WILLIAMS SONOMA INC
Form 10-Q
December 11, 2015
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## UNITED STATES

## SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q
(Mark One)

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

For the quarterly period ended November 1, 2015.
or

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

For the transition period from $\qquad$ to $\qquad$
Commission File Number: 001-14077

WILLIAMS-SONOMA, INC.
(Exact name of registrant as specified in its charter)
Delaware
(State or other jurisdiction of
incorporation or organization)
3250 Van Ness Avenue, San Francisco, CA
(Address of principal executive offices)
94-2203880
(I.R.S. Employer
Identification No.) 94109
Registrant s telephone number, including area code: (415) 421-7900
(Former name, former address and former fiscal year, if changed since last report)

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

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

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

Large accelerated filer x
Accelerated filer
Non-accelerated filer * (Do not check if a smaller reporting company)
Smaller reporting company Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes " No x

As of November 29, 2015, 89,843,783 shares of the registrant s Common Stock were outstanding.

WILLIAMS-SONOMA, INC.

## REPORT ON FORM 10-Q

## FOR THE QUARTER ENDED NOVEMBER 1, 2015

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## ITEM 1. FINANCIAL STATEMENTS

## WILLIAMS-SONOMA, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited)


See Notes to Condensed Consolidated Financial Statements.

## WILLIAMS-SONOMA, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

| In thousands | Thirteen Weeks Ended |  |  |  | Thirty-nine Weeks Ended |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | November 1, 2015 |  | November 2, 2014 |  | November 1, 2015 |  | November 2, 2014 |  |
| Net earnings | \$ | 70,482 | \$ | 64,908 | \$ | 168,940 | \$ | 161,817 |
| Other comprehensive income (loss), net of tax: |  |  |  |  |  |  |  |  |
| Foreign currency translation adjustments |  | $(1,370)$ |  | $(2,880)$ |  | $(4,197)$ |  | (937) |
| Change in fair value of derivative financial instruments |  | 118 |  | 351 |  | 539 |  | 144 |
| Reclassification adjustment for realized gains on derivative financial instruments |  | (250) |  | (7) |  | (922) |  | (527) |

$\begin{array}{lllllllll}\text { Comprehensive income } & \$ & 68,980 & \$ & 62,372 & \$ & 164,360 & \$ & 160,497\end{array}$
See Notes to Condensed Consolidated Financial Statements.

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## WILLIAMS-SONOMA, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

| In thousands, except per share amounts | 2015 | 2015 | 2014 |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: |
| ASSETS |  |  |  |  |  |
| Current assets | $\$$ | 72,264 | $\$$ | 222,927 | $\$$ |
| Cash and cash equivalents | 88,535 | 67,465 | 63,664 |  |  |
| Accounts receivable, net | $1,102,349$ | 887,701 | 979,719 |  |  |
| Merchandise inventories, net | 35,762 | 33,942 | 39,116 |  |  |
| Prepaid catalog expenses | 59,276 | 36,265 | 56,517 |  |  |
| Prepaid expenses | 130,684 | 130,618 | 121,380 |  |  |
| Deferred income taxes, net | 12,966 | 13,005 | 14,816 |  |  |
| Other assets | $1,501,836$ | $1,391,923$ | $1,382,915$ |  |  |
| Total current assets | 883,459 | 883,012 | 866,670 |  |  |
| Property and equipment, net | 2,560 | 4,265 | 4,142 |  |  |
| Non-current deferred income taxes, net | 47,821 | 51,077 | 50,220 |  |  |
| Other assets, net | $\$ 2,435,676$ | $\$$ | $2,330,277$ | $\$$ | $2,303,947$ |

LIABILITIES AND STOCKHOLDERS EQUITY
Current liabilities

| Accounts payable | $\$ 395,033$ | $\$$ | 397,037 | $\$$ |
| :--- | ---: | ---: | ---: | ---: |
| cccrued salaries, benefits and other | 115,720 | 136,012 | 117,410 |  |
| Customer deposits | 293,317 | 261,679 | 265,058 |  |
| Borrowings under revolving line of credit | 200,000 | 0 | 90,000 |  |
| Income taxes payable | 35,317 | 32,488 | 4,750 |  |
| Current portion of long-term debt | 0 | 1,968 | 1,968 |  |
| Other liabilities | 55,152 | 46,764 | 46,134 |  |
| Total current liabilities | $1,094,539$ | 875,948 | 936,552 |  |
| Deferred rent and lease incentives | 174,059 | 166,925 | 168,078 |  |
| Other long-term obligations | 50,545 | 62,698 | 62,942 |  |
| Total liabilities | $1,319,143$ | $1,105,571$ | $1,167,572$ |  |
| Commitments and contingencies |  |  |  |  |
| Stockholders equity |  |  |  |  |
| Preferred stock: $\$ .01$ par value; 7,500 shares authorized; none |  | 0 | 0 |  |


| Common stock: $\$ .01$ par value; 253,125 shares authorized; 90,010 , |  |  |  |
| :--- | ---: | ---: | ---: | ---: |
| 91,891 and 92,219 shares issued and outstanding at November 1, |  |  |  |
| 2015, February 1, 2015 and November 2, 2014, respectively | 901 | 919 | 923 |
| Additional paid-in capital | 538,737 | 527,261 | 519,783 |
| Retained earnings | 585,928 | 701,214 | 612,611 |
| Accumulated other comprehensive income (loss) | $(7,127)$ | $(2,548)$ | 5,203 |

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| Treasury stock, at cost | $(1,906)$ | $(2,140)$ | $(2,145)$ |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Total stockholders equity | $1,116,533$ | $1,224,706$ | $1,136,375$ |  |  |
| Total liabilities and stockholders equity | $\$ 2,435,676$ | $\$ 2,330,277$ | $\$ 2,303,947$ |  |  |
| See Notes to Condensed Consolidated Financial Statements. |  |  |  |  |  |

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## WILLIAMS-SONOMA, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

|  | Thirty-nine Weeks Ended <br> November 1, <br> November 2, <br> In thousands <br> Cash flows from operating activities: |  |
| :--- | ---: | ---: |
| Net earnings | 2015 | 2014 |
| Adjustments to reconcile net earnings to net cash provided by (used in) operating | 168,940 | $\$ 161,817$ |
| activities: |  |  |
| Depreciation and amortization | 125,093 | 121,135 |
| Loss on disposal/impairment of assets | 3,558 | 1,581 |
| Amortization of deferred lease incentives | $(18,326)$ | $(18,577)$ |
| Deferred income taxes | $(13,526)$ | $(13,031)$ |
| Tax benefit related to stock-based awards | 29,603 | 49,451 |
| Excess tax benefit related to stock-based awards | $(14,283)$ | $(24,408)$ |
| Stock-based compensation expense | 36,182 | 34,729 |
| Other | 91 | 352 |
| Changes in: |  |  |
| Accounts receivable | $(21,875)$ | $(4,455)$ |
| Merchandise inventories | $(216,294)$ | $(165,839)$ |
| Prepaid catalog expenses | $(1,820)$ | $(5,560)$ |
| Prepaid expenses and other assets | $(20,909)$ | $(22,000)$ |
| Accounts payable | $(10,179)$ | 8,193 |
| Accrued salaries, benefits and other current and long-term liabilities | $(13,494)$ | $(12,242)$ |
| Customer deposits | 32,016 | 36,897 |
| Deferred rent and lease incentives | 25,561 | 18,392 |
| Income taxes payable | 2,707 | $(44,634)$ |
| Net cash provided by operating activities | 93,045 | 121,801 |
| Cash flows from investing activities: | $(136,069)$ | $(131,670)$ |
| Purchases of property and equipment | 0 | 14,289 |
| Restricted cash receipts | 535 | 1,205 |
| Other | $(135,534)$ | $(116,176)$ |
| Net cash used in investing activities |  |  |
| Cash flows from financing activities: | 200,000 | 90,000 |
| Borrowings under revolving line of credit | $(196,497)$ | $(195,235)$ |
| Repurchase of common stock | $(96,020)$ | $(95,267)$ |
| Payment of dividends | $(31,019)$ | $(53,440)$ |
| Tax withholdings related to stock-based awards | 14,283 | 24,408 |
| Excess tax benefit related to stock-based awards | $(1,968)$ | 3,511 |
| Net proceeds related to stock-based awards | 0 | $(1,785)$ |
| Repayments of long-term obligations |  | $(4)$ |
| Other |  |  |
|  |  |  |


| Net cash used in financing activities | $(108,574)$ | $(227,812)$ |
| :--- | :---: | ---: |
| Effect of exchange rates on cash and cash equivalents | 400 | $(231)$ |
| Net decrease in cash and cash equivalents | $(150,663)$ | $(222,418)$ |
| Cash and cash equivalents at beginning of period | 222,927 | 330,121 |
| Cash and cash equivalents at end of period | 72,264 | $\$ 107,703$ |
| See Notes to Condensed Consolidated Financial Statements. |  |  |

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## WILLIAMS-SONOMA, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

## NOTE A. FINANCIAL STATEMENTS - BASIS OF PRESENTATION

These financial statements include Williams-Sonoma, Inc. and its wholly owned subsidiaries ( we, us or our ). The Condensed Consolidated Balance Sheets as of November 1, 2015 and November 2, 2014, the Condensed Consolidated Statements of Earnings and the Condensed Consolidated Statements of Comprehensive Income for the thirteen and thirty-nine weeks then ended, and the Condensed Consolidated Statements of Cash Flows for the thirty-nine weeks then ended, have been prepared by us, without audit. In our opinion, the financial statements include all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position at the balance sheet dates and the results of operations for the thirteen and thirty-nine weeks then ended. Intercompany transactions and accounts have been eliminated. The balance sheet as of February 1, 2015, presented herein, has been derived from our audited Consolidated Balance Sheet included in our Annual Report on Form 10-K for the fiscal year ended February 1, 2015.

The results of operations for the thirteen and thirty-nine weeks ended November 1, 2015 are not necessarily indicative of the operating results of the full year.

Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America ( U.S. GAAP ) have been omitted. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended February 1, 2015.

## New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2014-09, Revenue from Contracts with Customers, to clarify the principles of recognizing revenue and create common revenue recognition guidance between U.S. GAAP and International Financial Reporting Standards. This ASU is effective for fiscal years and interim periods within those years beginning after December 15, 2017. We are currently assessing the potential impact of this ASU on our Condensed Consolidated Financial Statements.

In November 2015, the FASB issued ASU 2015-17, Balance Sheet Classification of Deferred Taxes, which will require entities to present both deferred tax assets and deferred tax liabilities as noncurrent in a classified balance sheet. This ASU is effective for fiscal years and interim periods within those years beginning after December 15, 2016. We are currently assessing the impact of this ASU on our Condensed Consolidated Financial Statements.

## NOTE B. BORROWING ARRANGEMENTS

## Credit Facility

We have a $\$ 500,000,000$ unsecured revolving line of credit ( credit facility ) that may be used to borrow revolving loans or to request the issuance of letters of credit. We may, upon notice to the administrative agent, request existing or new lenders to increase the credit facility by up to $\$ 250,000,000$, at such lenders option, to provide for a total of $\$ 750,000,000$ of unsecured revolving credit. As of November 1, 2015, we were in compliance with our financial
covenants under the credit facility and, based on current projections, we expect to remain in compliance throughout fiscal 2015. The credit facility matures on November 19, 2019, at which time all outstanding borrowings must be repaid and all outstanding letters of credit must be cash collateralized.

We may elect interest rates calculated at (i) Bank of America s prime rate (or, if greater, the average rate on overnight federal funds plus one-half of one percent, or a rate based on LIBOR plus one percent) plus a margin based on our leverage ratio or (ii) LIBOR plus a margin based on our leverage ratio. During the third quarter of fiscal 2015 we borrowed $\$ 50,000,000$ under the credit facility and, as of November 1, 2015, we had borrowings of $\$ 200,000,000$ outstanding under our credit facility, at a weighted average interest rate of $1.11 \%$. During the third quarter of 2014, we borrowed $\$ 90,000,000$ under the credit facility, all of which was outstanding as of November 2, 2014, at a weighted average interest rate of $1.05 \%$. Additionally, as of November 1, 2015, issued but undrawn letters of credit totaling $\$ 13,346,000$ were outstanding under the credit facility. The standby letters of credit were issued to secure the liabilities associated with workers compensation and other insurance programs.

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## Letter of Credit Facilities

We have three unsecured letter of credit reimbursement facilities for a total of $\$ 70,000,000$, each of which matures on August 27, 2016. The letter of credit facilities contain covenants that are consistent with our unsecured revolving line of credit. Interest on unreimbursed amounts under the letter of credit facilities accrues at the lender s prime rate (or, if greater, the average rate on overnight federal funds plus one-half of one percent) plus $2.0 \%$. As of November 1, 2015, an aggregate of $\$ 8,111,000$ was outstanding under the letter of credit facilities, which represents only a future commitment to fund inventory purchases to which we had not taken legal title. The latest expiration possible for any future letters of credit issued under the facilities is January 24, 2017.

## NOTE C. STOCK-BASED COMPENSATION

## Equity Award Programs

Our Amended and Restated 2001 Long-Term Incentive Plan (the Plan ) provides for grants of incentive stock options, nonqualified stock options, stock-settled stock appreciation rights (collectively, option awards ), restricted stock awards, restricted stock units (including those that are performance-based), deferred stock awards (collectively, stock awards ) and dividend equivalents up to approximately $32,310,000$ shares in aggregate. As of November 1, 2015, there were approximately $9,422,000$ shares available for future grant under the Plan. Awards may be granted under the Plan to officers, employees and non-employee members of our board of directors (the Board ) or any parent or subsidiary. Shares issued as a result of award exercises or releases are primarily funded with the issuance of new shares.

## Option Awards

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

## Stock Awards

Annual grants of stock awards are limited to $1,000,000$ shares on a per person basis. Stock awards granted to employees generally vest evenly over a period of four years for service-based awards. Certain performance-based awards, which have variable payout conditions based on predetermined financial targets, vest three years from the date of grant. Certain stock awards and other agreements contain vesting acceleration clauses resulting from events including, but not limited to, retirement, merger or a similar corporate event. Stock awards granted to non-employee Board members generally vest in one year. Non-employee Board members automatically receive stock awards on the date of their initial election to the Board and annually thereafter on the date of the annual meeting of stockholders (so long as they continue to serve as a non-employee Board member).

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## Stock-Based Compensation Expense

We measure and record stock-based compensation expense for all employee stock-based awards using a fair value method. During the thirteen and thirty-nine weeks ended November 1, 2015, we recognized total stock-based compensation expense, as a component of selling, general and administrative expenses, of $\$ 11,269,000$ and $\$ 36,182,000$, respectively. During the thirteen and thirty-nine weeks ended November 2, 2014, we recognized total stock-based compensation expense of $\$ 12,538,000$ and $\$ 34,729,000$, respectively.

## Stock Options

The following table summarizes our stock option activity during the thirty-nine weeks ended November 1, 2015:

The following table summarizes our stock-settled stock appreciation right activity during the thirty-nine weeks ended November 1, 2015:

|  | Shares |
| :--- | ---: |
| Balance at February 1, 2015 | $1,159,948$ |
| Granted | 0 |
| Converted into common stock | $(510,949)$ |
| Cancelled | $(3,426)$ |
| Balance at November 1, 2015 | 645,573 |
| Vested at November 1, 2015 | 636,783 |
| Vested plus expected to vest at November 1, 2015 | 642,630 |
| Restricted Stock Units |  |

The following table summarizes our restricted stock unit activity during the thirty-nine weeks ended November 1, 2015:

## Shares

Balance at February 1, 2015 2,313,477

Granted 790,433
Released
Cancelled
Balance at November 1, 2015
2,323,004

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## NOTE D. EARNINGS PER SHARE

Basic earnings per share is computed as net earnings divided by the weighted average number of common shares outstanding for the period. Diluted earnings per share is computed as net earnings divided by the weighted average number of common shares outstanding and common stock equivalents for the period. Common stock equivalents consist of shares subject to stock-based awards with exercise prices less than or equal to the average market price of our common stock for the period, to the extent their inclusion would be dilutive.

The following is a reconciliation of net earnings and the number of shares used in the basic and diluted earnings per share computations:

| In thousands, except per share amounts | Net Earnings | Weighted <br> Average Shares | Earnings <br> Per Share |
| :--- | ---: | ---: | ---: |
| Thirteen weeks ended November 1, 2015 | $\$ 70,482$ | 90,437 | $\$ 0.78$ |
| Basic | $\$ 70,482$ | 91,801 | $\$ 0.77$ |
| Effect of dilutive stock-based awards | $\$ 64,908$ | 93,067 | $\$ 0.70$ |
| Diluted | $\$ 64,908$ | 94,920 | $\$ 0.68$ |
| Thirteen weeks ended November 2, 2014 <br> Basic | $\$ 168,940$ | 91,129 | $\$ 1.85$ |
| Effect of dilutive stock-based awards | $\$ 168,940$ | 92,576 | $\$ 1.82$ |
| Diluted | $\$ 161,817$ | 93,862 | $\$ 1.72$ |
| Thirty-nine weeks ended November 1, 2015 | $\$ 161,817$ | 95,603 | $\$ 1.69$ |

There were no stock-based awards excluded from the computation of diluted earnings per share for the thirteen or thirty-nine weeks ended November 1, 2015 and November 2, 2014.

## NOTE E. SEGMENT REPORTING

We have two reportable segments, e-commerce and retail. The e-commerce segment has the following merchandising strategies: Williams-Sonoma, Pottery Barn, Pottery Barn Kids, West Elm, PBteen, Williams-Sonoma Home, Rejuvenation and Mark and Graham, which sell our products through our e-commerce websites and direct-mail catalogs. Our e-commerce merchandising strategies are operating segments, which have been aggregated into one reportable segment, e-commerce. The retail segment has the following merchandising strategies: Williams-Sonoma, Pottery Barn, Pottery Barn Kids, West Elm and Rejuvenation, which sell our products through our retail stores. Our retail merchandising strategies are operating segments, which have been aggregated into one reportable segment, retail. Our operating segments have had similar historical economic characteristics and it is management s expectation that the operating segments will have similar long-term financial performance in the future.

These reportable segments are strategic business units that offer similar home-centered products. They are managed separately because the business units utilize two distinct distribution and marketing strategies. Based on management s
best estimate, our operating segments include allocations of certain expenses, including advertising and employment costs, to the extent they have been determined to benefit both channels. These operating segments are aggregated at the channel level for reporting purposes due to the fact that our brands are interdependent for economies of scale and we do not maintain fully allocated income statements at the brand level. As a result, material financial decisions related to the brands are made at the channel level. Furthermore, it is not practicable for us to report revenue by product group.

We use operating income to evaluate segment profitability. Operating income is defined as earnings (loss) before net interest income or expense and income taxes. Unallocated costs before interest and income taxes include employee-related costs, occupancy expenses (including depreciation expense), administrative costs and third-party service costs, primarily in our corporate departments. Unallocated assets include corporate cash and cash equivalents, deferred income taxes, the net book value of corporate facilities and related information systems, and other corporate long-lived assets.

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Income tax information by reportable segment has not been included as income taxes are calculated at a company-wide level and are not allocated to each reportable segment.

## Segment Information

| In thousands | E-commerce |  | Retail |  | Unallocated | Total |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Thirteen weeks ended November 1, 2015 |  |  |  |  |  |  |  |
| Net revenues ${ }^{1}$ | \$ | 628,191 | \$ | 603,891 | \$ 0 | \$ | 1,232,082 |
| Depreciation and amortization expense |  | 7,856 |  | 20,880 | 13,124 |  | 41,860 |
| Operating income (loss) |  | 137,828 |  | 49,213 | $(76,358)$ |  | 110,683 |
| Capital expenditures |  | 4,819 |  | 25,239 | 19,162 |  | 49,220 |
| Thirteen weeks ended November 2, 2014 |  |  |  |  |  |  |  |
| Net revenues ${ }^{1}$ | \$ | 586,976 | \$ | 556,186 | \$ 0 | \$ | 1,143,162 |
| Depreciation and amortization expense |  | 8,471 |  | 20,344 | 12,988 |  | 41,803 |
| Operating income (loss) |  | 136,617 |  | 49,973 | $(81,870)$ |  | 104,720 |
| Capital expenditures |  | 5,451 |  | 29,005 | 13,695 |  | 48,151 |
| Thirty-nine weeks ended November 1, 2015 |  |  |  |  |  |  |  |
| Net revenues ${ }^{1}$ | \$ | 1,730,677 | \$ | 1,659,109 | \$ 0 | \$ | 3,389,786 |
| Depreciation and amortization expense |  | 24,156 |  | 61,433 | 39,504 |  | 125,093 |
| Operating income (loss) |  | 387,863 |  | 117,842 | $(239,751)$ |  | 265,954 |
| Assets ${ }^{2}$ |  | 666,993 |  | 1,151,657 | 617,026 |  | 2,435,676 |
| Capital expenditures |  | 13,337 |  | 68,432 | 54,300 |  | 136,069 |
| Thirty-nine weeks ended November 2, 2014 |  |  |  |  |  |  |  |
| Net revenues ${ }^{1}$ | \$ | 1,600,854 | \$ | 1,555,740 | \$ 0 | \$ | 3,156,594 |
| Depreciation and amortization expense |  | 23,608 |  | 60,062 | 37,465 |  | 121,135 |
| Operating income (loss) |  | 378,365 |  | 117,227 | $(231,210)$ |  | 264,382 |
| Assets ${ }^{2}$ |  | 623,674 |  | 1,087,683 | 592,590 |  | 2,303,947 |
| Capital expenditures |  | 28,326 |  | 63,253 | 40,091 |  | 131,670 |

${ }^{1}$ Includes net revenues related to our international operations (including our operations in Canada, Australia, the United Kingdom and our franchise businesses) of approximately $\$ 80.0$ million and $\$ 54.6$ million for the thirteen weeks ended November 1, 2015 and November 2, 2014, respectively, and $\$ 201.7$ million and $\$ 161.1$ million for the thirty-nine weeks ended November 1, 2015 and November 2, 2014, respectively.
${ }^{2}$ Includes long-term assets related to our international operations of approximately $\$ 60.6$ million and $\$ 64.4$ million as of November 1, 2015 and November 2, 2014, respectively.

## NOTE F. COMMITMENTS AND CONTINGENCIES

We are involved in lawsuits, claims and proceedings incident to the ordinary course of our business. These disputes, which are not currently material, are increasing in number as our business expands and our company grows larger. We review the need for any loss contingency reserves and establish reserves when, in the opinion of management, it is probable that a matter would result in liability, and the amount of loss, if any, can be reasonably estimated. In view of the inherent difficulty of predicting the outcome of these matters, it may not be possible to determine whether any loss is probable or to reasonably estimate the amount of the loss until the case is close to resolution, in which case no reserve is established until that time. Any claims against us, whether meritorious or not, could be time consuming, result in costly litigation, require significant amounts of management time and result in the diversion of significant operational resources. The results of these lawsuits, claims and proceedings cannot be predicted with certainty.
However, we believe that the ultimate resolution of these current matters will not have a material adverse effect on our
consolidated financial statements taken as a whole.

## NOTE G. STOCK REPURCHASE PROGRAM AND DIVIDENDS

## Stock Repurchase Program

During the thirteen weeks ended November 1, 2015, we repurchased 922,127 shares of our common stock at an average cost of $\$ 77.54$ per share for a total cost of approximately $\$ 71,497,000$. During the thirty-nine weeks ended November 1, 2015, we repurchased 2,485,830 shares of our common stock at an average cost of $\$ 79.05$ per share for a total cost of approximately $\$ 196,497,000$. As of November 1, 2015, we held treasury stock of $\$ 1,906,000$, which represents the cost of shares available for re-issuance to satisfy future stock-based award settlements in certain foreign jurisdictions.

During the thirteen weeks ended November 2, 2014, we repurchased $1,247,046$ shares of our common stock at an average cost of $\$ 66.70$ per share for a total cost of approximately $\$ 83,181,000$. During the thirty-nine weeks ended November 2, 2014, we repurchased 2,935,753 shares of our common stock at an average cost of $\$ 66.50$ per share for a total cost of approximately $\$ 195,235,000$.

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Stock repurchases under this program may be made through open market and privately negotiated transactions at times and in such amounts as management deems appropriate. The timing and actual number of shares repurchased will depend on a variety of factors including price, corporate and regulatory requirements, capital availability and other market conditions. This stock repurchase program does not have an expiration date and may be limited or terminated at any time without prior notice.

## Dividends

We declared cash dividends of $\$ 0.35$ and $\$ 0.33$ per common share during the thirteen weeks ended November 1,2015 and November 2, 2014, respectively. We declared cash dividends of $\$ 1.05$ and $\$ 0.99$ per common share during the thirty-nine weeks ended November 1, 2015 and November 2, 2014, respectively.

## NOTE H. DERIVATIVE FINANCIAL INSTRUMENTS

We have retail and/or e-commerce businesses in Canada, Australia and the United Kingdom, and operations throughout Asia and Europe, which expose us to market risk associated with foreign currency exchange rate fluctuations. Substantially all of our purchases and sales are denominated in U.S. dollars, which limits our exposure to this risk. While the impact of foreign currency exchange rate fluctuations was not significant to us in the third quarter of fiscal 2015, we continue to see volatility in the exchange rates in the countries in which we do business. As we continue to expand globally, the foreign currency exchange risk related to the transactions of our foreign subsidiaries may increase. To mitigate this risk, we hedge a portion of our foreign currency exposure with foreign currency forward contracts in accordance with our risk management policies. We do not enter into such contracts for speculative purposes.

The assets or liabilities associated with the derivative instruments are measured at fair value and recorded in either other current assets or other current liabilities. As discussed below, the accounting for gains and losses resulting from changes in fair value depends on whether the derivative instrument is designated as a hedge and qualifies for hedge accounting in accordance with the Financial Accounting Standards Board Accounting Standards Codification ( ASC ) 815, Derivatives and Hedging.

## Cash Flow Hedges

We enter into foreign currency forward contracts designated as cash flow hedges for forecasted inventory purchases in U.S. dollars by our foreign subsidiaries. These hedges generally have terms of up to 12 months. All hedging relationships are formally documented, and the forward contracts are designed to mitigate foreign currency exchange risk on hedged transactions. We record the effective portion of changes in the fair value of our cash flow hedges in other comprehensive income ( OCI ) until the earlier of when the hedged forecasted inventory purchase occurs or the respective contract reaches maturity. Subsequently, as the inventory is sold to the customer, we reclassify amounts previously recorded in OCI to cost of goods sold. Changes in the fair value of the forward contract related to interest charges or forward points are excluded from the assessment and measurement of hedge effectiveness and are recorded immediately in other income (expense), net within selling, general and administrative expenses. Based on the rates in effect as of November 1, 2015, we expect to reclassify a net pre-tax gain of approximately $\$ 801,000$ from OCI to cost of goods sold over the next 12 months.

We also enter into non-designated foreign currency forward contracts to reduce the exchange risk associated with our assets and liabilities denominated in a foreign currency. Any foreign exchange gains (losses) related to these contracts are recognized in other income (expense), net.

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As of November 1, 2015 and November 2, 2014, we had foreign currency forward contracts outstanding (in U.S. dollars) as follows:

In thousands
Contracts to sell Canadian dollars and buy U.S. dollars
Contracts designated as cash flow hedges $\quad \$ 20,000 \quad \$ 14,600$

Contracts to sell Australian dollars and buy U.S. dollars Contracts not designated as cash flow hedges
Hedge effectiveness is evaluated prospectively at inception, on an ongoing basis, as well as retrospectively using regression analysis. Any measureable ineffectiveness of the hedge is recorded in other income (expense), net. No gain or loss was recognized for cash flow hedges due to hedge ineffectiveness and all hedges were deemed effective for assessment purposes for the thirteen and thirty-nine weeks ended November 1, 2015 and November 2, 2014.

The effect of derivative instruments in our Condensed Consolidated Financial Statements, pre-tax, was as follows:

$$
\text { Thirteen } \quad \text { Thirty-nine }
$$

## Thirteen Weeks Ended Thirty-nine Weeks Ended Weeks Ended Weeks Ended

In thousands
November 1, 2Nб5̄ember 2, 201※ovember 1, 2015 November 2, 2014
$\begin{array}{lllllllll}\text { Net gain recognized in OCI } & \$ & 158 & \$ & 472 & \$ & 729 & \$ & 270\end{array}$
Net gain reclassified from OCI into cost of goods

| sold | $\$$ | 339 | $\$$ | 7 | $\$$ | 1,250 | $\$$ | 527 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |

Net foreign exchange gain (loss) recognized in other income (expense):

| Instruments designated as cash flow hedges ${ }^{1}$ | $\$$ | $(12)$ | $\$$ | $(36)$ | $\$$ | $(54)$ | $\$$ | $(123)$ |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Instruments not designated or de-designated $^{2}$ | $\$$ | 748 | $\$$ | $(482)$ | $\$$ | 3,153 | $\$$ | 138 |

${ }^{1}$ Changes in fair value of the forward contract related to interest charges or forward points.
2 Changes in fair value for instruments not designated as cash flow hedges as well as de-designated instruments.
The fair values of our derivative financial instruments are presented below. All fair values for these derivatives were measured using Level 2 inputs as defined by the fair value hierarchy described in Note I.

In thousands
Derivatives designated as hedging instruments:

| Cash flow hedge foreign currency forward contracts | Other current assets | $\$$ | 412 | $\$$ | 372 |
| :--- | :--- | :--- | ---: | ---: | ---: |
| Cash flow hedge foreign currency forward contracts | Other current liabilities |  | 0 |  | 0 |
| Total, net |  | $\$$ | 412 | $\$$ | 372 |

Derivatives not designated as hedging instruments:

| Foreign currency forward contracts | Other current assets | $\$$ | 541 | $\$$ | 0 |
| :--- | :--- | :--- | ---: | :---: | :---: |
| Foreign currency forward contracts | Other current liabilities |  | 0 |  | $(9)$ |
| Total, net |  | $\$$ | 541 | $\$$ | $(9)$ |

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We record all derivative assets and liabilities on a gross basis. They do not meet the balance sheet netting criteria as discussed in ASC 210, Balance Sheet, because we do not have master netting agreements established with our derivative counterparties that would allow for net settlement.

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## NOTE I. FAIR VALUE MEASUREMENTS

Fair value is the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

We determine the fair value of financial and non-financial assets and liabilities using the fair value hierarchy established by ASC 820, Fair Value Measurement, which defines three levels of inputs that may be used to measure fair value, as follows:

Level 1: inputs which include quoted prices in active markets for identical assets or liabilities;

Level 2: inputs which include observable inputs other than Level 1 inputs, such as quoted prices in active markets for similar assets or liabilities; quoted prices for identical or similar assets or liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability; and

Level 3: inputs which include unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the underlying asset or liability.
The fair values of our cash and cash equivalents are based on Level 1 inputs, which include quoted prices in active markets for identical assets.

## Foreign Currency Derivatives and Hedging Instruments

We use the income approach to value our derivatives using observable Level 2 market data at the measurement date and standard valuation techniques to convert future amounts to a single present value amount, assuming that participants are motivated but not compelled to transact. Level 2 inputs are limited to quoted prices that are observable for the assets and liabilities, which include interest rates and credit risk ratings. We use mid-market pricing as a practical expedient for fair value measurements. Key inputs for currency derivatives are the spot rates, forward rates, interest rates and credit derivative market rates.

The counterparties associated with our foreign currency forward contracts are large credit-worthy financial institutions, and the derivatives transacted with these entities are relatively short in duration, therefore, we do not consider counterparty concentration and non-performance to be material risks at this time. Both we and our counterparties are expected to perform under the contractual terms of the instruments. None of the derivative contracts entered into are subject to credit risk-related contingent features or collateral requirements.

## Long-lived Assets

Long-lived assets are measured at fair value on a nonrecurring basis using Level 3 inputs as defined in the fair value hierarchy. The fair value is based on the present value of estimated future cash flows using a discount rate that approximates our weighted average cost of capital.

There were no transfers between Level 1, 2 or 3 categories during the thirteen and thirty-nine weeks ended November 1, 2015 or November 2, 2014.

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## NOTE J. ACCUMULATED OTHER COMPREHENSIVE INCOME

Changes in accumulated other comprehensive income (loss) by component, net of tax, are as follows:

| In thousands | Foreign Currency Translation | Cash Flow Hedges | Accumulated Other Comprehensive Income (Loss) |
| :---: | :---: | :---: | :---: |
| Balance at February 1, 2015 | \$ $(3,522)$ | \$ 974 | \$ $(2,548)$ |
| Foreign currency translation adjustments | 867 | 0 | 867 |
| Change in fair value of derivative instruments | 0 | (379) | (379) |
| Reclassification adjustment for realized gains on derivative financial instruments ${ }^{1}$ | 0 | (198) | (198) |
| Other comprehensive income (loss) | 867 | (577) | 290 |
| Balance at May 3, 2015 | $(2,655)$ | 397 | $(2,257)$ |
| Foreign currency translation adjustments | $(3,694)$ | 0 | $(3,694)$ |
| Change in fair value of derivative instruments |  | 800 | 800 |
| Reclassification adjustment for realized gains on derivative financial instruments ${ }^{1}$ | 0 | (474) | (474) |
| Other comprehensive income (loss) | $(3,694)$ | 326 | $(3,368)$ |
| Balance at August 2, 2015 | $(6,349)$ | 723 | $(5,625)$ |
| Foreign currency translation adjustments | $(1,370)$ | 0 | $(1,370)$ |
| Change in fair value of derivative instruments | 0 | 118 | 118 |
| Reclassification adjustment for realized gains on derivative financial instruments ${ }^{1}$ | 0 | (250) | (250) |
| Other comprehensive income (loss) | $(1,370)$ | (132) | $(1,502)$ |
| Balance at November 1, 2015 | \$ $(7,719)$ | 591 | \$ $(7,127)$ |
| Balance at February 2, 2014 | \$ 5,783 | 741 | \$ 6,524 |
| Foreign currency translation adjustments | 1,398 | 0 | 1,398 |
| Change in fair value of derivative instruments |  | (298) | (298) |
| Reclassification adjustment for realized gains on derivative financial instruments ${ }^{I}$ | 0 | (233) | (233) |
| Other comprehensive income (loss) | 1,398 | (531) | 867 |
| Balance at May 4, 2014 | 7,181 | 210 | 7,391 |
| Foreign currency translation adjustments | 545 | 0 | 545 |
| Change in fair value of derivative instruments | 0 | 91 | 91 |
| Reclassification adjustment for realized gains on derivative financial instruments ${ }^{l}$ | 0 | (287) | (287) |
| Other comprehensive income (loss) | 545 | (196) | 349 |
| Balance at August 3, 2014 | 7,726 | 14 | 7,741 |
| Foreign currency translation adjustments | $(2,880)$ | 0 | $(2,880)$ |
| Change in fair value of derivative instruments | 0 | 351 | 351 |
| Reclassification adjustment for realized gains on derivative financial instruments ${ }^{1}$ | 0 | (7) | (7) |
| Other comprehensive income (loss) | $(2,880)$ | 344 | $(2,536)$ |

Balance at November 2, 2014
\$ 4,846 \$ 358
\$ 5,203
${ }^{1}$ Refer to Note $H$ for additional disclosures about reclassifications out of accumulated other comprehensive income and their corresponding effects on the respective line items in the Condensed Consolidated Statements of Earnings.

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## ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

## FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they do not fully materialize or are proven incorrect, could cause our business and results of operations to differ materially from those expressed or implied by such forward-looking statements. Such forward-looking statements include statements related to: our beliefs regarding the resolution of current lawsuits, claims and proceedings; our stock repurchase program; our expectations regarding our cash flow hedges and foreign currency risks; our planned use of cash; our compliance with our financial covenants; our belief that our cash on-hand, in addition to our available credit facilities, will provide adequate liquidity for our business operations over the next 12 months; our beliefs regarding our exposure to foreign currency exchange rate fluctuations; and our beliefs regarding seasonal patterns associated with our business, as well as statements of belief and statements of assumptions underlying any of the foregoing. You can identify these and other forward-looking statements by the use of words such as may, should, expects, plans, anticipates, believes, estimates, predicts, intends, potential, negative of such terms, or other comparable terminology. The risks, uncertainties and assumptions referred to above that could cause our results to differ materially from the results expressed or implied by such forward-looking statements include, but are not limited to, those discussed under the heading Risk Factors in this document and our Annual Report on Form 10-K for the year ended February 1, 2015, and the risks, uncertainties and assumptions discussed from time to time in our other public filings and public announcements. All forward-looking statements included in this document are based on information available to us as of the date hereof, and we assume no obligation to update these forward-looking statements.

## OVERVIEW

Williams-Sonoma, Inc. is a specialty retailer of high-quality products for the home. These products, representing distinct merchandise strategies Williams-Sonoma, Pottery Barn, Pottery Barn Kids, West Elm, PBteen, Williams-Sonoma Home, Rejuvenation, and Mark and Graham are marketed through e-commerce websites, direct mail catalogs and 623 stores. We have retail and/or e-commerce businesses in the U.S., Canada, Australia and the United Kingdom, and ship our products to customers worldwide. Our catalogs reach customers throughout the U.S. and Australia. In addition, we have unaffiliated franchisees that operate stores in the Middle East, the Philippines and Mexico.

The following discussion and analysis of financial condition, results of operations, and liquidity and capital resources for the thirteen weeks ended November 1, 2015 ( third quarter of fiscal 2015 ), as compared to the thirteen weeks ended November 2, 2014 ( third quarter of fiscal 2014 ) and the thirty-nine weeks ended November 1, 2015 ( year-to-date 2015 ), as compared to the thirty-nine weeks ended November 2, 2014, ( year-to-date 2014 ), should be read in conjunction with our Condensed Consolidated Financial Statements and the notes thereto.

All explanations of changes in operational results are discussed in order of their magnitude.

## Third Quarter of Fiscal 2015 Financial Results

In the third quarter of fiscal 2015, our net revenues increased $7.8 \%$ to $\$ 1,232,082,000$, compared to $\$ 1,143,162,000$ in the third quarter of fiscal 2014, with comparable brand revenue growth of $4.5 \%$. The increase in net revenues was driven by an $8.6 \%$ increase in our retail net revenues and a $7.0 \%$ increase in our e-commerce net revenues. This growth included an increase in our international revenues of $46.5 \%$, primarily related to our international franchise
operations, and a $3.3 \%$ increase in retail leased square footage primarily due to 20 net new stores. By brand, this increase was primarily driven by West Elm, with particular strength in furniture. Diluted earnings per share in the third quarter of fiscal 2015 increased to $\$ 0.77$, versus $\$ 0.68$ in the third quarter of fiscal 2014, and we returned $\$ 103,473,000$ to our stockholders through stock repurchases and dividends.

E-commerce net revenues in the third quarter of fiscal 2015 increased $\$ 41,215,000$, or $7.0 \%$, compared to the third quarter of fiscal 2014. This growth was primarily driven by West Elm.

Retail net revenues in the third quarter of fiscal 2015 increased $\$ 47,705,000$, or $8.6 \%$, compared to the third quarter of fiscal 2014, including growth in our international revenues primarily from our international franchise operations, and a $3.3 \%$ increase in retail leased square footage primarily due to 20 net new stores. By brand, this increase was primarily driven by West Elm and Pottery Barn.

In Pottery Barn, our largest brand, comparable brand revenues increased 2.0\% in the third quarter of fiscal 2015 on top of $7.0 \%$ in the third quarter of fiscal 2014. We had strong growth where we offered newness and we saw strength across our living room upholstery and home furnishings offerings; however, we saw some softness in other categories. In the Williams-Sonoma brand, comparable brand revenues increased $1.2 \%$ in the third quarter of fiscal 2015 compared to the third quarter of fiscal 2014. Growth in cookware, electrics, cutlery and our Williams-Sonoma Home business drove these results. In West Elm, comparable brand revenues increased $15.7 \%$ in the third quarter of fiscal 2015 on top of $17.4 \%$ in the third quarter of fiscal 2014. Growth continued to be broad-based across categories. In Pottery Barn Kids, comparable brand revenues increased $4.7 \%$ in the third quarter of fiscal 2015 compared to the third quarter of fiscal 2014, primarily driven by our furniture and back-to-school businesses. In PBteen, comparable brand revenues decreased $0.9 \%$ in the third quarter of fiscal 2015 compared to the third quarter of fiscal 2014. Strength in our furniture and decorative accessories categories were offset by weaknesses in our textiles business.

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## Results of Operations

## NET REVENUES

Net revenues consist of e-commerce net revenues and retail net revenues. E-commerce net revenues include sales of merchandise to customers through our e-commerce websites and our catalogs, as well as shipping fees. Retail net revenues include sales of merchandise to customers at our retail stores, as well as shipping fees on any products shipped to our customers homes. Shipping fees consist of revenue received from customers for delivery of merchandise to their homes. Revenues are presented net of sales returns and other discounts.

The following table summarizes our net revenues for the third quarter of fiscal 2015 and fiscal 2014, and year-to-date 2015 and 2014:

|  | Thirteen Weeks Ended |  |  |  | Thirty-nine Weeks Ended |  |  |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
|  | November 1, | November 2, |  |  | November 1, | November 2, |  |  |  |

Net revenues in the third quarter of fiscal 2015 increased by $\$ 88,920,000$, or $7.8 \%$, compared to the third quarter of fiscal 2014, with comparable brand revenue growth of $4.5 \%$. The increase in net revenues was driven by an $8.6 \%$ increase in our retail net revenues and a $7.0 \%$ increase in our e-commerce net revenues. This growth included an increase in our international revenues of $46.5 \%$, primarily related to our international franchise operations, and a $3.3 \%$ increase in retail leased square footage primarily due to 20 net new stores. By brand, this increase was primarily driven by West Elm, with particular strength in furniture.

Net revenues for year-to-date 2015 increased by $\$ 233,192,000$ or $7.4 \%$, compared to year-to-date 2014 , with comparable brand revenue growth of $5.1 \%$. The increase in net revenues was driven by an $8.1 \%$ increase in our e-commerce net revenues and a $6.6 \%$ increase in our retail net revenues. This growth included an increase in our international revenues of $25.2 \%$, primarily related to our international franchise operations, and a $3.3 \%$ increase in retail leased square footage primarily due to 20 net new stores. This growth was driven by all brands, led by West Elm and Pottery Barn, with particular strength in furniture.

## Comparable Brand Revenue Growth

Comparable brand revenues include retail comparable store sales and e-commerce sales, as well as shipping fees, sales returns and other discounts associated with current period sales. Outlet comparable store net revenues are included in their respective brands. Comparable brand revenues exclude sales from certain operations until such time that we believe those sales are meaningful to evaluating the performance of the brand. Sales related to our international franchised stores have also been excluded as they are not operated by us.

Comparable stores are defined as permanent stores where gross square footage did not change by more than $20 \%$ in the previous 12 months and which have been open for at least 12 consecutive months without closure for seven or more consecutive days.

Thirteen Weeks Ended Thirty-nine Weeks Ended

|  | November 1, | November 2, November 1, | November 2, |  |
| :--- | ---: | ---: | ---: | ---: |
| Comparable brand revenue growth (decline) | 2015 | 2014 | 2015 | 2014 |
| Pottery Barn | $2.0 \%$ | $7.0 \%$ | $3.5 \%$ | $7.0 \%$ |
| Williams-Sonoma | $1.2 \%$ | $4.3 \%$ | $1.2 \%$ | $4.5 \%$ |
| West Elm | $15.7 \%$ | $17.4 \%$ | $15.6 \%$ | $17.6 \%$ |
| Pottery Barn Kids | $4.7 \%$ | $8.6 \%$ | $3.1 \%$ | $7.5 \%$ |
| PBteen | $(0.9 \%$ | $11.7 \%$ | $1.8 \%$ | $7.1 \%$ |
|  |  |  |  |  |
| Total | $4.5 \%$ | $8.7 \%$ | $5.1 \%$ | $8.1 \%$ |

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## E-COMMERCE NET REVENUES

|  | Thirteen Weeks Ended |  |  | Thirty-nine Weeks Ended |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | November 1, |  | ember 2, | November 1, |  | vember 2, |
| In thousands | 2015 |  | 2014 | 2015 |  | 2014 |
| E-commerce net revenues | \$ 628,191 | \$ | 586,976 | \$ 1,730,677 | \$ | 1,600,854 |
| E-commerce net revenue growth | 7.0\% |  | 14.7\% | 8.1\% |  | 13.6\% |

E-commerce net revenues in the third quarter of fiscal 2015 increased $\$ 41,215,000$, or $7.0 \%$, compared to the third quarter of fiscal 2014. This growth was primarily driven by West Elm.

E-commerce net revenues for year-to-date 2015 increased by $\$ 129,823,000$, or $8.1 \%$, compared to year-to-date 2014. This growth was driven by all brands, led by West Elm.

## RETAIL NET REVENUES AND OTHER DATA



Store Count
Avg. LSF Per Store
August 2, $\quad$ November 1, November 2,November 1, November 2,

|  | 2015 | Openings | Closings | 2015 | 2014 | 2015 | 2014 |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Williams-Sonoma | 241 | 4 | $(2)$ | 243 | 248 | 6,600 | 6,600 |
| Pottery Barn | 199 | 2 | $(1)$ | 200 | 198 | 13,700 | 13,700 |
| Pottery Barn Kids | 89 | 1 | 0 | 90 | 85 | 7,500 | 7,700 |
| West Elm | 78 | 6 | 0 | 84 | 68 | 13,400 | 13,800 |
| Rejuvenation | 5 | 1 | 0 | 6 | 4 | 9,000 | 13,200 |
| Total | 612 | 14 | $(3)$ | 623 | 603 | 9,900 | 9,900 |

Retail net revenues in the third quarter of fiscal 2015 increased $\$ 47,705,000$, or $8.6 \%$, compared to the third quarter of fiscal 2014, including growth in our international revenues primarily from our international franchise operations, and a $3.3 \%$ increase in retail leased square footage primarily due to 20 net new stores. By brand, this increase was primarily driven by West Elm and Pottery Barn.

Retail net revenues for year-to-date 2015 increased by $\$ 103,369,000$, or $6.6 \%$, compared to year-to-date 2014, including growth in our international revenues primarily from our international franchise operations, and a $3.3 \%$ increase in retail leased square footage primarily due to 20 net new stores. By brand, this increase was primarily driven by West Elm and Pottery Barn, partially offset by a decrease in Williams-Sonoma.

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## COST OF GOODS SOLD

|  | een Weeks Ende |  |  |  | -nine Weeks End |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  |  |  |  |  |  |
| In thousands |  |  | enu |  | 201Revenues |  | 1Revenues |  |
| Cost of goods | \$ 780,89 |  | 711,75 |  | , |  | \$ 1,974,681 |  |
| ${ }^{1}$ Includes total occupancy expenses of $\$ 159,415,000$ and $\$ 153,975,000$ for the third quarter of fiscal 2015 and the third quarter of fiscal 2014, respectively, and \$466,859,000 and \$448,556,000 for year-to-date 2015 and year-to-date 2014, respectively. |  |  |  |  |  |  |  |  |
| Cost of goods sold includes cost of goods, occupancy expenses and shipping costs. Cost of goods consists of cost of merchandise, inbound freight to our stores and distribution centers and other inventory related costs such as shrinkage, damages and replacements. Occupancy expenses consist of rent, depreciation and other occupancy costs, including common area maintenance, property taxes and utilities. Shipping costs consist of third-party delivery services and shipping materials. |  |  |  |  |  |  |  |  |

Our classification of expenses in cost of goods sold may not be comparable to other public companies, as we do not include non-occupancy related costs associated with our distribution network in cost of goods sold. These costs, which include distribution network employment, third party warehouse management and other distribution related administrative expenses, are recorded in selling, general and administrative expenses.

Within our reportable segments, the e-commerce channel does not incur freight-to-store or store occupancy expenses, and typically operates with lower markdowns and inventory shrinkage than the retail channel. However, the e-commerce channel incurs higher customer shipping, damage and replacement costs than the retail channel.

## Third Quarter of Fiscal 2015 vs. Third Quarter of Fiscal 2014

Cost of goods sold increased by $\$ 69,139,000$, or $9.7 \%$, in the third quarter of fiscal 2015 compared to the third quarter of fiscal 2014. Cost of goods sold as a percentage of net revenues increased to $63.4 \%$ in the third quarter of fiscal 2015 from $62.3 \%$ in the third quarter of fiscal 2014. This increase was driven by lower selling margins primarily associated with higher franchise revenues and increased shipping and fulfillment-related costs, partially offset by the leverage of occupancy expenses.

In the e-commerce channel, cost of goods sold as a percentage of net revenues increased in the third quarter of fiscal 2015 compared to the third quarter of fiscal 2014 primarily driven by increased shipping and fulfillment-related costs.

In the retail channel, cost of goods sold as a percentage of net revenues increased in the third quarter of fiscal 2015 compared to the third quarter of fiscal 2014 driven by lower selling margins primarily associated with higher franchise revenues and increased fulfillment-related costs, partially offset by the leverage of occupancy expenses.

## Year-to-date Fiscal 2015 vs. Year-to-date Fiscal 2014

Cost of goods sold increased by $\$ 178,451,000$, or $9.0 \%$, for year-to-date 2015 compared to year-to-date 2014. Cost of goods sold as a percentage of net revenues increased to $63.5 \%$ for year-to-date 2015 from $62.6 \%$ for year-to-date 2014. This increase was driven by lower selling margins primarily associated with higher franchise revenues and increased shipping and fulfillment-related costs, partially offset by the leverage of occupancy expenses.

In the e-commerce channel, cost of goods sold as a percentage of net revenues increased for year-to-date 2015 compared to year-to-date 2014 primarily driven by increased shipping and fulfillment-related costs.

In the retail channel, cost of goods sold as a percentage of net revenues increased for year-to-date 2015 compared to year-to-date 2014 driven by lower selling margins primarily associated with higher franchise revenues and increased fulfillment-related costs, partially offset by the leverage of occupancy expenses.

## SELLING, GENERAL AND ADMINISTRATIVE EXPENSES



Year-to-date 2015 vs. Year-to-date 2014
Selling, general and administrative expenses increased by $\$ 53,169,000$, or $5.8 \%$, for year-to-date 2015 compared to year-to-date 2014. Selling, general and administrative expenses as a percentage of net revenues decreased to $28.6 \%$ for year-to-date 2015 from $29.1 \%$ for year-to-date 2014. This decrease was driven by advertising efficiencies.

In the e-commerce channel, selling, general and administrative expenses as a percentage of net revenues decreased for year-to-date 2015 compared to year-to-date 2014 primarily driven by advertising efficiencies, partially offset by an increase in employment costs associated with incremental labor costs in our supply chain.

In the retail channel, selling, general and administrative expenses as a percentage of net revenues decreased for year-to-date 2015 compared to year-to-date 2014 primarily driven by the leverage of employment costs due to higher franchise revenues.

## INCOME TAXES

The effective tax rate was $36.3 \%$ for year-to-date 2015 and $38.8 \%$ for year-to-date 2014, reflecting our higher year-over-year earnings from international operations as well as the favorable resolution of certain income tax matters in fiscal 2015.

## LIQUIDITY AND CAPITAL RESOURCES

As of November 1, 2015, we held $\$ 72,264,000$ in cash and cash equivalents, the majority of which is held in demand deposit accounts, of which $\$ 52,836,000$ was held by our foreign subsidiaries. As is consistent within our industry, our cash balances are seasonal in nature, with the fourth quarter historically representing a significantly higher level of cash than other periods.

In fiscal 2015, we plan to use our cash resources to fund our inventory and inventory related purchases, advertising and marketing initiatives, stock repurchases, dividend payments and purchases of property and equipment. In addition to our cash balances on hand, we have a $\$ 500,000,000$ unsecured revolving line of credit ( credit facility ) that may be used to borrow revolving loans or to request the issuance of letters of credit. We may, upon notice to the administrative agent, request existing or new lenders to increase the credit facility by up to $\$ 250,000,000$, at such lenders option, to provide for a total of $\$ 750,000,000$ of unsecured revolving credit.

During the third quarter of fiscal 2015 we borrowed $\$ 50,000,000$ under the credit facility and, as of November 1, 2015, we had borrowings of $\$ 200,000,000$ outstanding under our credit facility. During the third quarter of 2014, we borrowed $\$ 90,000,000$ under the credit facility, all of which was outstanding as of November 2, 2014.

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As of November 1, 2015, issued but undrawn standby letters of credit totaling $\$ 13,346,000$ were outstanding under the credit facility. Additionally, as of November 1, 2015, we had three unsecured letter of credit reimbursement facilities for a total of $\$ 70,000,000$, of which $\$ 8,111,000$ was outstanding. These letter of credit facilities represent only a future commitment to fund inventory purchases to which we had not taken legal title. We are currently in compliance with all of our financial covenants under the credit facility and, based on our current projections, we expect to remain in compliance throughout fiscal 2015. We believe our cash on hand, in addition to our available credit facilities, will provide adequate liquidity for our business operations over the next 12 months.

## Cash Flows from Operating Activities

For year-to-date 2015, net cash provided by operating activities was $\$ 93,045,000$ compared to $\$ 121,801,000$ for year-to-date 2014. For year-to-date 2015, net cash provided by operating activities was primarily attributable to net earnings adjusted for non-cash items and an increase in customer deposits and deferred rent and lease incentives, partially offset by an increase in merchandise inventories. Net cash provided by operating activities decreased compared to year-to-date 2014 primarily due to an increase in merchandise inventories and a decrease in accounts payable, partially offset by an increase in income taxes payable resulting from the timing of payments.

## Cash Flows from Investing Activities

For year-to-date 2015, net cash used in investing activities was $\$ 135,534,000$ compared to $\$ 116,176,000$ for year-to-date 2014, and was primarily attributable to purchases of property and equipment. Net cash used in investing activities compared to year-to-date 2014 increased primarily due to restricted cash receipts received in year-to-date 2014 that did not recur in year-to-date 2015.

## Cash Flows from Financing Activities

For year-to-date 2015, net cash used in financing activities was $\$ 108,574,000$ compared to $\$ 227,812,000$ for year-to-date 2014. For year-to-date 2015, net cash used in financing activities was primarily attributable to repurchases of common stock and the payment of dividends, partially offset by borrowings under our revolving line of credit. Net cash used in financing activities compared to year-to-date 2014 decreased primarily due to increased borrowings under our revolving line of credit in year-to-date 2015 and a decrease in tax withholdings related to stock-based awards.

## Stock Repurchase Program and Dividend

See Note G to our Condensed Consolidated Financial Statements, Stock Repurchase Program and Dividends, within Item 1 of this Quarterly Report on Form 10-Q for further information.

## Critical Accounting Policies

Management s Discussion and Analysis of Financial Condition and Results of Operations is based on our Condensed Consolidated Financial Statements, which have been prepared in accordance with U.S. GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosures of contingent assets and liabilities. The estimates and assumptions are evaluated on an ongoing basis and are based on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results may differ significantly from these estimates. During the third quarter of fiscal 2015, there have been no significant changes to the critical accounting policies discussed in our Annual Report on Form 10-K for the year ended February 1, 2015.

## Seasonality

Our business is subject to substantial seasonal variations in demand. Historically, a significant portion of our revenues and net earnings have been realized during the period from October through January, and levels of net revenues and net earnings have typically been lower during the period from February through September. We believe this is the general pattern associated with the retail industry. In anticipation of our holiday selling season, we hire a substantial number of additional temporary employees in our retail stores, customer care centers and distribution centers, and incur significant fixed catalog production and mailing costs.

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## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risks, which include significant deterioration of the U.S. and foreign markets, changes in U.S. interest rates, foreign currency exchange rate fluctuations, and the effects of economic uncertainty which may affect the prices we pay our vendors in the foreign countries in which we do business. We do not engage in financial transactions for trading or speculative purposes.

## Interest Rate Risk

Our line of credit facility has a variable interest rate which, when drawn upon, subjects us to risks associated with changes in that interest rate. As of November 1, 2015, we had borrowings of $\$ 200,000,000$ outstanding under our line of credit facility. A hypothetical increase or decrease of one percentage point on our existing variable rate debt instrument would not materially affect our results of operations or cash flows.

In addition, we have fixed and variable income investments consisting of short-term investments classified as cash and cash equivalents, which are also affected by changes in market interest rates. As of November 1, 2015, our investments, made primarily in demand deposit accounts, are stated at cost and approximate their fair values.

## Foreign Currency Risks

We purchase a significant amount of inventory from vendors outside of the U.S. in transactions that are denominated in U.S. dollars. Approximately $2 \%$ of our international purchase transactions are in currencies other than the U.S. dollar, primarily the euro. Any foreign currency impact related to these international purchase transactions was not significant to us during the third quarter of fiscal 2015 or the third quarter of fiscal 2014. Since we pay for the majority of our international purchases in U.S. dollars, however, a decline in the U.S. dollar relative to other foreign currencies may subject us to risks associated with increased purchasing costs from our vendors in their effort to offset any lost profits associated with any currency devaluation. We cannot predict with certainty the effect that currency fluctuations may have on our financial statements or results of operations.

In addition, our retail and/or e-commerce businesses in Canada, Australia and the United Kingdom, and our operations throughout Asia and Europe, expose us to market risk associated with foreign currency exchange rate fluctuations. Substantially all of our purchases and sales are denominated in U.S. dollars, which limits our exposure to this risk. While the impact of foreign currency exchange rate fluctuations was not material to us in the third quarter of fiscal 2015, we have continued to see volatility in the exchange rates in the countries in which we do business. As we continue to expand globally, the foreign currency exchange risk related to our foreign operations may increase. To mitigate this risk, we hedge a portion of our foreign currency exposure with foreign currency forward contracts in accordance with our risk management policies (see Note H to our Condensed Consolidated Financial Statements).

## ITEM 4. CONTROLS AND PROCEDURES

## Evaluation of Disclosure Controls and Procedures

As of November 1, 2015, an evaluation was performed by management, with the participation of our Chief Executive Officer ( CEO ) and our Chief Financial Officer ( CFO ), of the effectiveness of our disclosure controls and procedures. Based on that evaluation, our management, including our CEO and CFO, concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow for timely discussions regarding required disclosures, and that such information is
recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission.

## Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting that occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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## PART II OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS

Information required by this Item is contained in Note F to our Condensed Consolidated Financial Statements within Part I of this Form 10-Q.

## ITEM 1A. RISK FACTORS

See Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended February 1, 2015 for a description of the risks and uncertainties associated with our business. There were no material changes to such risk factors in the current quarterly reporting period.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table provides information as of November 1, 2015 with respect to shares of common stock we repurchased during the third quarter of fiscal 2015. For additional information, please see Note G to our Condensed Consolidated Financial Statements within Part I of this Form 10-Q.

|  | Total Number of Shares | Total Number ofMaximum Dollar Value |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  |  |  | Part of a | May |
|  |  | Average Price | e Publicly | Yet Be Purchased |
| Fiscal period | Purchased ${ }^{1}$ | Paid Per ShaA | mnounced Program | Under the Program |
| August 3, 2015 to August 30, 2015 | 117,478 | \$ 83.87 | 117,478 | \$ 151,993,000 |
| August 31, 2015 to September 27, 2015 | 518,001 | \$ 76.73 | 3 518,001 | \$ 112,247,000 |
| September 28, 2015 to November 1, 2015 | 286,648 | \$ 76.40 | 286,648 | \$ 90,348,000 |
| Total | 922,127 | \$ 77.54 | 4 922,127 | \$ 90,348,000 |

${ }^{1}$ In March 2013, our board of directors announced a $\$ 750,000,000$ stock repurchase program. Stock repurchases under this program may be made through open market and privately negotiated transactions at times and in such amounts as management deems appropriate. The timing and actual number of shares repurchased will depend on a variety of factors including price, corporate and regulatory requirements, capital availability and other market conditions. This stock repurchase program does not have an expiration date and may be limited or terminated at any time without prior notice.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

## ITEM 5. OTHER INFORMATION

None.

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## ITEM 6. EXHIBITS

(a) Exhibits

Exhibit

| Number <br> $10.1^{*}$ | Exhibit Description <br> Second Amendment to Reimbursement Agreement between Williams-Sonoma, Inc., Williams-Sonoma <br> Singapore Pte. Ltd., and Bank of America, N.A., dated as of August 28, 2015 |
| :---: | :--- |
| $10.2^{*}$ | Second Amendment to Reimbursement Agreement between Williams-Sonoma, Inc., Williams-Sonoma <br> Singapore Pte. Ltd., and Wells Fargo Bank, N.A., dated as of August 28, 2015 |
| $10.3^{*}$ | Second Amendment to Reimbursement Agreement between Williams-Sonoma, Inc., Williams-Sonoma <br> Singapore Pte. Ltd., and U.S. Bank National Association, dated as of August 28, 2015 |
| $31.1^{*}$ | Certification of Chief Executive Officer, pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the <br> Securities Exchange Act, as amended |
| $31.2^{*}$ | Certification of Chief Financial Officer, pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities <br> Exchange Act, as amended |
| $32.1^{*}$ | Certification of Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to <br> Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2* | Certification of Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to <br> Section 906 of the Sarbanes-Oxley Act of 2002 |
| 101.INS* | XBRL Instance Document |
| 101.SCH* | XBRL Taxonomy Extension Schema Document |
| 101.CAL* | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF* | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB* | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE* | XBRL Taxonomy Extension Presentation Linkbase Document |

* Filed herewith.

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## SIGNATURE

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

WILLIAMS-SONOMA, INC.
By: /s/ Julie P. Whalen
Julie P. Whalen
Chief Financial Officer
Date: December 11, 2015

