

Macy's, Inc.
Form 10-Q
August 31, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended August 4, 2018

OR

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

For the transition period from to

Commission file number: 1-13536

Incorporated in Delaware I.R.S. Employer Identification No.
13-3324058

7 West Seventh Street
Cincinnati, Ohio 45202
(513) 579-7000
and
151 West 34th Street
New York, New York 10001
(212) 494-1602

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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 <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>	Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input type="checkbox"/>	Emerging growth company <input type="checkbox"/>
(Do not check if a smaller reporting company)				

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at August 4, 2018
Common Stock, \$0.01 par value per share	306,972,712 shares

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

MACY'S, INC.

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(millions, except per share figures)

	13 Weeks Ended		26 Weeks Ended	
	August 4,	July 29,	August 4,	July 29,
	2018	2017	2018	2017
Net sales	\$5,572	\$5,636	\$11,112	\$10,986
Credit card revenues, net	186	167	343	328
Cost of sales	(3,320)	(3,403)	(6,701)	(6,706)
Selling, general and administrative expenses	(2,164)	(2,161)	(4,247)	(4,218)
Gains on sale of real estate	46	43	70	111
Impairment and other costs	(17)	—	(36)	—
Operating income	303	282	541	501
Benefit plan income, net	11	14	22	27
Settlement charges	(50)	(51)	(50)	(51)
Interest expense	(69)	(82)	(140)	(168)
Gains (losses) on early retirement of debt	(5)	2	(5)	(1)
Interest income	7	3	12	5
Income before income taxes	197	168	380	313
Federal, state and local income tax expense	(33)	(60)	(84)	(128)
Net income	164	108	296	185
Net loss attributable to noncontrolling interest	2	3	10	4
Net income attributable to Macy's, Inc. shareholders	\$166	\$111	\$306	\$189
Basic earnings per share attributable to Macy's, Inc. shareholders	\$0.54	\$0.36	\$0.99	\$0.62
Diluted earnings per share attributable to Macy's, Inc. shareholders	\$0.53	\$0.36	\$0.98	\$0.62

The accompanying notes are an integral part of these Consolidated Financial Statements.

MACY'S, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

(millions)

	13 Weeks Ended August 4, 2018	July 29, 2017	26 Weeks Ended August 4, 2018	July 29, 2017
Net income	\$ 164	\$ 108	\$ 296	\$ 185
Other comprehensive income (loss):				
Actuarial gain (loss) on post employment and postretirement benefit plans, before tax	(29)	47	(29)	47
Reclassifications to net income:				
Amortization of net actuarial loss and prior service credit on post employment and postretirement benefit plans included in net income, before tax	9	9	18	18
Settlement charges, before tax	50	51	50	51
Tax effect related to items of other comprehensive income (loss)	(10)	(42)	(12)	(45)
Total other comprehensive income, net of tax effect	20	65	27	71
Comprehensive income	184	173	323	256
Comprehensive loss attributable to noncontrolling interest	2	3	10	4
Comprehensive income attributable to Macy's, Inc. shareholders	\$ 186	\$ 176	\$ 333	\$ 260

The accompanying notes are an integral part of these Consolidated Financial Statements.

MACY'S, INC.
CONSOLIDATED BALANCE SHEETS
(Unaudited)

(millions)

	August 4, 2018	February 3, 2018	July 29, 2017
ASSETS			
Current Assets:			
Cash and cash equivalents	\$1,068	\$1,455	\$783
Receivables	261	363	382
Merchandise inventories	4,956	5,178	4,980
Prepaid expenses and other current assets	580	650	571
Total Current Assets	6,865	7,646	6,716
Property and Equipment - net of accumulated depreciation and amortization of \$4,914, \$4,610 and \$5,159	6,547	6,672	6,822
Goodwill	3,908	3,897	3,897
Other Intangible Assets – net	483	488	493
Other Assets	865	880	810
Total Assets	\$18,668	\$19,583	\$18,738
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current Liabilities:			
Short-term debt	\$63	\$22	\$16
Merchandise accounts payable	1,795	1,590	1,669
Accounts payable and accrued liabilities	2,608	3,271	2,939
Income taxes	15	296	52
Total Current Liabilities	4,481	5,179	4,676
Long-Term Debt	5,473	5,861	6,301
Deferred Income Taxes	1,194	1,148	1,549
Other Liabilities	1,626	1,662	1,773
Shareholders' Equity:			
Macy's, Inc.	5,916	5,745	4,444
Noncontrolling interest	(22)	(12)	(5)
Total Shareholders' Equity	5,894	5,733	4,439
Total Liabilities and Shareholders' Equity	\$18,668	\$19,583	\$18,738

The accompanying notes are an integral part of these Consolidated Financial Statements.

MACY'S, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(millions)

	26 Weeks Ended	
	August 4, 2018	July 29, 2017
Cash flows from operating activities:		
Net income	\$ 296	\$ 185
Adjustments to reconcile net income to net cash provided by operating activities:		
Impairment and other costs	36	—
Settlement charges	50	51
Depreciation and amortization	470	487
Stock-based compensation expense	31	31
Gains on sale of real estate	(70)	(111)
Amortization of financing costs and premium on acquired debt	(5)	(10)
Changes in assets and liabilities:		
Decrease in receivables	88	119
Decrease in merchandise inventories	221	419
Decrease in prepaid expenses and other current assets	29	59
Increase in merchandise accounts payable	219	261
Decrease in accounts payable, accrued liabilities and other items not separately identified	(492)	(604)
Decrease in current income taxes	(271)	(302)
Increase in deferred income taxes	36	26
Change in other assets and liabilities not separately identified	(94)	(65)
Net cash provided by operating activities	544	546
Cash flows from investing activities:		
Purchase of property and equipment	(275)	(247)
Additions to capitalized software	(133)	(125)
Disposition of property and equipment	88	150
Other, net	8	12
Net cash used by investing activities	(312)	(210)
Cash flows from financing activities:		
Debt repaid	(357)	(560)
Dividends paid	(232)	(230)
Decrease in outstanding checks	(90)	(64)
Acquisition of treasury stock	—	(1)
Issuance of common stock	38	2
Proceeds from noncontrolling interest	5	6
Net cash used by financing activities	(636)	(847)
Net decrease in cash, cash equivalents and restricted cash	(404)	(511)
Cash, cash equivalents and restricted cash beginning of period	1,513	1,334
Cash, cash equivalents and restricted cash end of period	\$ 1,109	\$ 823
Supplemental cash flow information:		
Interest paid	\$ 156	\$ 183
Interest received	11	5
Income taxes paid (net of refunds received)	319	401

The accompanying notes are an integral part of these Consolidated Financial Statements.

MACY'S, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Summary of Significant Accounting Policies

Nature of Operations

Macy's, Inc. and subsidiaries (the "Company") is an omnichannel retail organization operating stores, websites and mobile applications under three brands (Macy's, Bloomingdale's and bluemercury) that sell a wide range of merchandise, including apparel and accessories (men's, women's and kids), cosmetics, home furnishings and other consumer goods. The Company's operations are conducted through approximately 860 Macy's, Macy's Backstage, Bloomingdale's, Bloomingdale's The Outlet, bluemercury and STORY in 44 states, the District of Columbia, Guam and Puerto Rico. In addition, Bloomingdale's in Dubai, United Arab Emirates and Al Zahra, Kuwait are operated under a license agreement with Al Tayer Insignia, a company of Al Tayer Group, LLC.

A description of the Company's significant accounting policies is included in the Company's Annual Report on Form 10-K for the fiscal year ended February 3, 2018 (the "2017 10-K"). The accompanying Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and notes thereto in the 2017 10-K.

Use of Estimates

The preparation of financial statements in conformity with United States generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Such estimates and assumptions are subject to inherent uncertainties, which may result in actual amounts differing from reported amounts.

The Consolidated Financial Statements for the 13 and 26 weeks ended August 4, 2018 and July 29, 2017, in the opinion of management, include all adjustments (consisting only of normal recurring adjustments) considered necessary to present fairly, in all material respects, the consolidated financial position and results of operations of the Company.

Seasonality

Because of the seasonal nature of the retail business, the results of operations for the 13 and 26 weeks ended August 4, 2018 and July 29, 2017 (which do not include the Christmas season) are not necessarily indicative of such results for the full fiscal year.

Reclassifications

Certain reclassifications were made to prior years' amounts to conform to the classifications of such amounts in the most recent years and adoption of new accounting standards as discussed in more detail below.

Comprehensive Income

Total comprehensive income represents the change in equity during a period from sources other than transactions with shareholders and, as such, includes net income. For the Company, the only other components of total comprehensive income for the 13 and 26 weeks ended August 4, 2018 and July 29, 2017 relate to post employment and postretirement plan items. Settlement charges incurred are included as a separate component of income before income taxes in the Consolidated Statements of Income. Amortization reclassifications out of accumulated other comprehensive loss are included in the computation of net periodic benefit cost (income) and are included in benefit plan income, net on the Consolidated Statements of Income. See Note 4, "Benefit Plans," for further information.

Revenue

Revenue is recognized when customers obtain control of goods and services promised by the Company. The amount of revenue recognized is based on the amount that reflects the consideration that is expected to be received in exchange for those respective goods and services. The Company's revenue generating activities include the following:

Retail Sales

Retail sales include merchandise sales, licensed department income, sales of private brand goods directly to third party retailers and sales of excess inventory to third parties. Sales of merchandise are recorded at the time of shipment to the

customer and are

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MACY'S, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

reported net of estimated merchandise returns and certain customer incentives. Commissions earned on sales generated by licensed departments are included as a component of total net sales and are recognized as revenue at the time merchandise is sold to customers. Service revenues (e.g., alteration and cosmetic services) are recorded at the time the customer receives the benefit of the service. The Company has elected to present sales taxes on a net basis and, as such, sales taxes are included in accounts payable and accrued liabilities until remitted to the taxing authorities.

For the 13 weeks ended August 4, 2018 and July 29, 2017, Macy's accounted for 89% of the Company's net sales. For the 26 weeks ended August 4, 2018 and July 29, 2017, Macy's accounted for 88% and 89%, respectively, of the Company's net sales. Disaggregation of the Company's net sales by family of business for the 13 and 26 weeks ended August 4, 2018 and July 29, 2017 were as follows:

	13 Weeks Ended		26 Weeks Ended	
	August 4, 2018	July 29, 2017	August 4, 2018	July 29, 2017
Net sales by family of business	(millions)			
Women's Accessories, Intimate Apparel, Shoes, Cosmetics and Fragrances	\$2,046	\$2,064	\$4,211	\$4,133
Women's Apparel	1,351	1,409	2,705	2,742
Men's and Kids	1,284	1,259	2,459	2,375
Home/Other (a)	891	904	1,737	1,736
Total	\$5,572	\$5,636	\$11,112	\$10,986

(a) Other primarily includes restaurant sales and breakage income from unredeemed gift cards.

Merchandise Returns

The Company estimates merchandise returns using historical data and recognizes an allowance that reduces net sales and cost of sales. The liability for merchandise returns is included in accounts payable and accrued liabilities on the Company's Consolidated Balance Sheets and was \$243 million, \$291 million and \$231 million as of August 4, 2018, February 3, 2018 and July 29, 2017, respectively. Included in prepaid expenses and other current assets is an asset totaling \$165 million, \$201 million and \$159 million as of August 4, 2018, February 3, 2018 and July 29, 2017, respectively, for the recoverable cost of merchandise estimated to be returned by customers.

Credit Card Revenues, net

In 2005, the Company entered into an arrangement with Citibank to sell the Company's private label and co-branded credit cards ("Credit Card Program"). Subsequent to this initial arrangement and associated amendments, in 2014, the Company entered into an amended and restated Credit Card Program Agreement (the "Program Agreement") with Citibank. As part of the Program Agreement, the Company receives payments for providing a combination of interrelated services and intellectual property to Citibank in support of the underlying Credit Card Program. Revenue based on the spending activity of the underlying accounts is recognized as the respective card purchases occur and the Company's profit share is recognized based on the performance of the underlying portfolio. Revenue associated with the establishment of new credit accounts and assisting in the receipt of payments for existing accounts is recognized as such activities occur. Credit card revenues include finance charges, late fees and other revenue generated by the Company's Credit Card Program, net of fraud losses and expenses associated with establishing new accounts.

Customer Loyalty Programs

The Company maintains customer loyalty programs in which customers earn points based on their purchases. Under the Macy's brand, points are earned based on customers' spending on Macy's private label and co-branded credit cards as well as non-proprietary cards during certain tender-neutral promotional events. Under the Bloomingdale's brand, the Company offers a tender neutral points-based program. The Company recognizes the estimated net amount of the rewards that will be earned and redeemed as a reduction to net sales at the time of the initial transaction and as tender

when the points are subsequently redeemed by a customer. The liability for customer loyalty programs is included in accounts payable and accrued liabilities on the Company's Consolidated Balance Sheets and was \$48 million, \$73 million and \$61 million as of August 4, 2018, February 3, 2018 and July 29, 2017, respectively.

Gift Cards

The Company only offers no-fee, non-expiring gift cards to its customers. At the time gift cards are sold, no revenue is recognized; rather, the Company records an accrued liability to customers. The liability is relieved and revenue is recognized

MACY'S, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

equal to the amount redeemed at the time gift cards are redeemed for merchandise. The Company records revenue from unredeemed gift cards (breakage) in net sales on a pro-rata basis over the time period gift cards are actually redeemed. At least three years of historical data, updated annually, is used to determine actual redemption patterns. The liability for unredeemed gift cards is included in accounts payable and accrued liabilities on the Company's Consolidated Balance Sheets and was \$614 million, \$821 million and \$596 million as of August 4, 2018, February 3, 2018 and July 29, 2017, respectively.

Newly Adopted Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers, which established principles to report useful information to financial statements users about the nature, timing and uncertainty of revenue from contracts with customers. ASU No. 2014-09 along with various related amendments comprise ASC Topic 606, Revenue from Contracts with Customers, and provide guidance that is applicable to all contracts with customers regardless of industry-specific or transaction-specific fact patterns. The new standard and its related updates were adopted by the Company on February 4, 2018. On the effective date, the Company elected to apply the new guidance retrospectively to each prior period presented which resulted in an increase to retained earnings of \$72 million and \$54 million at the beginning of fiscal 2018 and fiscal 2017, respectively.

Overall, the new standard did not have a material impact on the results of the Company's operations or consolidated statements of financial position, but impacted the presentation and timing of certain revenue transactions. Specifically, the changes included gross presentation of the Company's estimates for future sales returns and related recoverable assets, presenting income from credit operations, gift card breakage income, and certain loyalty program income as separate components of revenue and recognizing gift card breakage revenue over the period of redemption for gift cards associated with certain returns. The Company's evaluation of the new standards included a review of certain vendor arrangements to determine whether the Company acts as principal or agent in such arrangements and such evaluation did not result in any material changes in gross versus net presentation as a result of the adoption of the new standards.

In March 2017, the FASB issued ASU No. 2017-07, Compensation-Retirement Benefits (ASC Topic 715), which requires employers to disaggregate the service cost component from other components of net periodic benefit costs and to disclose the amounts of net periodic benefit costs that are included in each income statement line item. The standard requires employers to report the service cost component in the same line item as other compensation costs and to report the other components of net periodic benefit costs (which include interest costs, expected return on plan assets, amortization of prior service cost or credits and actuarial gains and losses) separately and outside a subtotal of operating income. The Company adopted this standard effective February 4, 2018 on a retrospective basis to each prior period presented and has recognized its net periodic benefit costs, excluding service costs, in benefit plan income, net on its Consolidated Statements of Income.

In 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (ASC Topic 230): Restricted Cash, and ASU No. 2016-15, Statement of Cash Flows (ASC Topic 230): Classification of Certain Cash Receipts and Cash Payments. These standards were issued to resolve numerous diversities in practice with regard to the presentation and classification of certain cash receipts and payments in the statement of cash flows. The standards were effective for the Company on February 4, 2018, and were adopted using a retrospective transition method to each prior period presented. As a result of these standards, the Company included its beginning-of-period restricted cash balances of \$58 million and end-of-period restricted cash balances of \$41 million when reconciling the Consolidated Statement of

Cash Flow movement for the 26 weeks ended August 4, 2018. Similarly, for the 26 weeks ended July 29, 2017, the Company included its beginning-of-period restricted cash balances of \$37 million and end-of-period restricted cash balances of \$40 million. In addition to these changes, the Company changed the classification of \$10 million of cash payments for the prepayment of debt from an operating outflow to a financing outflow for the 26 weeks ended July 29, 2017.

In February 2018, the FASB issued ASU No. 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, which allows for stranded tax effects in accumulated other comprehensive income resulting from H.R. 1, originally known as the “Tax Cuts and Jobs Act,” to be reclassified to retained earnings. The Company early adopted this standard during the first quarter of 2018 and, as a result, reclassified \$164 million of stranded tax effects to retained earnings.

MACY'S, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

2. Earnings Per Share Attributable to Macy's, Inc. Shareholders

The following tables set forth the computation of basic and diluted earnings per share attributable to Macy's, Inc. shareholders:

	13 Weeks Ended			
	August 4, 2018		July 29, 2017	
	Net	Shares	Net	Shares
	Income		Income	
	(millions, except per share data)			
Net income attributable to Macy's, Inc. shareholders and average number of shares outstanding	\$ 166	306.8	\$ 111	304.5
Shares to be issued under deferred compensation and other plans		0.9		1.0
	\$ 166	307.7	\$ 111	305.5
Basic earnings per share attributable to Macy's, Inc. shareholders	\$0.54		\$0.36	
Effect of dilutive securities:				
Stock options, restricted stock and restricted stock units		4.3		1.0
	\$ 166	312.0	\$ 111	306.5
Diluted earnings per share attributable to Macy's, Inc. shareholders	\$0.53		\$0.36	

	26 Weeks Ended			
	August 4, 2018		July 29, 2017	
	Net	Shares	Net	Shares
	Income		Income	
	(millions, except per share data)			
Net income attributable to Macy's, Inc. shareholders and average number of shares outstanding	\$ 306	306.2	\$ 189	304.4
Shares to be issued under deferred compensation and other plans		0.9		0.8
	\$ 306	307.1	\$ 189	305.2
Basic earnings per share attributable to Macy's, Inc. shareholders	\$0.99		\$0.62	
Effect of dilutive securities:				
Stock options, restricted stock and restricted stock units		3.6		1.5
	\$ 306	310.7	\$ 189	306.7
Diluted earnings per share attributable to Macy's, Inc. shareholders	\$0.98		\$0.62	

In addition to the stock options and restricted stock units reflected in the foregoing tables, stock options to purchase 12.8 million shares of common stock and restricted stock units relating to 1.4 million shares of common stock were outstanding at August 4, 2018, but were not included in the computation of diluted earnings per share because their

inclusion would have been antidilutive or they were subject to performance conditions that had not been met.

In addition to the stock options and restricted stock units reflected in the foregoing tables, stock options to purchase 16.7 million shares of common stock and restricted stock units relating to 1.1 million shares of common stock were outstanding at July 29, 2017, but were not included in the computation of diluted earnings per share because their inclusion would have been antidilutive or they were subject to performance conditions that had not been met.

MACY'S, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

3. Financing Activities

The following table shows the detail of debt repayments:

	26 Weeks Ended August 4, 2018 2017 (millions)	
7.45% Senior debentures due 2017	\$—	\$ 300
6.9% Senior debentures due 2029	90	3
4.5% Senior notes due 2034	80	—
6.7% Senior notes due 2028	60	3
6.375% Senior notes due 2037	43	135
6.7% Senior debentures due 2034	28	28
7.0% Senior debentures due 2028	27	2
6.65% Senior debentures due 2024	11	4
6.9% Senior debentures due 2032	5	72
9.5% Amortizing debentures due 2021	2	2
9.75% Amortizing debentures due 2021	1	1
	\$347	\$ 550

During the 26 weeks ended August 4, 2018, the Company repurchased \$344 million face value of senior notes and debentures. The debt repurchases were made in the open market for a total cost of \$354 million, including expenses related to the transactions. Such repurchases resulted in the recognition of expense of \$5 million during the 13 and 26 weeks ended August 4, 2018 presented as losses on early retirement of debt on the Consolidated Statements of Income.

During the 26 weeks ended July 29, 2017, the Company repurchased \$247 million face value of senior notes and debentures. The debt repurchases were made in the open market for a total cost of \$257 million, including expenses related to the transactions. Such repurchases resulted in the recognition of income of \$2 million and expense of \$1 million during the 13 and 26 weeks ended July 29, 2017, respectively, presented as gains and losses on early retirement of debt on the Consolidated Statements of Income.

During the 26 weeks ended July 29, 2017, the Company also repaid, at maturity, \$300 million of 7.45% Senior debentures due July 2017.

4. Benefit Plans

The Company has defined contribution plans which cover substantially all employees who work 1,000 hours or more in a year. In addition, the Company has a funded defined benefit plan ("Pension Plan") and an unfunded defined benefit supplementary retirement plan ("SERP"), which provides benefits, for certain employees, in excess of qualified plan limitations. Effective January 1, 2012, the Pension Plan was closed to new participants, with limited exceptions, and effective January 2, 2012, the SERP was closed to new participants.

In February 2013, the Company announced changes to the Pension Plan and SERP whereby eligible employees no longer earn future pension service credits after December 31, 2013, with limited exceptions. All retirement benefits

attributable to service in subsequent periods are provided through defined contribution plans.

In addition, certain retired employees currently are provided with specified health care and life insurance benefits ("Postretirement Obligations"). Eligibility requirements for such benefits vary, but generally state that benefits are available to eligible employees who were hired prior to a certain date and retire after a certain age with specified years of service. Certain employees are subject to having such benefits modified or terminated.

MACY'S, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

The defined contribution plan expense and actuarially determined components of the net periodic benefit cost (income) associated with the defined benefit plans are as follows:

	13 Weeks Ended August 4, 2018		26 Weeks Ended July 29, 2017	
	(millions)		(millions)	
401(k) Qualified Defined Contribution Plan	\$24	\$ 24	\$47	\$45
Non-Qualified Defined Contribution Plan	\$1	\$ —	\$1	\$—
Pension Plan				
Service cost	\$1	\$ 2	\$3	\$3
Interest cost	27	27	53	54
Expected return on assets	(53)	(57)	(106)	(113)
Recognition of net actuarial loss	8	8	16	16
Amortization of prior service credit	—	—	—	—
	\$(17)	\$(20)	\$(34)	\$(40)
Supplementary Retirement Plan				
Service cost	\$—	\$ —	\$—	\$—
Interest cost	5	5	11	11
Recognition of net actuarial loss	2	2	4	4
Amortization of prior service cost	—	—	—	—
	\$7	\$ 7	\$15	\$15
Total Retirement Expense	\$15	\$ 11	\$29	\$20
Postretirement Obligations				
Service cost	\$—	\$ —	\$—	\$—
Interest cost	1	2	2	3
Recognition of net actuarial gain	(1)	(1)	(2)	(2)
Amortization of prior service credit	—	—	—	—
	\$—	\$ 1	\$—	\$1

For the 13 and 26 weeks ended August 4, 2018 and July 29, 2017, the Company incurred non-cash settlement charges of \$50 million and \$51 million, respectively, related to the Company's defined benefit plans. These charges relate to the pro-rata recognition of net actuarial losses associated with the Company's defined benefit plans and are the result of an increase in lump sum distributions associated with store closings, organizational restructuring and a voluntary separation program, and periodic distribution activity.

MACY'S, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

5. Fair Value Measurements

The following table shows the Company's financial assets that are required to be measured at fair value on a recurring basis, by level within the hierarchy as defined by applicable accounting standards:

	August 4, 2018					July 29, 2017			
	Fair Value Measurements					Fair Value Measurements			
	Quoted Prices					Quoted Prices			
	in					in			
	Active	Significant	Significant			Active	Significant	Significant	
	Market	Observable	Unobservable			Market	Observable	Unobservable	
Total	for	Inputs	Inputs	Total	for	Inputs	Inputs	Total	for
	Identical	(Level 2)	(Level 3)		Identical	(Level 2)	(Level 3)		Identical
	(Level				(Level				(Level
	1)				1)				1)
	(millions)					(millions)			
Marketable equity and debt securities	\$96	\$ 27	\$ 69	\$ —	\$99	\$ 22	\$ 77	\$ —	\$ —

Other financial instruments not measured at fair value on a recurring basis include cash and cash equivalents, receivables, certain short-term investments and other assets, short-term debt, merchandise accounts payable, accounts payable and accrued liabilities and long-term debt. With the exception of long-term debt, the carrying amount of these financial instruments approximates fair value because of the short maturity of these instruments. The fair values of long-term debt, excluding capitalized leases, are generally estimated based on quoted market prices for identical or similar instruments, and are classified as Level 2 measurements within the hierarchy as defined by applicable accounting standards.

The following table shows the estimated fair value of the Company's long-term debt, excluding capital leases and other obligations:

	August 4, 2018			July 29, 2017		
	Notional	Carrying	Fair	Notional	Carrying	Fair
	Amount	Amount	Value	Amount	Amount	Value
	(millions)					
Long-term debt	\$5,423	\$ 5,447	\$5,314	\$6,209	\$ 6,274	\$6,217

6. Condensed Consolidating Financial Information

Certain debt obligations of the Company, which constitute debt obligations of Macy's Retail Holdings, Inc. ("Subsidiary Issuer"), a 100%-owned subsidiary of Macy's, Inc. ("Parent"), are fully and unconditionally guaranteed by Parent. In the following condensed consolidating financial statements, "Other Subsidiaries" includes all other direct subsidiaries of Parent, including Bluemercury, Inc., FDS Bank, West 34th Street Insurance Company New York, Macy's Merchandising Corporation, Macy's Merchandising Group, Inc. and its subsidiaries Macy's Merchandising Group (Hong Kong) Limited, Macy's Merchandising Group Procurement, LLC, Macy's Merchandising Group International, LLC, Macy's Merchandising Group International (Hong Kong) Limited, and its majority-owned subsidiary Macy's China Limited. "Subsidiary Issuer" includes operating divisions and non-guarantor subsidiaries of the Subsidiary Issuer on an equity basis. The assets and liabilities and results of operations of the non-guarantor subsidiaries of the Subsidiary Issuer are also reflected in "Other Subsidiaries."

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Condensed Consolidating Statements of Comprehensive Income for the 13 and 26 weeks ended August 4, 2018 and July 29, 2017, Condensed Consolidating Balance Sheets as of August 4, 2018, July 29, 2017 and February 3, 2018, and the related Condensed Consolidating Statements of Cash Flows for the 26 weeks ended August 4, 2018 and July 29, 2017 are presented on the following pages.

MACY'S, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

Condensed Consolidating Statement of Comprehensive Income

For the 13 Weeks Ended August 4, 2018

(millions)

	Parent	Subsidiary Issuer	Other Subsidiaries	Consolidating Adjustments	Consolidated
Net sales	\$—	\$ 2,072	\$ 4,914	\$ (1,414)	\$ 5,572
Credit card revenues, net	—	3	183	—	186
Cost of sales	—	(1,271)	(3,463)	1,414	(3,320)
Selling, general and administrative expenses	—	(812)	(1,352)	—	(2,164)
Gains on sale of real estate	—	19	27	—	46
Impairment and other costs	—	2	(19)	—	(17)
Operating income	—	13	290	—	303
Benefit plan income, net	—	4	7	—	11
Settlement charges	(6)	(16)	(28)	—	(50)
Interest (expense) income, net:					
External	5	(69)	2	—	(62)
Intercompany	—	(17)	17	—	—
Losses on early retirement of debt	—	(5)	—	—	(5)
Equity in earnings of subsidiaries	167	8	—	(175)	—
Income (loss) before income taxes	166	(82)	288	(175)	197
Federal, state and local income tax benefit (expense)	—	30	(63)	—	(33)
Net income (loss)	166	(52)	225	(175)	164
Net loss attributable to noncontrolling interest	—	—	2	—	2
Net income (loss) attributable to Macy's, Inc. shareholders	\$ 166	\$ (52)	\$ 227	\$ (175)	\$ 166
Comprehensive income (loss)	\$ 186	\$ (35)	\$ 236	\$ (203)	\$ 184
Comprehensive loss attributable to noncontrolling interest	—	—	2	—	2
Comprehensive income (loss) attributable to Macy's, Inc. shareholders	\$ 186	\$ (35)	\$ 238	\$ (203)	\$ 186

MACY'S, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

Condensed Consolidating Statement of Comprehensive Income

For the 13 Weeks Ended July 29, 2017

(millions)

	Parent	Subsidiary Issuer	Other Subsidiaries	Consolidating Adjustments	Consolidated
Net sales	\$ —	\$ 2,220	\$ 4,789	\$ (1,373)	\$ 5,636
Credit card revenues, net	—	5	162	—	167
Cost of sales	—	(1,391)	(3,385)	1,373	(3,403)
Selling, general and administrative expenses	—	(856)	(1,305)	—	(2,161)
Gains on sale of real estate	—	26	17	—	43
Operating income	—	4	278	—	282
Benefit plan income, net	—	5	9	—	14
Settlement charges	—	(17)	(34)	—	(51)
Interest (expense) income, net:					
External	2	(82)	1	—	(79)
Intercompany	—	(34)	34	—	—
Gains on early retirement of debt	—	2	—	—	2
Equity in earnings of subsidiaries	109	29	—	(138)	—
Income (loss) before income taxes	111	(93)	288	(138)	168
Federal, state and local income tax benefit (expense)	—	56	(116)	—	(60)
Net income (loss)	111	(37)	172	(138)	108
Net loss attributable to noncontrolling interest	—	—	3	—	3
Net income (loss) attributable to Macy's, Inc. shareholders	\$ 111	\$ (37)	\$ 175	\$ (138)	\$ 111
Comprehensive income	\$ 176	\$ 24	\$ 216	\$ (243)	\$ 173
Comprehensive loss attributable to noncontrolling interest	—	—	3	—	3
Comprehensive income attributable to Macy's, Inc. shareholders	\$ 176	\$ 24	\$ 219	\$ (243)	\$ 176

MACY'S, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

Condensed Consolidating Statement of Comprehensive Income

For the 26 Weeks Ended August 4, 2018

(millions)

	Parent	Subsidiary Issuer	Other Subsidiaries	Consolidating Adjustments	Consolidated
Net sales	\$—	\$ 4,081	\$ 10,277	\$ (3,246)	\$ 11,112
Credit card revenues (expense), net	—	(3)	346	—	343
Cost of sales	—	(2,591)	(7,356)	3,246	(6,701)
Selling, general and administrative expenses	—	(1,641)	(2,606)	—	(4,247)
Gains on sale of real estate	—	42	28	—	70
Impairment and other costs	—	2	(38)	—	(36)
Operating income (loss)	—	(110)	651	—	541
Benefit plan income, net	—	8	14	—	22
Settlement charges	(6)	(16)	(28)	—	(50)
Interest (expense) income, net:					
External	9	(139)	2	—	(128)
Intercompany	—	(36)	36	—	—
Losses on early retirement of debt	—	(5)	—	—	(5)
Equity in earnings of subsidiaries	304	109	—	(413)	—
Income (loss) before income taxes	307	(189)	675	(413)	380
Federal, state and local income tax benefit (expense)	(1)	67	(150)	—	(84)
Net income (loss)	306	(122)	525	(413)	296
Net loss attributable to noncontrolling interest	—	—	10	—	10
Net income (loss) attributable to Macy's, Inc. shareholders	\$ 306	\$ (122)	\$ 535	\$ (413)	\$ 306
Comprehensive income (loss)	\$ 333	\$ (99)	\$ 540	\$ (451)	\$ 323
Comprehensive loss attributable to noncontrolling interest	—	—	10	—	10
Comprehensive income (loss) attributable to Macy's, Inc. shareholders	\$ 333	\$ (99)	\$ 550	\$ (451)	\$ 333

MACY'S, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

Condensed Consolidating Statement of Comprehensive Income

For the 26 Weeks Ended July 29, 2017

(millions)

	Parent	Subsidiary Issuer	Other Subsidiaries	Consolidating Adjustments	Consolidated
Net sales	\$—	\$ 4,285	\$ 9,919	\$ (3,218)	\$ 10,986
Credit card revenues (expense), net	—	(2)	330	—	328
Cost of sales	—	(2,778)	(7,146)	3,218	(6,706)
Selling, general and administrative expenses	(1)	(1,623)	(2,594)	—	(4,218)
Gains on sale of real estate	—	92	19	—	111
Operating income (loss)	(1)	(26)	528	—	501
Benefit plan income, net	—	10	17	—	27
Settlement charges	—	(17)	(34)	—	(51)
Interest (expense) income, net:					
External	3	(167)	1	—	(163)
Intercompany	—	(69)	69	—	—
Losses on early retirement of debt	—	(1)	—	—	(1)
Equity in earnings of subsidiaries	188	31	—	(219)	—
Income (loss) before income taxes	190	(239)	581	(219)	313
Federal, state and local income tax benefit (expense)	(1)	83	(210)	—	(128)
Net income (loss)	189	(156)	371	(219)	185
Net loss attributable to noncontrolling interest	—	—	4	—	4
Net income (loss) attributable to Macy's, Inc. shareholders	\$ 189	\$ (156)	\$ 375	\$ (219)	\$ 189
Comprehensive income (loss)	\$ 260	\$ (89)	\$ 418	\$ (333)	\$ 256
Comprehensive loss attributable to noncontrolling interest	—	—	4	—	4
Comprehensive income (loss) attributable to Macy's, Inc. shareholders	\$ 260	\$ (89)	\$ 422	\$ (333)	\$ 260

MACY'S, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

Condensed Consolidating Balance Sheet

As of August 4, 2018

(millions)

	Parent	Subsidiary Issuer	Other Subsidiaries	Consolidating Adjustments	Consolidated
ASSETS:					
Current Assets:					
Cash and cash equivalents	\$744	\$ 66	\$ 258	\$ —	\$ 1,068
Receivables	1	43	217	—	261
Merchandise inventories	—	2,121	2,835	—	4,956
Prepaid expenses and other current assets	—	135	445	—	580
Income taxes	46	—	—	(46)	—
Total Current Assets	791	2,365	3,755	(46)	6,865
Property and Equipment – net	—	3,253	3,294	—	6,547
Goodwill	—	3,326	582	—	3,908
Other Intangible Assets – net	—	41	442	—	483
Other Assets	—	89	776	—	865
Deferred Income Taxes	10	—	—	(10)	—
Intercompany Receivable	1,347	—	1,038	(2,385)	—
Investment in Subsidiaries	3,876	3,140	—	(7,016)	—
Total Assets	\$6,024	\$ 12,214	\$ 9,887	\$ (9,457)	\$ 18,668
LIABILITIES AND SHAREHOLDERS' EQUITY:					
Current Liabilities:					
Short-term debt	\$—	\$ 42	\$ 21	\$ —	\$ 63
Merchandise accounts payable	—	788	1,007	—	1,795
Accounts payable and accrued liabilities	84	777	1,747	—	2,608
Income taxes	—	33	28	(46)	15
Total Current Liabilities	84	1,640	2,803	(46)	4,481
Long-Term Debt	—	5,457	16	—	5,473
Intercompany Payable	—	2,385	—	(2,385)	—
Deferred Income Taxes	—	588	616	(10)	1,194
Other Liabilities	24	441	1,161	—	1,626
Shareholders' Equity:					
Macy's, Inc.	5,916	1,703	5,313	(7,016)	5,916
Noncontrolling Interest	—	—	(22)	—	(22)
Total Shareholders' Equity	5,916	1,703	5,291	(7,016)	5,894
Total Liabilities and Shareholders' Equity	\$6,024	\$ 12,214	\$ 9,887	\$ (9,457)	\$ 18,668

MACY'S, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

Condensed Consolidating Balance Sheet

As of July 29, 2017

(millions)

	Parent	Subsidiary Issuer	Other Subsidiaries	Consolidating Adjustments	Consolidated
ASSETS:					
Current Assets:					
Cash and cash equivalents	\$421	\$ 78	\$ 284	\$ —	\$ 783
Receivables	—	132	250	—	382
Merchandise inventories	—	2,236	2,744	—	4,980
Prepaid expenses and other current assets	—	132	439	—	571
Total Current Assets	421	2,578	3,717	—	6,716
Property and Equipment – net	—	3,388	3,434	—	6,822
Goodwill	—	3,315	582	—	3,897
Other Intangible Assets – net	—	47	446	—	493
Other Assets	1	53	756	—	810
Deferred Income Taxes	25	—	—	(25)	—
Intercompany Receivable	1,011	—	2,256	(3,267)	—
Investment in Subsidiaries	3,110	3,743	—	(6,853)	—
Total Assets	\$4,568	\$ 13,124	\$ 11,191	\$ (10,145)	\$ 18,738
LIABILITIES AND SHAREHOLDERS' EQUITY:					
Current Liabilities:					
Short-term debt	\$—	\$ 6	\$ 10	\$ —	\$ 16
Merchandise accounts payable	—	698	971	—	1,669
Accounts payable and accrued liabilities	24	917	1,998	—	2,939
Income taxes	28	2	22	—	52
Total Current Liabilities	52	1,623	3,001	—	4,676
Long-Term Debt	—	6,284	17	—	6,301
Intercompany Payable	—	3,267	—	(3,267)	—
Deferred Income Taxes	—	746	828	(25)	1,549
Other Liabilities	72	425	1,276	—	1,773
Shareholders' Equity:					
Macy's, Inc.	4,444	779	6,074	(6,853)	4,444
Noncontrolling Interest	—	—	(5)	—	(5)
Total Shareholders' Equity	4,444	779	6,069	(6,853)	4,439
Total Liabilities and Shareholders' Equity	\$4,568	\$ 13,124	\$ 11,191	\$ (10,145)	\$ 18,738

MACY'S, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

Condensed Consolidating Balance Sheet

As of February 3, 2018

(millions)

	Parent	Subsidiary Issuer	Other Subsidiaries	Consolidating Adjustments	Consolidated
ASSETS:					
Current Assets:					
Cash and cash equivalents	\$ 1,109	\$ 58	\$ 288	\$ —	\$ 1,455
Receivables	—	85	278	—	363
Merchandise inventories	—	2,344	2,834	—	5,178
Prepaid expenses and other current assets	—	165	485	—	650
Total Current Assets	1,109	2,652	3,885	—	7,646
Property and Equipment – net	—	3,349	3,323	—	6,672
Goodwill	—	3,315	582	—	3,897
Other Intangible Assets – net	—	44	444	—	488
Other Assets	1	89	790	—	880
Deferred Income Taxes	11	—	—	(11) —
Intercompany Receivable	884	—	2,388	(3,272) —
Investment in Subsidiaries	4,032	4,126	—	(8,158) —
Total Assets	\$6,037	\$ 13,575	\$ 11,412	\$ (11,441) \$ 19,583
LIABILITIES AND SHAREHOLDERS' EQUITY:					
Current Liabilities:					
Short-term debt	\$—	\$ 6	\$ 16	\$ —	\$ 22
Merchandise accounts payable	—	653	937	—	1,590
Accounts payable and accrued liabilities	159	980	2,132	—	3,271
Income taxes	113	30	153	—	296
Total Current Liabilities	272	1,669	3,238	—	5,179
Long-Term Debt	—	5,844	17	—	5,861
Intercompany Payable	—	3,272	—	(3,272) —
Deferred Income Taxes	—	559	600	(11)