay in the effective date, the Company updated its calculations for the effect of these regulations, which resulted in an increase to deferred tax assets and a corresponding reduction in our income tax provision in the amount of $1 million. The change in 2016 resulted in an increase to deferred tax assets and a corresponding reduction in our income tax provision of $9 million.

(5) During the fourth quarter of 2017, the Company determined that certain valuation allowances should be established against deferred tax assets associated with the Runners Point and Sidestep stores and e-commerce businesses.

(6) During the third quarter of 2016, we performed a scheduled reassessment of the value of the intellectual property provided to our European business by Foot Locker in the U.S. during the fourth quarter of 2012. The new, higher valuation resulted in catch-up deductions that reduced tax expense by $10 million.

Return on Invested Capital

ROIC is presented below and represents a non-GAAP measure. We believe it is a meaningful measure because it quantifies how efficiently we generated operating income relative to the capital we have invested in the business. In order to calculate ROIC, we adjust our results to reflect our operating leases as if they qualified for capital lease treatment. Operating leases are the primary financing vehicle used to fund store expansion and, therefore, we believe that the presentation of these leases as if they were capital leases is appropriate. Accordingly, the asset base and net income amounts are adjusted to reflect this in the calculation of ROIC. ROIC, subject to certain adjustments, is also used as a measure in executive long-term incentive compensation.

The closest U.S. GAAP measure to ROIC is Return on Assets (“ROA”) and is also represented below. ROA increased to 13.9 percent as compared to 7.3 percent in the prior year. This improvement reflects the increase in net income as compared with the prior year, which included charges related to the pension matter and the effects of tax reform.

Our ROIC increased to 12.0 percent in 2018, as compared to 11.0 percent in the prior year. Average invested capital decreased compared with the prior year and after-tax earnings increased, which resulted in the overall increase in ROIC. Average invested capital decreased as a result of the effect of opening fewer new stores, more stores that are operating on a month-to-month basis or paying variable rents coupled with foreign exchange rate fluctuations. The earnings increase is more fully discussed on the following pages.

	2018		2017		2016	
ROA (1)	13.9	%	7.3	%	17.4	%
ROIC %	12.0	%	11.0	%	15.1	%

(1) Represents net income of $541 million, $284 million, and $664 million divided by average total assets of $3,891 million, $3,901 million, and $3,808 million for 2018, 2017, and 2016, respectively.

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Calculation of ROIC:

	2018	2017	2016
	($ in millions)		
Adjusted EBIT	$ 741	$ 762	$ 1,012
+ Rent expense	750	735	690
- Estimated depreciation on capitalized operating leases (1)	(603)	(593)	(552)
Adjusted net operating profit	888	904	1,150
- Adjusted income tax expense (2)	(241)	(304)	(409)
= Adjusted return after taxes (3)	$ 647	$ 600	$ 741
Average total assets	$ 3,891	$ 3,901	$ 3,808
- Average cash and cash equivalents	(870)	(948)	(1,034)
- Average non-interest bearing current liabilities	(690)	(614)	(656)
- Average merchandise inventories	(1,274)	(1,293)	(1,296)
+ Average estimated asset base of capitalized operating leases (1)	2,989	2,978	2,687
+ 13 month average merchandise inventories	1,337	1,413	1,388
= Average invested capital	$ 5,383	$ 5,437	$ 4,897
ROIC %	12.0 %	11.0 %	15.1 %

(1) The determination of the capitalized operating leases and the adjustments to income have been calculated on a lease-by-lease basis and have been consistently calculated in each of the years presented above. Capitalized operating leases represent the best estimate of the asset base that would be recorded for operating leases as if they had been classified as capital or as if the property were purchased. The present value of operating leases is discounted using various interest rates ranging from 1.7 percent to 14.5 percent, which represents our incremental borrowing rate at inception of the lease. The capitalized operating leases and related income statement amounts disclosed above do not reflect the requirements of Accounting Standards Update 2016 02, Leases.

(2) The adjusted income tax expense represents the marginal tax rate applied to net operating profit for each of the periods presented.

(3) The adjusted return after taxes does not include interest expense that would be recorded on a capital lease.

Overview of Consolidated Results

	2018	2017	2016
	(in millions, except per share data)		
Sales	$ 7,939	$ 7,782	$ 7,766
Sales per square foot	504	495	515
Gross margin	2,528	2,456	2,636
Selling, general and administrative expenses	1,614	1,501	1,472
Depreciation and amortization	178	173	158

Operating Results			
Division profit	$ 789	810	1,070
Less: Pension litigation and reorganization charges	18	191	—
Less: Corporate expense	72	48	70
Income from operations	699	571	1,000
Interest income (expense), net	9	2	(2)
Other income	5	5	6
Income before income taxes	$ 713	578	1,004
Net income	$ 541	$ 284	$ 664
Diluted earnings per share	$ 4.66	$ 2.22	$ 4.91

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Highlights of our 2018 financial performance include:

· Sales and comparable-store sales, as noted in the table below, both increased and benefitted from improved assortments compared with the prior year. We worked closely with our strategic partners to deliver exciting and exclusive product offerings and improved our local product assortments. Additionally, in early 2018 we changed our organizational structure by aligning our stores and e-commerce businesses in support of our omni-channel strategies. The benefits from that realignment are noted in the results of the e-commerce business.

	2018	2017	2016
Sales increase	2.0 %	0.2 %	4.8 %
Comparable-store sales increase / (decrease)	2.7 %	(3.1) %	4.3 %

· Footwear sales represented 82 percent of total sales for all periods presented.
· Our stores and direct-to-customer sales channels experienced overall comparable-sales gains of 1.1 percent and 12.3 percent, respectively.
· Sales per square foot increased by 1.8 percent to $504.
· Sales of our direct-to-customers channel increased by 10.5 percent to $1,225 million, as compared with $1,109 million in 2017 and increased by 110 basis points as a percentage of total sales to 15.4 percent. The direct business has been steadily increasing as a percentage of total sales over the last several years. Our growth reflected our expansion into new geographies and customers' acceptance of our technology improvements.
· Gross margin, as a percentage of sales, increased by 20 basis points to 31.8 percent in 2018. The improvement was primarily driven by an increase in our merchandise margin rate, reflecting a lower markdown rate as compared with the prior year.
· SG&A expenses were 20.3 percent of sales, an increase of 100 basis points as compared with the prior year. The overall increase reflected higher wages, higher incentive compensation expense, and an increase in costs incurred in connection with our ongoing investment in various technology and infrastructure projects.
· Net income was $541 million, or $4.66 diluted earnings per share, which represented a significant increase from the prior-year period. This increase reflected, in part, the charge recorded in the prior year related to the pension matter and tax reform. Adjusted net income was $547 million, or $4.71 diluted earnings per share, an increase of 18.0 percent from the corresponding non-GAAP prior-year period.
· Net income margin increased to 6.8 percent as compared with 3.6 percent in the prior year. Our adjusted net income margin increased to 6.9 percent in 2018 as compared to 6.6 percent in the prior year.

Highlights of our financial position for the period ended February 2, 2019 include:

· We ended the year in a strong financial position. At year end, we had $767 million of cash and cash equivalents, net of debt. Cash and cash equivalents at February 2, 2019 were $891 million.
· Net cash provided by operating activities was $781 million. This result included pension contributions of $128 million and a $97 million payment to class counsel related to the pension litigation matter. Excluding these outflows, operating activities were strong and reflected the Company's improved working capital management, with inventories declining slightly despite higher sales.
· Cash capital expenditures during 2018 totaled $187 million and were primarily directed to the remodeling or relocation of 122 stores, the build-out of 45 new stores, as well as other technology and infrastructure projects.
· We made minority investments of $89 million during 2018, bringing our total investments to $104 million. These investments are part of the Company's broader strategic initiatives aimed at strengthening and diversifying our role within the sneaker community. Additionally, we expect that these strategic investments allow us to better adapt to the dynamically evolving consumer and retail landscape by strengthening our capabilities, providing diversification,

and gaining greater insights into youth culture.

- During 2018, we returned significant amounts of cash to our shareholders. Dividends totaling $158 million were declared and paid during 2018, and 7.9 million shares were repurchased under our share repurchase program at a cost of $375 million. In February 2019, our Board of Directors approved a dividend increase of 10 percent and approved a new 3-year $1.2 billion share repurchase program. These initiatives demonstrate our commitment to delivering meaningful returns to our shareholders.

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Sales

All references to comparable-store sales for a given period relate to sales of stores that were open at the period-end and had been open for more than one year. The computation of consolidated comparable-store sales also includes direct-to-customers sales. Stores opened or closed during the period are not included in the comparable-store base; however, stores closed temporarily for relocation or remodeling are included. Computations exclude the effect of foreign currency fluctuations. Comparable-store sales for 2017 does not include the sales from the 53rd week.

The information shown below represents certain sales metrics by sales channel:

	2018	2017	2016
Stores	($ in millions)		
Sales	$ 6,714	$ 6,673	$ 6,744
$ Change	$ 41	$ (71)	
% Change	0.6 %	(1.1) %	
% of total sales	84.6 %	85.7 %	86.8 %
Comparable sales increase (decrease)	1.1 %	(4.7) %	3.6 %
Direct-to-customers			
Sales	$ 1,225	$ 1,109	$ 1,022
$ Change	$ 116	$ 87	
% Change	10.5 %	8.5 %	
% of total sales	15.4 %	14.3 %	13.2 %
Comparable sales increase	12.3 %	6.9 %	8.8 %

Effective with the first quarter of 2018, the Company discloses one reportable segment and, accordingly, the following discussion describes the changes in sales by banner on an omni-channel basis, meaning that each banner's results are inclusive of its store and e-commerce activity, unless noted otherwise.

2018 compared with 2017

Sales of $7,939 million in 2018 increased by 2.0 percent from sales of $7,782 million in 2017. Excluding the effect of foreign currency fluctuations, sales increased by 1.7 percent as compared with 2017. Comparable-store sales increased 2.7 percent during 2018 as compared with the corresponding prior-year period.

Both of our sales channels generated positive results as compared with the prior year. The overall comparable sales growth was led by our direct-to-customers channel, which increased by 12.3 percent as compared with the corresponding prior-year period. The improvement in our direct-to-customers channel reflected positive customer sentiment as a result of various e-commerce customer experience enhancements. Our stores channel also performed well and generated a comparable sales increase of 1.1 percent as compared with the corresponding prior-year period. Both channels benefitted from improved product assortments, including higher sales from our marquee business and secondary brands.

Excluding the effect of foreign currency fluctuations and the 53rd week in 2017, the increase in total sales was across most of our banners and was led by our North American operations. The largest gains were experienced by Eastbay, Kids Foot Locker, Foot Locker, and Champs Sports. The banners that experienced declines during 2018 included Runners Point, Sidestep, SIX:02, and Footaction. Our operations in Europe ended the year relatively flat as compared with the corresponding prior-year period as the fourth quarter's high single-digit sales increase was not quite enough to offset the declines experienced earlier in the year.

From a product perspective, footwear and apparel sales led the increase. Sales of men's and children's footwear increased, while sales of women's footwear declined. The decline in sales of women's footwear primarily reflected declines in sales of women's running and court styles as the prior year included the success of certain women's offerings with no comparable offerings in the current year. Our apparel sales increased primarily due to improvements in our men's and children's product offerings.

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2017 compared with 2016

Sales of $7,782 million in 2017 increased by 0.2 percent from sales of $7,766 million in 2016. Results from 2017 include the effect of the 53rd week, which represented sales of $95 million. Excluding the effect of foreign currency fluctuations, sales declined 0.5 percent as compared with 2016. Comparable-store sales declined 3.1 percent during 2017 as compared with 2016.

The overall decline in comparable-store sales was primarily driven by a decrease in footwear sales. By channel, our direct-to-customers business led the overall result. Comparable-sales for the direct-to-customers channel increased 6.9 percent in 2017 as compared to 2016. The comparable-sales gain primarily reflected growth in our domestic and international store-banner e-commerce businesses coupled with an increase in our Eastbay business. Internationally, we continued to expand the geographies that we serve in 2017, including most notably launching our e-commerce business in Australia.

During 2017, we experienced a decline in footwear sales which reflected a lack of depth and variety of innovative new product at the premium end of the athletic footwear market to suit our customers' quickly-changing style preferences. Children's and women's footwear sales were the major contributors to the comparable-store declines in footwear, although men's footwear also experienced a modest comparable-store decline. Women's court styles primarily contributed to the comparable-store decline in women's footwear, particularly in Foot Locker, Lady Foot Locker, and Foot Locker Europe. The comparable store-sales decrease in children's footwear mostly reflected declines in the basketball category. Gains in men's lifestyle running shoes were not enough to compensate for the sales declines in basketball and court lifestyle footwear, again due to insufficient product depth.

Gross Margin

	2018	2017	2016
Gross margin rate	31.8 %	31.6 %	33.9 %
Basis point increase / (decrease) in the gross margin rate	20	(230)	10
Components of the change-			
Merchandise margin rate improvement / (decline)	30	(160)	20
Higher occupancy and buyers' compensation expense rate	(10)	(70)	(10)

Gross margin is calculated as sales minus cost of sales. Cost of sales includes: the cost of merchandise, freight, distribution costs including related depreciation expense, shipping and handling, occupancy and buyers' compensation. Occupancy costs include rent, common area maintenance charges, real estate taxes, general maintenance, and utilities.

The gross margin rate increased to 31.8 percent in 2018 as compared to 31.6 percent in the prior year. The merchandise margin rate improvement primarily reflected lower markdown rates as we increased full-price selling especially as the year progressed. This was partially offset by a continued decline in our shipping and handling revenue as a result of a higher frequency of free shipping offers. The change in the gross margin rate also reflects a 10 basis point increase in the occupancy and buyers' compensation rate as compared with 2017. Excluding the 53rd week of 2017, the occupancy and buyers' compensation expense rate improved by 10 basis points.

The gross margin rate decreased to 31.6 percent in 2017 as compared to 33.9 percent in 2016. The decline in the merchandise margin rate in 2017 primarily reflected a higher markdown rate. The higher markdowns were the result of a more promotional environment and were necessary to ensure merchandise inventory remained current and in line with the sales trend. Although to a lesser degree, a decline in our shipping and handling revenue also negatively affected the merchandise margin. The decline in the gross margin rate also reflected an increase in the occupancy and buyers' compensation rate as compared to 2016. Rent-related costs continued to increase while our sales were relatively flat. The increase in rent-related costs was primarily driven by entering into leases for high-profile locations.

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Selling, General and Administrative Expenses (SG&A)

	2018	2017	2016
	($ in millions)		
SG&A	$ 1,614	$ 1,501	$ 1,472
$ Change	$ 113	$ 29	57
% Change	7.5 %	2.0 %	4.0
SG&A as a percentage of sales	20.3 %	19.3 %	19.0 %

SG&A increased by $113 million and 7.5 percent in 2018, as compared with the prior year. As a percentage of sales, the SG&A rate increased by 100 basis points as compared with 2017. Excluding the effect of foreign currency fluctuations, SG&A increased by $105 million and 7.0 percent as compared with the prior year.

The higher SG&A expense rate in 2018 reflected higher wages, higher incentive compensation expense, and an increase in costs incurred in connection with our ongoing investment in various technology and infrastructure projects. Higher incentive compensation, including share-based compensation tied to performance, was recorded reflecting our strong performance relative to our financial targets as compared with the prior year that included minimal expense. Additionally, during 2017, the Company recorded hurricane-related expenses of $7 million. A benefit of $5 million was recorded during 2018 relating to insurance recoveries for damaged inventory and fixed assets for losses incurred in 2017 during Hurricane Maria. Together, these two factors affected SG&A expense by $12 million.

The rise in the SG&A expense rate during 2017, as compared to 2016, primarily related to our stores, partially offset by a decline in our e-commerce SG&A rate. During 2017, we experienced increases in store-related compensation costs as a result of increased minimum wage levels. Additionally, we incurred higher expenses related to wages, such as payroll taxes and benefits. These increases in the SG&A expense rate were partially offset by declines in incentive compensation and marketing related costs. The 53rd week contributed $16 million of additional expenses in 2017, however, as a percentage of sales, the SG&A rate remained unchanged at 19.3 percent.

Depreciation and Amortization

	2018	2017	2016
	($ in millions)		
Depreciation and amortization	$ 178	$ 173	$ 158
$ Change	$ 5	$ 15	10
% Change	2.9 %	9.5 %	6.8

Depreciation and amortization increased by $5 million in 2018 as compared with 2017. The effect of foreign currency fluctuations on depreciation and amortization for the current year was not significant. The increases in both 2018 and 2017 reflect a rise in capital spending on store improvements, the enhancement of our digital sites, and various other technologies and infrastructure.

Division Profit

Included in our 2018 division profit were non-cash impairment charges of $19 million related to the write-down of tradenames, store fixtures, and leasehold improvements related to Runners Point, Sidestep, and SIX:02. The effect of the impairment charges decreased the division profit rate by 30 basis points. The Company will be closing its SIX:02 stores during 2019, however lease termination payments are not expected to be significant. While our gross margin rate increased, our expenses grew at a faster rate thereby reducing division profit. The increase in gross margin and expenses are more fully discussed in other sections.

Division profit for 2017 also included a non-cash impairment charge of $20 million related to the write-down of primarily store fixtures and leasehold improvements. SIX:02 recorded a charge of $16 million and our Runners Point and Sidestep stores recorded a charge of $4 million. The effect of the impairment charges decreased the division profit rate by 30 basis points. Most of the remaining decline in the division profit rate when comparing 2017 to 2016 was related to a decrease in the merchandise margin rate reflecting higher markdowns coupled with an increase in the SG&A rate. The division profit decline in 2017 was most pronounced in our European business. The 53rd week did not have a significant effect on the overall division profit rate.

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Litigation and Other Charges

Litigation and other charges recorded totaled $37 million, $211 million, and $6 million for 2018, 2017, and 2016, respectively.

Included in division profit are non-cash impairment charges recorded during 2018, 2017, and 2016 of $4 million, $20 million, and $6 million, respectively. These charges related to the write-down of store fixtures and leasehold improvements of our Runners Point, Sidestep, and SIX:02 stores. Additionally, in 2018 we recorded a charge of $15 million to write down the value of the Runners Point tradename.

Related to our pension litigation, we recorded charges totaling $18 million during 2018. This amount included charges of $13 million, which represented adjustments to the estimated cost of reformation and interest. Professional fees in connection with the plan reformation were incurred totaling $5 million. During 2017, the Company recorded charges totaling $178 million related to the same matter.

We reduced and reorganized our division and corporate staff during 2017, which resulted in a charge of $13 million. The substantial majority of which was for severance and related costs.

Corporate Expense

	2018	2017	2016
	($ in millions)		
Corporate expense	$ 72	$ 48	$ 70
$ Change	$ 24	$ (22)	(7)

Corporate expense consists of unallocated general and administrative expenses as well as depreciation and amortization related to the Company's corporate headquarters, centrally managed departments, unallocated insurance and benefit programs, certain foreign exchange transaction gains and losses, and other items. Depreciation and amortization included in corporate expense was $18 million, $16 million, and $14 million in 2018, 2017, and 2016, respectively.

The allocation of corporate expense to the operating divisions is adjusted annually based upon an internal study; accordingly, the allocation increased by $40 million in 2018, thus reducing corporate expense. Excluding the corporate allocation change, corporate expense increased by $64 million as compared with 2017. This increase was primarily due to technology spending related to our various technology initiatives and higher incentive compensation, including the portion of share-based compensation that is tied to the Company's performance. Share-based compensation increased by $7 million as compared with the prior year.

Corporate expense decreased by $22 million in 2017 as compared with 2016. The annual adjustment of the allocation of corporate expense to the operating divisions reduced corporate expense by $4 million. The remaining $18 million decline was primarily due to a $13 million decline in incentive compensation, which reflected the Company's underperformance relative to its plan. Share-based compensation declined by $7 million and is also primarily related to the portion of share-based compensation that is tied directly to the Company's performance. Additionally, the decline in corporate expense also reflected a decrease of $4 million relating to the 2016 corporate headquarters relocation costs. These decreases were partially offset by a $2 million litigation charge, increased corporate support costs, such as information technology and real estate management, and increased depreciation and amortization expense. The effect of the 53rd week on corporate expense was not significant.

Interest (Income) / Expense, Net

	2018	2017	2016
	($ in millions)		
Interest expense	$ 11	$ 12	$ 11
Interest income	(20)	(14)	(9)
Interest (income) / expense, net	$ (9)	$ (2)	$ 2
Weighted-average interest rate (excluding fees)	7.0 %	7.3 %	7.2

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The changes during 2018 and 2017 primarily relate to the amounts earned as interest income. Interest income increased by $6 million in 2018 as compared with 2017 and increased $5 million in 2017 as compared with 2016. The increase for both periods primarily represented increased income due to higher average interest rates on our cash investments. The increase in interest income during 2018 also reflected the effects of cash repatriation to the U.S., where we earned a higher average interest rate. We did not have any short-term borrowings, other than small amounts related to capital leases, for any of the periods presented.

Income Taxes

Public Law 115-97, informally known as the Tax Cuts and Jobs Act (the “Tax Act”), was enacted on December 22, 2017. The Tax Act significantly revised the U.S. corporate income tax by, among other things, lowering the statutory corporate tax rate from 35 percent to 21 percent, eliminating certain deductions, imposing a mandatory one-time tax on accumulated earnings of foreign subsidiaries, introducing new tax regimes, and changing how foreign earnings are subject to U.S. tax.

The Company made estimates of the effects and recorded provisional amounts in its 2017 financial statements as permitted under Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act (“SAB 118”), which provided guidance on accounting for the Tax Act’s effects. During the fourth quarter of 2018, we completed our accounting for the Tax Act based on the current facts and regulatory guidance available at the end of the SAB 118 measurement period.

Our effective tax rate for 2018 was 24.1 percent, as compared with 50.8 percent in 2017. The decrease was primarily attributable to the absence in 2018 of the substantial one-time Tax Act related charges detailed below, the reduction in the corporate federal income tax rate from 35 percent to 21 percent, and a $28 million benefit from the completion of our accounting for the Tax Act. See also Note 17, Income Taxes for more information under “Item 8. Consolidated Financial Statements and Supplementary Data.”

Partially offsetting these decreases was a 2018 Dutch tax rate reduction that resulted in tax expense of $4 million for the write-down of Dutch deferred tax assets. In 2017, we recorded tax expense of $2 million for a French tax rate reduction.

We regularly assess the adequacy of provisions for income tax contingencies in accordance with the applicable authoritative guidance on accounting for income taxes. As a result, reserves for unrecognized tax benefits may be adjusted due to new facts and developments, such as changes to interpretations of relevant tax law, assessments from taxing authorities, settlements with taxing authorities, and lapses of statutes of limitations. The effective tax rate for 2018 and 2017 includes reserve releases totaling $5 million and $1 million, respectively, due to audit settlements and lapses of statutes of limitations.

In the fourth quarter of 2017, we recorded a provisional tax of $99 million for the mandatory deemed repatriation of historical foreign sourced net earnings and related items as well as tax expense of $8 million related to the establishment of valuation allowances against certain foreign deferred tax assets. Offsetting these expenses were $9 million of excess tax benefits from share-based compensation reflecting the change required by ASC 718 which we adopted during 2017.

Excluding the reserve releases, foreign tax rate changes, repatriation tax, the establishment of valuation allowances, and the effects of excess tax benefits recorded during 2017, the effective tax rate for 2018 decreased as compared with 2017, due to the federal income tax rate reduction.

The effective tax rate for 2017 was 50.8 percent, as compared with 33.9 percent in 2016. Excluding the provisional repatriation and related items, the establishment of valuation allowances, the effects of excess tax benefits, the effect of the charges recorded during 2017, the IP valuation catch-up deductions in 2016, and the effect of Section 987 Regulations on 2016, the effective tax rate for 2017 decreased as compared with 2016, primarily due to the partial year benefit of the federal income tax rate reduction as well as mix of income.

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Liquidity and Capital Resources

Liquidity

Our primary source of liquidity has been cash flow from operations, while the principal uses of cash have been to: fund inventory and other working capital requirements; finance capital expenditures related to store openings, store remodelings, internet and mobile sites, information systems, and other support facilities; make retirement plan contributions, quarterly dividend payments, and interest payments; and fund other cash requirements to support the development of our short-term and long-term operating strategies. We generally finance real estate with operating leases. We believe our cash, cash equivalents, and future cash flow from operations will be adequate to fund these requirements.

The Company may also from time to time repurchase its common stock or seek to retire or purchase outstanding debt through open market purchases, privately negotiated transactions, or otherwise. Such repurchases and retirement of debt, if any, will depend on prevailing market conditions, liquidity requirements, contractual restrictions, and other factors. The amounts involved may be material. As of February 2, 2019, approximately $383 million remained available under our current $1.2 billion share repurchase program. On February 20, 2019, the Board of Directors approved a new 3-year, $1.2 billion share repurchase program extending through January 2022, replacing the previous program.

Also on February 20, 2019, the Board of Directors declared a quarterly dividend of $0.38 per share to be paid on May 3, 2019, representing a 10 percent increase over the previous quarterly per share amount.

As discussed further in the Legal Proceedings note under “Item 8. Financial Statements and Supplementary Data,” during the second quarter of 2018, the Company reformed its U.S. qualified pension plan which required the remeasurement of the pension liabilities, as well as payment to plaintiff’s counsel of $97 million representing class counsel fees awarded in the judgment. During the fourth quarter of 2017, we deposited $150 million into a qualified settlement fund, classified as restricted cash. This fund was used to pay plaintiff’s counsel fees and the balance of the settlement fund will be used for future pension contributions during 2019. The timing and the amount of actual contributions to the pension plan are dependent on the funded status of the plan and various other factors, such as interest rates and the performance of the plan’s assets.

Any material adverse change in customer demand, fashion trends, competitive market forces, or customer acceptance of our merchandise mix and retail locations, uncertainties related to the effect of competitive products and pricing, our reliance on a few key suppliers for a significant portion of our merchandise purchases and risks associated with global product sourcing, economic conditions worldwide, the effects of currency fluctuations, as well as other factors listed under the heading “Disclosure Regarding Forward-Looking Statements,” could affect our ability to continue to fund our liquidity needs from business operations.

Maintaining access to merchandise that we consider appropriate for our business may be subject to the policies and practices of our key suppliers. Therefore, we believe that it is critical to continue to maintain satisfactory relationships with these key suppliers. In 2018 and 2017, we purchased approximately 90 percent and 93 percent, respectively, of our merchandise from our top five suppliers and expect to continue to obtain a significant percentage of our athletic product from these suppliers in future periods. Approximately 66 percent in 2018 and 67 percent in 2017 was purchased from one supplier — Nike, Inc.

Planned capital expenditures in 2019 are $273 million and lease acquisition costs related to our operations in Europe are $2 million. Included in this total is $173 million dedicated to elevating our customers’ in-store experience through continued relocation and remodels in major cities and key markets. It includes the remodeling and expansion of approximately 190 existing stores, as well as the planned opening of approximately 80 stores, including the continued expansion of our “power” stores – pinnacle retail experiences that delivers connected customer interactions through service, experience, product, and a sense of community - and our expansion in Asia with a limited number of locations. Planned spending for 2019 also includes $100 million for digital and other investments, including additional enhancements to our mobile and web platforms, the continued roll-out of our new point-of-sale software, new point-of-sale hardware, expanding data analytics capabilities, and supply chain initiatives. We have the ability to revise and reschedule much of the anticipated capital expenditure program, should our financial position require it.

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Free Cash Flow (non-GAAP measure)

In addition to net cash provided by operating activities, we use free cash flow as a useful measure of performance and as an indication of our financial strength and our ability to generate cash. We define free cash flow as net cash provided by operating activities less capital expenditures (which is classified as an investing activity). We believe the presentation of free cash flow is relevant and useful for investors because it allows investors to evaluate the cash generated from underlying operations in a manner similar to the method used by management. Free cash flow is not defined under U.S. GAAP. Therefore, it should not be considered a substitute for income or cash flow data prepared in accordance with U.S. GAAP and may not be comparable to similarly titled measures used by other companies. It should not be inferred that the entire free cash flow amount is available for discretionary expenditures.

The following table presents a reconciliation of net cash flow provided by operating activities, the most directly comparable U.S. GAAP financial measure, to free cash flow.

	2018	2017	2016
	($ in millions)		
Net cash provided by operating activities	$ 781	$ 813	$ 844
Capital expenditures	(187)	(274)	(266)
Free cash flow	$ 594	$ 539	$ 578

Operating Activities

	2018	2017	2016
	($ in millions)		
Net cash provided by operating activities	$ 781	$ 813	$ 844
$ Change	$ (32)	$ (31)	53

The amount provided by operating activities reflects income adjusted for non-cash items and working capital changes. Adjustments to net income for non-cash items include non-cash impairment charges, depreciation and amortization, deferred income taxes, and share-based compensation expense.

The decline in 2018 in cash provided by operating activities compared with the prior year reflected an increase to net income and higher net inflows associated with changes in working capital, which were more than offset by an increase in pension-related payments. During 2018, $97 million was paid in class counsel fees in connection with the pension litigation matter, and we also contributed $128 million to our U.S. qualified pension plan, as compared with $25 million in 2017. During 2016, we contributed $33 million to the U.S. qualified pension plan and $3 million to our Canadian qualified pension plan. The amounts and timing of pension contributions are dependent on several factors, including asset performance.

Cash paid for income taxes were $184 million, $237 million, and $341 million for 2018, 2017, and 2016, respectively.

Investing Activities

	2018	2017	2016
	($ in millions)		
Net cash used in investing activities	$ 274	$ 289	$ 266
$ Change	$ (15)	$ 23	36

Capital expenditures in 2018 were $187 million, a decrease of $87 million as compared with the prior year. This represented a decline in spending on store projects partially offset by an increase related to technology projects. During 2018, we completed the remodeling or relocation of 122 existing stores and opened 45 new stores.

Capital expenditures in 2017 were $274 million, primarily related to the remodeling or relocation of 183 existing stores, and the build-out of 94 new stores. The increase in 2017 as compared with 2016 primarily related to our corporate headquarters build out and two new flagship stores.

Investing activities for 2018 included $89 million related to various minority investments as compared with $15 million in 2017. The current year also includes $2 million received in insurance proceeds for fixed assets from an insurance claim relating to Hurricane Maria.

Financing Activities

	2018	2017	2016
	($ in millions)		
Net cash used in financing activities	$ 527	$ 616	$ 556
$ Change	$ (89)	$ 60	56

Cash used in financing activities consisted primarily of our return to shareholders initiatives, including our share repurchase program and cash dividend payments, as follows:

	2018	2017	2016
	($ in millions)		
Share repurchases	$ 375	$ 467	$ 432
Dividends paid on common stock	158	157	147
Total returned to shareholders	$ 533	$ 624	$ 579

During 2018, 2017, and 2016, we repurchased 7,886,705 shares, 12,413,590 shares, and 6,984,643 shares of our common stock under our share repurchase programs, respectively. Additionally, the Company declared and paid dividends representing a quarterly rate of $0.345, $0.31, and $0.275 per share in 2018, 2017, and 2016, respectively. During 2018, 2017 and 2016, we paid $1 million, $10 million and $7 million, respectively, to satisfy tax withholding obligations relating to the vesting of share-based equity awards. Offsetting the amounts above were proceeds received from the issuance of common stock and treasury stock in connection with the employee stock programs of $7 million, $18 million, and $33 million for 2018, 2017, and 2016, respectively.

During 2016, we paid fees of $2 million in connection with the credit agreement, see below for further details. Additionally, we made payments during 2016 relating to capital lease obligations of $1 million. These obligations were recorded in connection with the acquisition of the Runners Point Group.

Capital Structure

On May 19, 2016, we entered into a credit agreement with our banks (“2016 Credit Agreement”). The 2016 Credit Agreement provides for a $400 million asset-based revolving credit facility maturing on May 19, 2021. During the term of the 2016 Credit Agreement, we may also increase the commitments by up to $200 million, subject to customary conditions. Interest is determined, at our option, by the federal funds rate plus a margin of 0.125 percent to 0.375 percent, or a Eurodollar rate, determined by reference to LIBOR, plus a margin of 1.125 percent to 1.375 percent depending on availability under the 2016 Credit Agreement. In addition, we are paying a commitment fee of 0.20 percent per annum on the unused portion of the commitments.

The 2016 Credit Agreement provides for a security interest in certain of our domestic store assets, including inventory assets, accounts receivable, cash deposits, and certain insurance proceeds. We are not required to comply with any financial covenants unless certain events of default have occurred and are continuing, or if availability under the 2016 Credit Agreement does not exceed the greater of $40 million and 10 percent of the Loan Cap (as defined in the 2016 Credit Agreement). There are no restrictions relating to the payment of dividends and share repurchases as long as no default or event of default has occurred and the aggregate principal amount of unused commitments under the 2016 Credit Agreement is not less than 15 percent of the lesser of the aggregate amount of the commitments and the Borrowing Base, determined as of the preceding fiscal month and on a proforma basis for the following six fiscal months. We do not currently expect to borrow under the facility in 2019, other than amounts used to support standby letters of credit.

Credit Rating

As of April 2, 2019, our corporate credit ratings from Standard & Poor's and Moody's Investors Service are BB+ and Ba1, respectively. In addition, Moody's Investors Service has rated our senior unsecured notes Ba2.

Debt Capitalization and Equity (non-GAAP Measure)

For purposes of calculating debt to total capitalization, we include the present value of operating lease commitments in total net debt. Total net debt including the present value of operating leases is considered a non-GAAP financial measure.

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The present value of operating leases is discounted using various interest rates ranging from 1.7 percent to 14.5 percent, which represent our incremental borrowing rate at inception of the lease. Operating leases are the primary financing vehicle used to fund store expansion and, therefore, we believe that the inclusion of the present value of operating leases in total debt is useful to our investors, credit constituencies, and rating agencies.

	2018	2017
	($ in millions)	
Long-term debt	$ 124	$ 125
Present value of operating leases	3,447	3,729
Total debt including the present value of operating leases	3,571	3,854
Less:		
Cash and cash equivalents	891	849
Total net debt including the present value of operating leases	2,680	3,005
Shareholders’ equity	2,506	2,519