FOOT LOCKER, INC.
Form 10-Q
September 07, 2016
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended: July 30, 2016

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: 1-10299

(Exact name of registrant as specified in its charter)

New York	13-3513936
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

330 West 34th Street, New York, New York 10001

(Address of principal executive offices, Zip Code)

(212-720-3700)

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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 Accelerated filer Non-accelerated filer 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

Number of shares of Common Stock outstanding as of August 26, 2016: 133,249,505

FOOT LOCKER, INC.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

FOOT LOCKER, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

($ in millions, except shares)

	July 30, 2016 (Unaudited)	August 1, 2015 (Unaudited)	January 30, 2016 *
ASSETS			
Current assets			
Cash and cash equivalents	$ 945	$ 970	$ 1,021
Merchandise inventories	1,339	1,317	1,285
Other current assets	301	268	300
	2,585	2,555	2,606
Property and equipment, net	726	644	661
Deferred taxes	174	222	234
Goodwill	156	156	156
Other intangible assets, net	44	46	45
Other assets	77	81	73
	$ 3,762	$ 3,704	$ 3,775
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Accounts payable	$ 348	$ 359	$ 279
Accrued and other liabilities	326	380	420
Current portion of capital lease obligations	1	2	1
	675	741	700
Long-term debt and obligations under capital leases	128	130	129
Other liabilities	381	254	393
Total liabilities	1,184	1,125	1,222
Shareholders' equity			

Common stock and paid-in capital: 174,250,091; 172,536,861 and 173,397,913 shares outstanding, respectively	1,147	1,060	1,108
Retained earnings	3,426	3,013	3,182
Accumulated other comprehensive loss	(343)	(338)	(366)
Less: Treasury stock at cost: 41,174,061; 33,207,045 and 36,421,104 shares, respectively	(1,652)	(1,156)	(1,371)
Total shareholders' equity	2,578	2,579	2,553
	$ 3,762	$ 3,704	$ 3,775

See Accompanying Notes to Condensed Consolidated Financial Statements.

* The balance sheet at January 30, 2016 has been derived from the previously reported audited financial statements at that date, but does not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in Foot Locker, Inc.'s Annual Report on Form 10-K for the year ended January 30, 2016.

FOOT LOCKER, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(in millions, except per share amounts)

	Thirteen weeks ended		Twenty-six weeks ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
Sales	$ 1,780	$ 1,695	$ 3,767	$ 3,611
Cost of sales	1,193	1,142	2,484	2,388
Selling, general and administrative expenses	350	331	711	676
Depreciation and amortization	39	36	78	71
Interest expense, net	1	1	1	2
Other income	(1)	—	(3)	(1)
	1,582	1,510	3,271	3,136
Income before income taxes	198	185	496	475
Income tax expense	71	66	178	172
Net income	$ 127	$ 119	$ 318	$ 303
Basic earnings per share	$ 0.94	$ 0.85	$ 2.35	$ 2.17
Weighted-average shares outstanding	134.4	139.6	135.4	139.8
Diluted earnings per share	$ 0.94	$ 0.84	$ 2.33	$ 2.14
Weighted-average shares outstanding, assuming dilution	135.5	141.3	136.6	141.7

See Accompanying Notes to Condensed Consolidated Financial Statements.

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FOOT LOCKER, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

($ in millions)

	Thirteen weeks ended		Twenty-six weeks ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
Net income	$ 127	$ 119	$ 318	$ 303
Other comprehensive income, net of income tax				
Foreign currency translation adjustment:				
Translation adjustment arising during the period, net of income tax	(27)	(23)	17	(22)
Cash flow hedges:				
Change in fair value of derivatives, net of income tax	3	—	3	(1)
Available for sale securities:				
Unrealized gain on available for sale securities	1	—	1	—
Pension and postretirement adjustments:				
Amortization of net actuarial gain/loss and prior service cost included in net periodic benefit costs, net of income tax expense of $1, $1, $2 and $2 million, respectively, and foreign currency fluctuations	3	3	2	4
Comprehensive income	$ 107	$ 99	$ 341	$ 284

See Accompanying Notes to Condensed Consolidated Financial Statements.

FOOT LOCKER, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

($ in millions)

	Twenty-six weeks ended	
	July 30, 2016	August 1, 2015
From Operating Activities		
Net income	$ 318	$ 303
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	78	71
Share-based compensation expense	11	11
Excess tax benefits on share-based compensation	(10)	(24)
Qualified pension plan contributions	(25)	—
Change in assets and liabilities:		
Merchandise inventories	(50)	(75)
Accounts payable	67	61
Accrued and other liabilities	(13)	(16)
Other, net	(7)	3
Net cash provided by operating activities	369	334
From Investing Activities		
Capital expenditures	(131)	(116)
Net cash used in investing activities	(131)	(116)
From Financing Activities		
Purchase of treasury shares	(276)	(205)
Dividends paid on common stock	(74)	(70)
Proceeds from exercise of stock options	14	38
Treasury stock reissued under employee stock plan	4	5

Excess tax benefits on share-based compensation	10	24
Payment of revolving credit agreement costs	(2)	—
Reduction in long-term debt and obligations under capital leases	—	(1)
Net cash used in financing activities	(324)	(209)
Effect of Exchange Rate Fluctuations on Cash and Cash Equivalents	10	(6)
Net Change in Cash and Cash Equivalents	(76)	3
Cash and Cash Equivalents at Beginning of Period	1,021	967
Cash and Cash Equivalents at End of Period	$ 945	$ 970
Cash Paid During the Period:		
Interest	$ 5	$ 5
Income taxes	$ 216	$ 178

See Accompanying Notes to Condensed Consolidated Financial Statements.

FOOT LOCKER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying condensed consolidated financial statements contained in this report are unaudited. In the opinion of management, the condensed consolidated financial statements include all adjustments, which are of a normal recurring nature, necessary for a fair presentation of the results for the interim periods of the fiscal year ending January 28, 2017 and of the fiscal year ended January 30, 2016. Certain items included in these statements are based on management's estimates. Actual results may differ from those estimates. The results of operations for any interim period are not necessarily indicative of the results expected for the year. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the Notes to Consolidated Financial Statements contained in Foot Locker, Inc.'s (the "Company") Form 10-K for the year ended January 30, 2016, as filed with the U.S. Securities and Exchange Commission (the "SEC") on March 24, 2016.

Recent Accounting Pronouncements

In November 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes. ASU 2015-17 requires all deferred tax liabilities and assets to be presented in the balance sheet as noncurrent. The Company early adopted this standard on a prospective basis as of the quarter ended April 30, 2016. As a result, the Company reclassified deferred tax assets and deferred tax liabilities classified as current to noncurrent. No prior periods were retrospectively adjusted.

In February 2016, the FASB issued ASU 2016-02, Leases. This ASU revises the existing guidance related to leases by requiring lessees to recognize a lease liability and a right-of-use asset for all leases, as well as additional disclosure regarding leasing arrangements. This standard will be effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, and requires a modified retrospective adoption, with earlier adoption permitted. The Company is currently evaluating the effects of the adoption of this ASU on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. ASU 2016-09 simplifies certain aspects of the accounting for share-based payment transactions, including tax consequences, classification of awards, the option to recognize stock compensation expense with actual forfeitures as they occur, and the classifications on the statement of cash flows. ASU 2016-09 is effective for annual reporting beginning after December 15, 2016, including interim periods within that reporting period, with early adoption permitted. The manner of adoption varies, with certain provisions applied on a retrospective or modified retrospective approach, while others are applied prospectively. The Company is currently evaluating the effects of the adoption of this ASU on its consolidated financial statements.

In April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing. ASU 2016-10 clarifies the implementation guidance on identifying performance obligations and licensing on the previously issued ASU 2014-09, Revenue from Contracts with Customers. In May 2016, the FASB issued ASU 2016-11, Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815): Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting. ASU 2016-11 rescinds several SEC Staff Announcements that are codified in Topic 605, including, among other items, guidance relating to accounting for shipping and handling fees and freight services. ASU 2016-10 and ASU 2016-11 are effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim periods within that year. ASU 2016-10 and ASU 2016-11 can be adopted either retrospectively to each prior reporting period presented or as a cumulative-effect adjustment as of the date of adoption. The Company is currently evaluating the effects of the adoption of these ASUs on its consolidated financial statements.

Other recently issued accounting pronouncements did not, or are not believed by management to, have a material effect on the Company’s present or future consolidated financial statements.

FOOT LOCKER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

2. Segment Information

The Company has determined that its reportable segments are those that are based on its method of internal reporting. The Company has two reportable segments, Athletic Stores and Direct-to-Customers. The Company evaluates performance based on several factors, of which the primary financial measure is division results. Division profit reflects income before income taxes, corporate expense, non-operating income, and net interest expense.

	Thirteen weeks ended		Twenty-six weeks ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
	($ in millions)			
Sales				
Athletic Stores	$ 1,576	$ 1,503	$ 3,311	$ 3,184
Direct-to-Customers	204	192	456	427
Total sales	$ 1,780	$ 1,695	$ 3,767	$ 3,611
Operating Results				
Athletic Stores	$ 193	$ 176	$ 470	$ 443
Direct-to-Customers	22	27	60	67
Division profit	215	203	530	510
Less: Corporate expense	17	17	36	34
Operating profit	198	186	494	476
Interest expense, net	1	1	1	2
Other income (1)	1	—	3	1
Income before income taxes	$ 198	$ 185	$ 496	$ 475

(1) Other income includes non-operating items, such as lease termination gains, royalty income, insurance recoveries, and the changes in fair value, premiums paid, and realized gains associated with foreign currency option contracts.

3. Goodwill

Annually during the first quarter, or more frequently if impairment indicators arise, the Company reviews goodwill and intangible assets with indefinite lives for impairment. The annual review of goodwill and intangible assets with indefinite lives performed during the first quarter of 2016 did not result in the recognition of impairment. The following table provides a summary of goodwill by reportable segment.

	July 30, 2016	August 1, 2015	January 30, 2016
	($ in millions)		
Athletic Stores	$ 17	$ 17	$ 17
Direct-to-Customers	139	139	139
	$ 156	$ 156	$ 156

4. Other Intangible Assets, net

The components of finite-lived intangible assets and intangible assets not subject to amortization are as follows:

	July 30, 2016			August 1, 2015			January 30, 2016		
($ in millions)	Gross value	Accum. amort.	Net Value	Gross Value	Accum. amort.	Net Value	Gross value	Accum. amort.	Net Value
Amortized intangible assets: (1)									
Lease acquisition costs	$ 120	$ (108)	$ 12	$ 121	$ (111)	$ 10	$ 119	$ (107)	$ 12
Trademarks / trade names	20	(13)	7	21	(12)	9	20	(12)	8
Favorable leases	7	(5)	2	7	(4)	3	7	(5)	2
	$ 147	$ (126)	$ 21	$ 149	$ (127)	$ 22	$ 146	$ (124)	$ 22

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

	July 30, 2016	August 1, 2015	January 30, 2016
	Net Value	Net Value	Net Value
Indefinite life intangible assets: (1)			
Runners Point Group trademarks / trade names	$ 23	$ 24	$ 23
Other intangible assets, net	$ 44	$ 46	$ 45

(1) The change in the ending balances also reflects the effect of foreign currency fluctuations due primarily to the movements of the euro in relation to the U.S. dollar.

Amortization of $2 million was recorded for the twenty-six week period ended July 30, 2016. This was partially offset by $1 million of lease acquisition additions primarily related to our European businesses, which are being amortized over a weighted-average life of 10 years.

	Thirteen weeks ended		Twenty-six weeks ended	
($ in millions)	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
Amortization expense	$ 1	$ 1	$ 2	$ 2

Estimated future amortization expense for finite life intangible assets is as follows:

	($ in millions)
Remainder of 2016	$ 2
2017	4
2018	3
2019	3
2020	3
2021	2

5. Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss (“AOCL”), net of tax, is comprised the following:

	July 30, 2016	August 1, 2015	January 30, 2016
	($ in millions)		
Foreign currency translation adjustments	$ (102)	$ (97)	$ (119)
Cash flow hedges	5	(4)	2
Unrecognized pension cost and postretirement benefit	(246)	(236)	(248)
Unrealized loss on available-for-sale security	—	(1)	(1)
	$ (343)	$ (338)	$ (366)

The changes in AOCL for the twenty-six weeks ended July 30, 2016 were as follows:

($ in millions)	Foreign Currency Translation Adjustments	Cash Flow Hedges	Items Related to Pension and Postretirement Benefits	Unrealized Loss on Available-For-Sale Security	Total
Balance as of January 30, 2016	$ (119)	$ 2	$ (248)	$ (1)	$ (366)
OCI before reclassification	17	3	(2)	1	19
Reclassified from AOCI	—	—	4	—	4
Other comprehensive income/ (loss)	17	3	2	1	23
Balance as of July 30, 2016	$ (102)	$ 5	$ (246)	$ —	$ (343)

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Reclassifications from AOCL for the twenty-six weeks ended July 30, 2016 were as follows:

		($ in millions)
Amortization of actuarial (gain) loss:		
Pension benefits- amortization of actuarial loss	$	7
Postretirement benefits- amortization of actuarial gain		(1)
Net periodic benefit cost (see Note 10)		6
Income tax benefit		(2)
Net of tax	$	4

6. Revolving Credit Facility

On May 19, 2016, the Company entered into a new credit agreement with its banks (“2016 Credit Agreement”) that replaced the Company’s prior credit agreement (“2011 Restated Credit Agreement”). The 2016 Credit Agreement provides for a $400 million asset-based revolving credit facility maturing on May 19, 2021. Additionally, during the term of the 2016 Credit Agreement, the Company may increase the commitments by up to $200 million, subject to customary conditions. Interest is determined, at the Company’s option, by the federal funds rate plus a margin of 0.125 percent to 0.375 percent, or a Eurodollar rate, determined by reference to LIBOR, plus a margin of 1.125 percent to 1.375 percent depending on availability under the 2016 Credit Agreement. In addition, the Company will pay a commitment fee of 0.20 percent per annum on the unused portion of the commitments.

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

The Company uses the credit facility to support standby letters of credit in connection with insurance programs and the amount outstanding as of July 30, 2016 was not significant. The Company's management does not currently expect to borrow under the facility in 2016. The Company paid approximately $2 million in fees relating to the new credit facility. Deferred financing fees are amortized over the life of the facility on a straight-line basis, which is comparable to the interest method. The unamortized balance at July 30, 2016 was $2 million. Interest expense including facility fees, related to the revolving credit facility was $1 million for both the thirteen and twenty-six weeks ended July 30, 2016 and August 1, 2015.

7. Financial Instruments

The Company operates internationally and utilizes certain derivative financial instruments to mitigate its foreign currency exposures, primarily related to third-party and intercompany forecasted transactions. As a result of the use of derivative instruments, the Company is exposed to the risk that counterparties will fail to meet their contractual obligations. To mitigate this counterparty credit risk, the Company has a practice of entering into contracts only with major financial institutions selected based upon their credit ratings and other financial factors. The Company monitors the creditworthiness of counterparties throughout the duration of the derivative instrument. Additional information is contained within Note 8, Fair Value Measurements.

FOOT LOCKER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Derivative Holdings Designated as Hedges

For a derivative to qualify as a hedge at inception and throughout the hedged period, the Company formally documents the nature of the hedged items and the relationships between the hedging instruments and the hedged items, as well as its risk-management objectives, strategies for undertaking the various hedge transactions, and the methods of assessing hedge effectiveness and ineffectiveness. In addition, for hedges of forecasted transactions, the significant characteristics and expected terms of a forecasted transaction must be specifically identified, and it must be probable that each forecasted transaction would occur. If it were deemed probable that the forecasted transaction would not occur, the gain or loss on the derivative instrument would be recognized in earnings immediately. No such gains or losses were recognized in earnings for any of the periods presented. Derivative financial instruments qualifying for hedge accounting must maintain a specified level of effectiveness between the hedging instrument and the item being hedged, both at inception and throughout the hedged period, which management evaluates periodically.

The primary currencies to which the Company is exposed are the euro, British pound, Canadian dollar, and Australian dollar. For the most part, merchandise inventories are purchased by each geographic area in their respective local currency. The most significant exception to this is the United Kingdom, whose merchandise inventory purchases are denominated in euros. For option and foreign exchange forward contracts designated as cash flow hedges of the purchase of inventory, the effective portion of gains and losses is deferred as a component of AOCL and is recognized as a component of cost of sales when the related inventory is sold. The amount reclassified to cost of sales related to such contracts was not significant for any of the periods presented. The effective portion of gains or losses associated with other forward contracts is deferred as a component of AOCL until the underlying transaction is reported in earnings. The ineffective portion of gains and losses related to cash flow hedges recorded to earnings was also not significant for any of the periods presented. When using a forward contract as a hedging instrument, the Company excludes the time value of the contract from the assessment of effectiveness. At quarter-end, all of the Company’s hedged forecasted transactions were less than twelve months, and the Company expects all derivative-related amounts reported in AOCL to be reclassified to earnings within twelve months.

The net change in the fair value of the foreign exchange derivative financial instruments designated as cash flow hedges of the purchase of inventory was a $3 million gain for both the thirteen and the twenty-six weeks ended July 30, 2016, and therefore decreased AOCL. At July 30, 2016, there was a $5 million gain included in AOCL. For the thirteen weeks ended August 1, 2015, the net change in fair value was not significant, and was a $1 million loss for the twenty-six weeks ended August 1, 2015. The notional value of the foreign exchange contracts designed as hedges outstanding at July 30, 2016 was $82 million, and these contracts mature at various dates through July 2017.

Derivative Holdings Not Designated as Hedges

The Company enters into foreign exchange forward contracts that are not designated as hedges in order to manage the costs of foreign-currency denominated merchandise purchases and intercompany transactions. Changes in the fair value of these foreign exchange forward contracts are recorded in earnings immediately within selling, general and administrative expenses. The net change in fair value was not significant for the thirteen weeks ended July 30, 2016 and resulted in expense of $1 million for the twenty-six weeks ended July 30, 2016. The net change in fair value resulted in income of $1 million and $2 million for the thirteen and twenty-six weeks ended August 1, 2015, respectively. The notional value of the foreign exchange contracts not designed as hedges outstanding at July 30, 2016 was $14 million, and these contracts mature at various dates through December 2016.

The Company mitigates the effect of fluctuating foreign exchange rates on the reporting of foreign-currency denominated earnings by entering into currency option contracts. Changes in the fair value of these foreign currency option contracts, which are not designated as hedges, are recorded in earnings immediately within other income. The realized gains, premiums paid, and changes in the fair market value recorded were not significant for any of the periods presented. No such contracts were outstanding at July 30, 2016.

FOOT LOCKER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Additionally, the Company enters into diesel fuel forward and option contracts to mitigate a portion of the Company's freight expense due to the variability caused by fuel surcharges imposed by our third-party freight carriers. Changes in the fair value of these contracts are recorded in earnings immediately. The effect was not significant for any of the periods presented. No such contracts were outstanding at July 30, 2016.

Fair Value of Derivative Contracts

The following represents the fair value of the Company's derivative contracts. Many of the Company's agreements allow for a netting arrangement. The following is presented on a gross basis, by type of contract:

($ in millions)	Balance Sheet Caption	July 30, 2016	August 1, 2015	January 30, 2016
Hedging Instruments:				
Foreign exchange forward contracts	Current assets	$ 6	$ —	$ 3
Foreign exchange forward contracts	Current liabilities	$ —	$ 5	$ —
Non-hedging Instruments:				
Foreign exchange forward contracts	Current assets	$ —	$ 1	$ —

8. Fair Value Measurements

The Company's financial assets recorded at fair value are categorized as follows:

Level 1 – Quoted prices for identical instruments in active markets.

Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs or significant value-drivers are observable in active markets.

Level 3 – Model-derived valuations in which one or more significant inputs or significant value-drivers are unobservable.

The following tables provide a summary of the Company's recognized assets and liabilities that are measured at fair value on a recurring basis:

($ in millions)	As of July 30, 2016			As of August 1, 2015			As of January 30, 2016		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Assets									
Available-for-sale securities	$ —	$ 7	$ —	$ —	$ 6	$ —	$ —	$ 6	$ —
Foreign exchange forward contracts	—	6	—	—	2	—	—	3	—
Total Assets	$ —	$ 13	$ —	$ —	$ 8	$ —	$ —	$ 9	$ —
Liabilities									
Foreign exchange forward contracts	—	—	—	—	6	—	—	—	—
Total Liabilities	$ —	$ —	$ —	$ —	$ 6	$ —	$ —	$ —	$ —

Securities classified as available-for-sale are recorded at fair value with unrealized gains and losses reported, net of tax, in other comprehensive income, unless unrealized losses are determined to be other than temporary. The fair value of the auction rate security is determined by using quoted prices for similar instruments in active markets and accordingly is classified as a Level 2 instrument.

The Company's derivative financial instruments are valued using market-based inputs to valuation models. These valuation models require a variety of inputs, including contractual terms, market prices, yield curves, and measures of volatility and, therefore, are classified as Level 2 instruments.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

There were no transfers into or out of Level 1, Level 2, or Level 3 assets and liabilities for any of the periods presented.

The carrying value and estimated fair value of long-term debt and obligations under capital leases were as follows:

	July 30, 2016	August 1, 2015	January 30, 2016
	($ in millions)		
Carrying value	$ 129	$ 132	$ 130
Fair value	$ 151	$ 157	$ 156

The fair value of long-term debt is determined by using model-derived valuations in which all significant inputs or significant value drivers are observable in active markets and, therefore, are classified as Level 2. The carrying values of cash and cash equivalents and other current receivables and payables approximate their fair value.

9. Earnings Per Share

The Company accounts for and discloses earnings per share using the treasury stock method. Basic earnings per share is computed by dividing net income for the period by the weighted-average number of common shares outstanding. Restricted stock awards, which contain non-forfeitable rights to dividends, are considered participating securities and are included in the calculation of basic earnings per share. Diluted earnings per share reflects the weighted-average number of common shares outstanding during the period used in the basic earnings per share computation plus dilutive common stock equivalents.

The computation of basic and diluted earnings per share is as follows:

	Thirteen weeks ended		Twenty-six weeks ended	
	July 30,	August 1,	July 30,	August 1,

	2016	2015	2016	2015
	(in millions, except per share data)			
Net Income	$ 127	$ 119	$ 318	$ 303
Weighted-average common shares outstanding	134.4	139.6	135.4	139.8
Basic earnings per share	$ 0.94	$ 0.85	$ 2.35	$ 2.17
Weighted-average common shares outstanding	134.4	139.6	135.4	139.8
Dilutive effect of potential common shares	1.1	1.7	1.2	1.9
Weighted-average common shares outstanding assuming dilution	135.5	141.3	136.6	141.7
Diluted earnings per share	$ 0.94	$ 0.84	$ 2.33	$ 2.14

Options to purchase 1.1 million and 0.7 million shares of common stock were not included in the computation of diluted earnings per share for the thirteen weeks ended July 30, 2016 and August 1, 2015, respectively. Options to purchase 1.0 million and 0.6 million shares of common stock were not included in the computation of diluted earnings per share for the twenty-six weeks ended July 30, 2016 and August 1, 2015, respectively. These options were not included because the effect would have been antidilutive. Contingently issuable shares of 0.3 million and 0.4 million have not been included as the vesting conditions have not been satisfied as of July 30, 2016 and August 1, 2015, respectively.

FOOT LOCKER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

10. Pension and Postretirement Plans

The Company has defined benefit pension plans covering certain of its North American employees, which are funded in accordance with the provisions of the laws where the plans are in effect. In addition, the Company has a defined benefit pension plan covering certain employees of the Runners Point Group.

In addition to providing pension benefits, the Company sponsors postretirement medical and life insurance plans, which are available to most of its retired U.S. employees. These medical and life insurance plans are contributory and are not funded.

The following are the components of net periodic pension benefit cost and net periodic postretirement benefit income, which is recognized as part of SG&A expense:

	Pension Benefits				Postretirement Benefits			
	Thirteen weeks ended		Twenty-six weeks ended		Thirteen weeks ended		Twenty-six weeks ended	
($ in millions)	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
Service cost	$ 4	$ 4	$ 8	$ 8	$ —	$ —	$ —	$ —
Interest cost	7	6	13	12	—	1	—	1
Expected return on plan assets	(9)	(10)	(18)	(19)	—	—	—	—
Amortization of net loss (gain)	3	4	7	7	—	(1)	(1)	(1)
Net benefit expense (income)	$ 5	$ 4	$ 10	$ 8	$ —	$ —	$ (1)	$ —

During the first quarter of 2016, the Company made a contribution of $25 million to the U.S. qualified plan. The Company continually evaluates the amount and timing of any future contributions. The Company contributed $8 million to the U.S. qualified plan on August 31, 2016. The Company currently expects to contribute $4 million to the Canadian qualified plan during the fourth quarter of 2016. Actual contributions are dependent on several factors, including the outcome of the ongoing pension litigation. See Note 12, Legal Proceedings, for further information.

11. Share-Based Compensation

Total compensation expense included in SG&A, and the associated tax benefits recognized related to the Company's share-based compensation plans were as follows:

	Thirteen weeks ended		Twenty-six weeks ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
	($ in millions)			
Options and shares purchased under the employee stock purchase plan	$ 2	$ 3	$ 5	$ 6
Restricted stock and restricted stock units	4	2	6	5
Total share-based compensation expense	$ 6	$ 5	$ 11	$ 11
Tax benefit recognized	$ 2	$ 1	$ 3	$ 3
Excess income tax benefit from settled equity-classified share-based awards reported as a cash flow from financing activities			$ 10	$ 24

FOOT LOCKER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Valuation Model and Assumptions

The Company uses a Black-Scholes option-pricing model to estimate the fair value of share-based awards. The Black-Scholes option-pricing model incorporates various and highly subjective assumptions, including expected term and expected volatility. The following table shows the Company's assumptions used to compute the share-based compensation expense for awards granted during the twenty-six weeks ended July 30, 2016 and August 1, 2015:

	Stock Option Plans		Stock Purchase Plan	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
Weighted-average risk free rate of interest	1.4 %	1.5 %	0.4 %	0.2 %
Expected volatility	30 %	30 %	26 %	24 %
Weighted-average expected award life (in years)	5.7	6.0	1.0	1.0
Dividend yield	1.7 %	1.6 %	1.7 %	1.7 %
Weighted-average fair value	$ 15.68	$ 16.01	$ 15.19	$ 9.53

The information in the following table covers options granted under the Company's stock option plans for the twenty-six weeks ended July 30, 2016:

	Number of Shares (in thousands)	Weighted-Average Remaining Contractual Life (in years)	Weighted-Average Exercise Price (per share)
Options outstanding at the beginning of the year	3,694		$ 32.62
Granted	482		63.47
Exercised	(669)		21.56
Expired or cancelled	(54)		59.03
Options outstanding at July 30, 2016	3,453	5.7	$ 38.65
Options exercisable at July 30, 2016	2,420	4.3	$ 29.34
Options vested and expected to vest at July 30, 2016	3,413	5.6	$ 38.38
Options available for future grant at July 30, 2016	12,006		

The total fair value of options vested as of July 30, 2016 and August 1, 2015 was $8 million and $14 million, respectively. The cash received from option exercises for the thirteen and twenty-six weeks ended July 30, 2016 was $7 million and $14 million, respectively. The cash received from option exercises for the thirteen and twenty-six weeks ended August 1, 2015 was $15 million and $38 million, respectively.

The total intrinsic value of options exercised (the difference between the market price of the Company’s common stock on the exercise date and the price paid by the optionee to exercise the option) is presented below:

	Thirteen weeks ended		Twenty-six weeks ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
	($ in millions)			
Exercised	$ 12	$ 29	$ 26	$ 65

The total tax benefit realized from option exercises was $5 million and $10 million for the thirteen and twenty-six weeks ended July 30, 2016, respectively, and was $11 million and $25 million for the corresponding prior-year periods.

FOOT LOCKER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The aggregate intrinsic value for stock options outstanding, outstanding and exercisable, and vested and expected to vest (the difference between the Company's closing stock price on the last trading day of the period and the exercise price of the options, multiplied by the number of in-the-money stock options) is presented below:

	Twenty-six weeks ended July 30, 2016	Twenty-six weeks ended August 1, 2015
	($ in millions)	
Outstanding	$ 76	$ 173
Outstanding and exercisable	$ 74	$ 152
Vested and expected to vest	$ 76	$ 172

As of July 30, 2016 there was $9 million of total unrecognized compensation cost, net of estimated forfeitures, related to nonvested stock options, which is expected to be recognized over a remaining weighted-average period of 1.6 years. The following table summarizes information about stock options outstanding and exercisable at July 30, 2016:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
	(in thousands, except prices per share and contractual life)				
$9.85 to $15.10	721	2.1	$ 12.99	721	$ 12.99
$18.80 to $30.92	710	3.6	23.76	710	23.76
$34.12 to $56.35	936	6.4	41.54	739	39.53
$62.02 to $73.21	1,086	8.7	62.92	250	62.15
	3,453	5.7	$ 38.65	2,420	$ 29.34

Restricted Stock and Restricted Stock Units

Restricted shares of the Company's common stock and restricted stock units ("RSU") may be awarded to certain officers, key employees of the Company, and to nonemployee directors. Additionally, RSU awards are made to employees in connection with the Company's long-term incentive program. Each RSU represents the right to receive one share of the Company's common stock provided that the performance and vesting conditions are satisfied. There were 671,690 and 581,713 RSU awards outstanding as of July 30, 2016 and August 1, 2015, respectively.

Generally, awards fully vest after the passage of time, typically three years. However, RSU awards made in connection with the Company's long-term incentive program are earned after the attainment of certain performance metrics and vest after the passage of time. Restricted stock is considered outstanding at the time of grant and the holders have voting rights. Dividends are paid to holders of restricted stock that vest with the passage of time. With regard to performance-based restricted stock, dividends will be accumulated and paid after the performance criteria are met. No dividends are paid or accumulated on RSU awards. Compensation expense is recognized using the market value at the date of grant and is amortized over the vesting period, provided the recipient continues to be employed by the Company.

FOOT LOCKER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Restricted stock and RSU activity for the thirteen weeks ended July 30, 2016 is summarized as follows:

	Number of Shares (in thousands)	Weighted-Average Remaining Contractual Life (in years)	Weighted-Average Grant Date Fair Value (per share)
Nonvested at beginning of year	803		$ 45.19
Granted	361		63.74
Vested	(212)		36.54
Expired or cancelled	(125)		39.28
Nonvested at July 30, 2016	827	1.5	$ 56.39
Aggregate value ($ in millions)	$ 47		

The total value of awards for which restrictions lapsed during the twenty-six weeks ended July 30, 2016 and August 1, 2015 was $8 million and $10 million, respectively. As of July 30, 2016, there was $19 million of total unrecognized compensation cost net of forfeitures related to nonvested restricted awards.

12. Legal Proceedings

Legal proceedings pending against the Company or its consolidated subsidiaries consist of ordinary, routine litigation, including administrative proceedings, incidental to the business of the Company or businesses that have been sold or disposed of by the Company in past years. These legal proceedings include commercial, intellectual property, customer, environmental, and employment-related claims.

The Company and the Company’s U.S. retirement plan are defendants in a class action (Osberg v. Foot Locker Inc. et ano., filed in the U.S. District Court for the Southern District of New York) in which the plaintiff alleges that, in connection with the 1996 conversion of the retirement plan to a defined benefit plan with a cash balance formula, the Company and the retirement plan failed to properly advise plan participants of the “wear-away” effect of the conversion. Plaintiff’s claims were for breach of fiduciary duty under the Employee Retirement Income Security Act of 1974, as amended, and violation of the statutory provisions governing the content of the Summary Plan Description. The trial was held in July 2015 and the court issued a decision in September 2015 in favor of the class on the foregoing claims. The court ordered that the Plan be reformed. The Company is appealing the court’s decision, and the judgment has been stayed pending the outcome of the appeal. As a result of this development, the Company determined that it is probable a liability exists. The Company's reasonable estimate of this liability is a range between $100 million and $200 million, with no amount within that range more probable than any other amount. Therefore, in accordance with U.S. GAAP, the Company recorded a charge of $100 million pre-tax ($61 million after-tax) in the third quarter of 2015. This amount has been classified as a long-term liability. The Company will continue to vigorously defend itself in this case. In light of the uncertainties involved in this matter, there is no assurance that the ultimate resolution will not differ from the amount currently accrued by the Company.

Management does not believe that the outcome of any such legal proceedings pending against the Company or its consolidated subsidiaries, as described above, would have a material adverse effect on the Company's consolidated financial position, liquidity, or results of operations, taken as a whole, based upon current knowledge and taking into consideration current accruals. Litigation is inherently unpredictable, and judgments could be rendered or settlements entered into that could adversely affect the Company's operating results or cash flows in a particular period.

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

Business Overview

Foot Locker, Inc., through its subsidiaries, operates in two reportable segments – Athletic Stores and Direct-to-Customers. The Athletic Stores segment is one of the largest athletic footwear and apparel retailers in the world, with formats that include Foot Locker, Lady Foot Locker, SIX:02, Kids Foot Locker, Champs Sports, Footaction, Runners Point, and Sidestep. The Direct-to-Customers segment includes Footlocker.com, Inc. and other affiliates, including Eastbay, Inc., and our international ecommerce businesses, which sell to customers through their Internet and mobile sites and catalogs.

The Foot Locker brand is one of the most widely recognized names in the markets in which the Company operates, epitomizing premium quality for the active lifestyle customer. This brand equity has aided the Company’s ability to successfully develop and increase its portfolio of complementary retail store formats, such as Lady Foot Locker, and Kids Foot Locker, as well as Footlocker.com, its direct-to-customer business. Through various marketing channels, including broadcast, digital, social, print, and various sports sponsorships and events, the Company reinforces its image with a consistent message — namely, that it is the destination for athletically inspired shoes and apparel with a wide selection of merchandise in a full-service environment.

Store Count

At July 30, 2016, the Company operated 3,401 stores as compared with 3,383 and 3,419 stores at January 30, 2016 and August 1, 2015, respectively. A total of 69 franchised stores were operating at July 30, 2016, as compared with 64 and 75 stores at January 30, 2016 and August 1, 2015, respectively. Revenue from the franchised stores was not significant for any of the periods presented. These stores are not included in the Company’s operating store count above.

Foreign Currency Fluctuations (non-GAAP measure)

Throughout the following discussions, where amounts are expressed as excluding the effects of foreign currency fluctuations, such changes are determined by translating all amounts using average foreign exchange rates for the same period of the prior year. We believe that presenting amounts on a constant currency basis is useful to investors because it enables them to better understand the changes in our business.

Sales

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

Sales increased by $85 million, or 5.0 percent, to $1,780 million for the thirteen weeks ended July 30, 2016, from $1,695 million for the thirteen weeks ended August 1, 2015. For the twenty-six weeks ended July 30, 2016, sales of $3,767 million increased 4.3 percent from sales of $3,611 million in the corresponding prior-year period. Excluding the effect of foreign currency fluctuations, sales increased by 5.4 percent and 4.6 percent for the thirteen and twenty-six weeks ended July 30, 2016, respectively.

Comparable-store sales increased by 4.7 and 3.7 percent for the thirteen and twenty-six weeks ended July 30, 2016, respectively.

Gross Margin

	Thirteen weeks ended		Twenty-six weeks ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
Gross margin rate	33.0 %	32.6 %	34.1 %	33.9 %
Basis point change in the gross margin rate	40		20	
Components of the change-				
Merchandise margin rate improvement	50		40	
Higher occupancy and buyers' compensation expense rate	(10)		(20)	

The gross margin rate improved by 40 and 20 basis points for the thirteen and twenty-six weeks ended July 30, 2016, respectively. This reflected a merchandise margin rate improvement of 50 and 40 basis points for the thirteen and twenty-six weeks ended July 30, 2016, respectively. The merchandise margin rate improvement primarily reflected a lower markdown rate within the Athletic Stores segment, as we increased full-price selling during the current quarter and year-to-date periods, partially offset by increased second quarter promotional activity within our Direct-to-Customers segment.

Occupancy and buyer's compensation expense increased at a rate higher than the increase in sales and reduced the gross margin rate by 10 and 20 basis points for the thirteen and twenty-six weeks ended July 30, 2016, respectively. The increase in the occupancy and buyer's compensation rate is due, in part, to certain high-profile store locations within New York City that are not currently generating sales because they are in the process of being remodeled or opened.

Selling, General and Administrative Expenses (SG&A)

	Thirteen weeks ended		Twenty-six weeks ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
	($ in millions)			
SG&A	$ 350	$ 331	$ 711	$ 676

$ Change	$ 19		$ 35	$
% Change	5.7 %		5.2 %	
SG&A as a percentage of sales	19.7 %	19.5 %	18.9 %	18.7 %

SG&A increased by $19 million and $35 million for the thirteen and twenty-six weeks ended July 30, 2016, respectively, as compared with the corresponding prior-year periods. The effect of foreign currency fluctuations for the current quarter and year-to-date periods was not significant. Comparing the SG&A rate to the prior-year periods, the rate increased by 20 basis points for both the thirteen and twenty-six weeks ended July 30, 2016. This higher expense rate was related to the Direct-to Customers segment, which increased its marketing efforts in order to drive traffic to its websites. Additionally, corporate expense for the twenty-six weeks ended July 30, 2016 included costs of $4 million associated with the relocation of the corporate headquarters within New York City.

Depreciation and Amortization

	Thirteen weeks ended		Twenty-six weeks ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
	($ in millions)			
Depreciation and amortization	$ 39	$ 36	$ 78	$ 71
$ Change	$ 3		$ 7	
% Change	8.3 %		9.9 %	

Depreciation and amortization increased by $3 million and $7 million for the thirteen and twenty-six weeks ended July 30, 2016, respectively, as compared with the corresponding prior-year periods. The increase in depreciation and amortization reflected increased capital spending on store projects, enhancing our digital sites, and other various technologies.

Interest Expense, Net

	Thirteen weeks ended		Twenty-six weeks ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
	($ in millions)			
Interest expense	$ 3	$ 2	$ 6	$ 5
Interest income	(2)	(1)	(5)	(3)
Interest expense, net	$ 1	$ 1	$ 1	$ 2

Net interest expense was unchanged for the thirteen weeks ended July 30, 2016 as compared with the corresponding prior-year period. For the twenty-six weeks ended July 30, 2016, net interest expense decreased by $1 million as compared with the corresponding prior-year period, which primarily represented increased income due to higher average interest rates on our cash investments.

Income Taxes

The Company recorded income tax provisions of $71 million and $178 million, which represented an effective tax rate of 35.9 percent for both the thirteen and twenty-six weeks ended July 30, 2016. For the thirteen and twenty-six weeks ended August 1, 2015, the Company recorded income tax provisions of $66 million and $172 million, which represented effective tax rates of 35.8 percent and 36.2 percent, respectively. The Company's interim provision for income taxes is measured using an annual effective tax rate adjusted for discrete items that occur within the periods presented.

The Company regularly assesses the adequacy of its provisions for income tax contingencies in accordance with applicable authoritative guidance on accounting for income taxes. As a result, the Company may adjust the reserves for unrecognized tax benefits considering new facts and developments, such as changes to interpretations of relevant tax law, assessments from taxing authorities, settlements with taxing authorities, and lapses of statutes of limitation. For the twenty-six weeks ended July 30, 2016, the changes in the tax reserves were not significant. The effective tax rate for the twenty-six weeks ended August 1, 2015 included tax benefits of $1 million from reserve releases due to settlements of tax examinations.

For the thirteen weeks ended August 1, 2015, the Company recorded discrete items of approximately $1 million representing tax benefits related to an adjustment to deductible compensation costs due to executive changes and a Canadian provincial tax rate change.

Excluding the reserve releases and other discrete items for the thirteen and twenty-six weeks ended July 30, 2016, the change in the effective tax rate, as compared with the corresponding prior-year periods, was primarily due to a higher proportion of income earned in lower tax jurisdictions outside the U.S.

The Company currently expects its full-year tax rate to be approximately 36.0 percent, excluding the effect of any nonrecurring items that may occur. The actual rate will vary depending primarily on the level and mix of income earned in the United States as compared with its international operations.

Net Income

For the thirteen weeks ended July 30, 2016, net income increased by $8 million, or 6.7 percent, and diluted earnings per share increased by 11.9 percent to $0.94 per share, as compared with the corresponding prior-year period. For the twenty-six weeks ended July 30, 2016, net income increased by $15 million, or 5.0 percent, above the corresponding prior-year period. Diluted earnings per share increased by 8.9 percent to $2.33 per share. In addition to the growth in net income for both the quarter and year-to-date periods, the increase in diluted earnings per share was also positively affected by the Company’s continued share repurchase program.

Segment Information

The Company has determined that its reportable segments are those that are based on its method of internal reporting. The Company has two reportable segments, Athletic Stores and Direct-to-Customers. The Company evaluates performance based on several factors, of which the primary financial measure is division results. Division profit reflects income before income taxes, corporate expense, non-operating income, and net interest expense.

The following table summarizes results by segment:

	Thirteen weeks ended		Twenty-six weeks ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
	($ in millions)			
Sales				
Athletic Stores	$ 1,576	$ 1,503	$ 3,311	$ 3,184
Direct-to-Customers	204	192	456	427
	$ 1,780	$ 1,695	$ 3,767	$ 3,611
Operating Results				
Athletic Stores	$ 193	$ 176	$ 470	$ 443
Direct-to-Customers	22	27	60	67
Division profit	215	203	530	510
Less: Corporate expense	17	17	36	34
Operating profit	198	186	494	476
Other income (1)	1	—	3	1
Earnings before interest expense and income taxes	199	186	497	477
Interest expense, net	1	1	1	2
Income before income taxes	$ 198	$ 185	$ 496	$ 475

(1) Other income includes non-operating items, such as lease termination gains, royalty income, insurance recoveries and the changes in fair value, premiums paid, and realized gains associated with foreign currency option contracts.

Athletic Stores

	Thirteen weeks ended		Twenty-six weeks ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
	($ in millions)			
Sales	$ 1,576	$ 1,503	$ 3,311	$ 3,184
$ Change	$ 73		$ 127	$
% Change	4.9 %		4.0 %	
Division profit	$ 193	$ 176	$ 470	$ 443
Division profit margin	12.2 %	11.7 %	14.2 %	13.9 %

Excluding the effect of foreign currency fluctuations, Athletic Stores segment sales increased by 5.2 percent and 4.3 percent for the thirteen and twenty-six weeks ended July 30, 2016, respectively, as compared with the corresponding prior-year period.

Comparable-store sales increased by 4.3 percent and 3.2 percent for the thirteen and twenty-six weeks ended July 30, 2016, respectively. Both footwear and apparel generated comparable-store sales gains for both periods. Within the footwear category, sales gains for the quarter and year-to-date periods were led by court classic and casual styles, with running also contributing to the gains. In addition, basketball generated gains during the second quarter, which was an improvement from the first quarter when sales declined.

Most divisions within this segment experienced comparable-store sales gains for both the quarter and year-to-date periods, led by Foot Locker Canada and Champs Sports. Foot Locker Canada maintained the momentum generated in the first quarter by the NBA All-Star Game held in Toronto, Canada, with gains generated from sales of both running and basketball shoes. The increased sales of both court classic and casual styles also benefited the children's footwear category, which experienced strong comparable-store gains across multiple banners for both the quarter and year-to-date periods.

Apparel comparable-store sales gains for both the quarter and year-to-date periods were led by Foot Locker Europe and Champs Sports, primarily representing sales of men's branded apparel. Champs Sports also benefited from sales of both private-label and licensed apparel.

Lady Foot Locker/SIX:02 combined experienced a comparable-store decline for the quarter and year-to-date periods, as gains in footwear sales were not enough to offset declines in apparel. Footwear sales were primarily driven by lifestyle running and court styles. Declines in performance apparel drove the overall decrease in the apparel category, with improvement in sales of lifestyle products. We are continuing to work with our vendors to refine our assortment of women's apparel to include more athletically-inspired lifestyle assortments, as those assortments are resonating with our customers.

Runners Point and Sidestep also experienced comparable-store declines for the quarter and year-to-date periods. Both banners continued to face assortment and traffic challenges. Our focus for these banners is to improve and better diversify our product offerings along with providing a more elevated in-store experience. Management believes that these initiatives, along with marketing campaigns targeted to improve traffic to the stores, will position the banners for future growth. Management will continue to monitor the results of this business during the third quarter and will assess, if necessary, the impact of various initiatives on the projected performance of this division, which may include an impairment review.

Athletic Stores division profit increased 9.7 percent and 6.1 percent for the thirteen and twenty-six weeks ended July 30, 2016, respectively, as compared with the corresponding prior-year period. Division profit, as a percentage of sales increased to 12.2 percent and 14.2 percent for the thirteen and twenty-six weeks ended July 30, 2016, respectively, as compared with 11.7 percent and 13.9 percent for the respective corresponding prior-year periods. The improvement in division profit margin reflected an improved merchandise margin rate driven primarily by a lower markdown rate as well as disciplined expense management.

Direct-to-Customers

	Thirteen weeks ended		Twenty-six weeks ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
	($ in millions)			
Sales	$ 204	$ 192	$ 456	$ 427
$ Change	$ 12		$ 29	
% Change	6.3 %		6.8 %	
Division profit	$ 22	$ 27	$ 60	$ 67
Division profit margin	10.8 %	14.1 %	13.2 %	15.7 %

Comparable-sales for the Direct-to-Customers segment increased by 7.1 percent for both the thirteen and twenty-six weeks ended July 30, 2016. This increase was driven by the continued growth of ecommerce associated with our store-banner websites, both domestically and internationally, which was partially offset by declines in our Eastbay and Runners Point ecommerce businesses.

Footwear continues to be our strongest category and was led by the Jordan brand, women's casual styles, and children's footwear, each of which posted strong comparable-sales gains during the quarter and year-to-date periods. Eastbay's sales decreased for the quarter and year-to-date periods, which reflected the customer's continued shift away from performance-related product and the increased liquidation activity in the marketplace particularly affecting our sales of sporting equipment.

Direct-to-Customers division profit for the thirteen and twenty-six weeks ended July 30, 2016 decreased by $5 million and $7 million, respectively, as compared with the corresponding prior-year periods. Division profit, as a percentage of sales, was 10.8 percent and 13.2 percent for the thirteen and twenty-six weeks ended July 30, 2016, respectively, as compared with 14.1 percent and 15.7 percent for the corresponding prior-year periods. The division profit decline for the quarter was primarily related to higher marketing related costs coupled with a lower gross margin rate within our domestic ecommerce business due to higher promotional activity. The year-to-date performance was affected by the same factors, coupled with lower shipping and handling revenue associated with free shipping offers.

Corporate Expense

	Thirteen weeks ended		Twenty-six weeks ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
	($ in millions)			
Corporate expense	$ 17	$ 17	$ 36	$ 34
$ Change	$ —		$ 2	

Corporate expense consists of unallocated SG&A, as well as depreciation and amortization related to the Company's corporate headquarters, centrally managed departments, unallocated insurance and benefit programs, certain foreign exchange transaction gains and losses, and other items. Depreciation and amortization included in corporate expense was $4 million and $7 million for the thirteen and twenty-six weeks ended July 30, 2016, respectively, which increased by $1 million for both the quarter and year-to-date periods as compared with the corresponding prior-year periods.

The allocation of corporate expense to the operating divisions is adjusted annually based upon an internal study; accordingly, the allocation increased by $2 million and $4 million for the thirteen and twenty-six weeks ended July 30, 2016, respectively, thus reducing corporate expense. Excluding the corporate allocation change as well as depreciation and amortization, corporate expense, as compared with the corresponding prior-year periods, increased by $1 million and $5 million for the thirteen and twenty-six weeks ended July 30, 2016, respectively. The increase in corporate expense for the twenty-six weeks ended July 30, 2016 was primarily related to the $4 million of costs incurred to relocate of our corporate headquarters within New York City, which was completed during the first quarter.

Liquidity and Capital Resources

Liquidity

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

The Company may also from time to time repurchase its common stock or seek to retire or purchase outstanding debt through open market purchases, privately negotiated transactions, or otherwise. Share repurchases and retirement of debt, if any, will depend on prevailing market conditions, liquidity requirements, contractual restrictions, and other factors. The amounts involved may be material. As of July 30, 2016, approximately $361 million remained available under the Company’s current $1 billion share repurchase program.

As discussed further in the Legal Proceedings note under “Item 1. Financial Statements,” during the third quarter of 2015 the Company recorded a pre-tax charge of $100 million ($61 million after-tax). In light of the uncertainties involved in this matter, there is no assurance that the ultimate resolution will not differ from the amount currently accrued by the Company. The $100 million charge has been classified as a long-term liability due to the uncertainty involved with the resolution of this litigation, as the appeals process can be lengthy. The pension plan is currently sufficiently funded to absorb a $100 million liability and, accordingly, we do not anticipate the need to make any pension contributions in the near term in connection with this matter. The timing and the amount of contributions to the pension plan are dependent on the funded status of the plan and various other factors, such as interest rates and the performance of the plan's assets.

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

Operating Activities

	Twenty-six weeks ended	
	July 30, 2016	August 1, 2015
	($ in millions)	
Net cash provided by operating activities	$ 369	$ 334
$ Change	$ 35	

The amount provided by operating activities reflects net income adjusted for non-cash items and working capital changes. Adjustments to net income for non-cash items include depreciation and amortization, share-based compensation expense, and share-based related tax benefits. The increase from the prior year primarily reflects the Company's earnings strength coupled with working capital improvements. This was partially offset by a $25 million contribution to the U.S. qualified pension plan. No such contribution was made in the corresponding prior-year period.

Investing Activities

	Twenty-six weeks ended	
	July 30, 2016	August 1, 2015
	($ in millions)	
Net cash used in investing activities	$ 131	$ 116
$ Change	$ 15	

Capital expenditures represented a $15 million increase from the prior year, which reflected a higher number of store projects in progress for the current year, as well as increased spending on corporate technology projects. The Company's full-year forecast for capital expenditures is expected to be in the range of $282 million to $287 million, which includes approximately $215 million related to the remodeling or relocation of approximately 230 existing stores and approximately 100 new store openings, as well as approximately $70 million for the development of information systems, websites, infrastructure, and our corporate headquarters relocation within New York City.

Financing Activities

	Twenty-six weeks ended	
	July 30, 2016	August 1, 2015
	($ in millions)	
Net cash used in financing activities	$ 324	$ 209
$ Change	$ 115	

During the twenty-six weeks ended July 30, 2016, the Company repurchased 4,724,691 shares of its common stock for $276 million, as compared with 3,490,000 shares repurchased for $205 million in the corresponding prior-year period. The Company declared and paid dividends during the first two quarters of 2016 and 2015 of $74 million and

$70 million, respectively. This represented quarterly rates of $0.275 and $0.25 per share for 2016 and 2015, respectively. Additionally, the Company received proceeds from the issuance of common stock in connection with employee stock programs of $18 million and $43 million for the twenty-six weeks ended July 30, 2016 and August 1, 2015, respectively. In connection with stock option exercises and share-based compensation programs, the Company recorded excess tax benefits of $10 million and $24 million as a financing activity for the twenty-six weeks ended July 30, 2016 and August 1, 2015, respectively. The decreased excess tax benefit primarily reflected a lower number of stock option exercises during the first two quarters of 2016 as compared with the corresponding prior-year period. In May 2016, the Company entered into a new $400 million credit agreement and in connection with this transaction the Company paid fees of $2 million. The activity for the twenty-six weeks ended August 1, 2015 also reflected payments made on capital lease obligations of $1 million.

Critical Accounting Policies and Estimates

There have been no significant changes to the Company’s critical accounting policies and estimates from the information provided in Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” included in the Annual Report on Form 10-K for the fiscal year ended January 30, 2016.

Recent Accounting Pronouncements

Descriptions of the recently issued accounting principles are included Item 1. “Financial Statements” in Note 1, Summary of Significant Accounting Policies, to the Condensed Consolidated Financial Statements.

Disclosure Regarding Forward-Looking Statements

This report contains forward-looking statements within the meaning of the federal securities laws. Other than statements of historical facts, all statements which address activities, events, or developments that the Company anticipates will or may occur in the future, including, but not limited to, such things as future capital expenditures, expansion, strategic plans, financial objectives, dividend payments, stock repurchases, growth of the Company’s business and operations, including future cash flows, revenues, and earnings, and other such matters, are forward-looking statements. These forward-looking statements are based on many assumptions and factors which are detailed in the Company’s filings with the Securities and Exchange Commission, including the effects of currency fluctuations, customer demand, fashion trends, competitive market forces, uncertainties related to the effect of competitive products and pricing, customer acceptance of the Company’s merchandise mix and retail locations, the Company’s reliance on a few key suppliers for a majority of its merchandise purchases (including a significant portion from one key supplier), cybersecurity breaches, pandemics and similar major health concerns, unseasonable weather, deterioration of global financial markets, economic conditions worldwide, deterioration of business and economic conditions, any changes in business, political and economic conditions due to the threat of future terrorist activities in the United States or in other parts of the world and related U.S. military action overseas, the ability of the Company to execute its business and strategic plans effectively with regard to each of its business units, and risks associated with global product sourcing, including political instability, changes in import regulations, and disruptions to transportation services and distribution.

For additional discussion on risks and uncertainties that may affect forward-looking statements, see “Risk Factors” disclosed in the 2015 Annual Report on Form 10-K. Any changes in such assumptions or factors could produce significantly different results. The Company undertakes no obligation to update forward-looking statements, whether as a result of new information, future events, or otherwise.

Item 4. Controls and Procedures

The Company’s management performed an evaluation under the supervision and with the participation of the Company’s Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”), and completed an evaluation as of July 30, 2016 of the effectiveness of the design and operation of the Company’s disclosure controls and procedures (as that term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)). Based on that evaluation, the Company’s CEO and CFO concluded that the Company’s disclosure controls and procedures were effective to ensure that information relating to the Company that is required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC rules and forms, and is accumulated and communicated to management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

During the quarter ended July 30, 2016, there were no changes in the Company’s internal control over financial reporting (as defined in Rules 13a-15(f) of the Exchange Act) that materially affected or are reasonably likely to affect the Company’s internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

Information regarding the Company’s legal proceedings is contained in the Legal Proceedings note under Item 1. “Financial Statements.”

Item 1A. Risk Factors

There were no material changes to the risk factors disclosed in the 2015 Annual Report on Form 10-K.

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

The following table provides information with respect to shares of the Company’s common stock that the Company repurchased during the twenty-six weeks ended July 30, 2016:

	Total	Average	Total Number of Shares Purchased as	Approximate Dollar Value of Shares that may

Date Purchased	Number of Shares Purchased (1)	Price Paid Per Share (1)	Part of Publicly Announced Program (2)	yet be Purchased Under the Program (2)
May 1, 2016 - May 28, 2016	1,089,900	$ 58.06	1,089,900	$ 485,727,940
May 29, 2016 - July 2, 2016	1,749,351	54.48	1,744,586	390,685,865
July 3, 2016 - July 30, 2016	519,031	57.03	519,031	361,083,451
	3,358,282	56.04	3,353,517	

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

(2) On February 17, 2015, the Board of Directors approved a 3-year, $1 billion share repurchase program extending through January 2018.

Item 6. Exhibits

(a) Exhibits
The exhibits that are in this report immediately follow the index.

SIGNATURE

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

Date: September 7, 2016	FOOT LOCKER, INC.
	/s/ Lauren B. Peters LAUREN B. PETERS Executive Vice President and Chief Financial Officer

FOOT LOCKER, INC.

INDEX OF EXHIBITS

Exhibit No.	Description
10.1†*	Form of Restricted Stock Unit Award Agreement (New Hire).
12*	Computation of Ratio of Earnings to Fixed Charges.
15*	Accountants' Acknowledgement.
31.1*	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32**	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99*	Report of Independent Registered Public Accounting Firm.
101.INS*	XBRL Instance Document.
101.SCH*	XBRL Taxonomy Extension Schema.
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase.
101.DEF*	XBRL Taxonomy Extension Definition Linkbase.
101.LAB*	XBRL Taxonomy Extension Label Linkbase.
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase.

† Management contract or compensatory plan or arrangement.
* Filed herewith.
** Furnished herewith.