

WILLIAMS SONOMA INC
Form 10-Q
December 06, 2017
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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 October 29, 2017.

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: 001-14077

WILLIAMS-SONOMA, INC.

(Exact name of registrant as specified in its charter)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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, a smaller reporting company, or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company and emerging growth company in Rule 12b-2 of the Exchange Act.

| | |
|---|---------------------------|
| Large accelerated filer | Accelerated filer |
| Non-accelerated filer (Do not check if a smaller reporting company) | Smaller reporting company |
| Emerging growth company | |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards 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

As of November 26, 2017, 84,175,180 shares of the registrant's Common Stock were outstanding.

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WILLIAMS-SONOMA, INC.

REPORT ON FORM 10-Q

FOR THE QUARTER ENDED OCTOBER 29, 2017

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(Unaudited)

| | Thirteen Weeks Ended | | Thirty-nine Weeks Ended | |
|---|-------------------------|---------------------|----------------------------|---------------------|
| | October 29, 2017 | October 30, 2016 | October 29, 2017 | October 30, 2016 |
| <i>In thousands, except per share amounts</i> | | | | |
| E-commerce net revenues | \$ 690,045 | \$ 648,743 | \$ 1,901,348 | \$ 1,824,660 |
| Retail net revenues | 609,291 | 596,642 | 1,711,101 | 1,677,571 |
| Net revenues | 1,299,336 | 1,245,385 | 3,612,449 | 3,502,231 |
| Cost of goods sold | 832,269 | 787,162 | 2,326,911 | 2,240,952 |
| Gross profit | 467,067 | 458,223 | 1,285,538 | 1,261,279 |
| Selling, general and administrative expenses | 356,254 | 348,244 | 1,030,667 | 1,004,499 |
| Operating income | 110,813 | 109,979 | 254,871 | 256,780 |
| Interest (income) expense, net | 594 | 488 | 974 | 587 |
| Earnings before income taxes | 110,219 | 109,491 | 253,897 | 256,193 |
| Income taxes | 38,906 | 40,113 | 90,112 | 95,433 |
| Net earnings | \$ 71,313 | \$ 69,378 | \$ 163,785 | \$ 160,760 |
| Basic earnings per share | \$ 0.84 | \$ 0.78 | \$ 1.90 | \$ 1.81 |
| Diluted earnings per share | \$ 0.84 | \$ 0.78 | \$ 1.89 | \$ 1.79 |
| Shares used in calculation of earnings per share: | | | | |
| Basic | 84,940 | 88,382 | 86,111 | 88,906 |
| Diluted | 85,384 | 89,144 | 86,582 | 89,764 |

*See Notes to Condensed Consolidated Financial Statements.***WILLIAMS-SONOMA, INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(Unaudited)

| | Thirteen Weeks Ended | | Thirty-nine Weeks Ended | |
|------------------------------------|-------------------------|---------------------|----------------------------|---------------------|
| | October 29, 2017 | October 30, 2016 | October 29, 2017 | October 30, 2016 |
| <i>In thousands</i> | | | | |
| Net earnings | \$ 71,313 | \$ 69,378 | \$ 163,785 | \$ 160,760 |
| Other comprehensive income (loss): | | | | |

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| | | | | |
|--|-----------|-----------|------------|------------|
| Foreign currency translation adjustments | 40 | (1,731) | 1,864 | 472 |
| Change in fair value of derivative financial instruments, net of tax (tax benefit) of \$133, \$184, \$(52) and \$(208) | 373 | 520 | (138) | (587) |
| Reclassification adjustment for realized (gain) loss on derivative financial instruments, net of tax (tax benefit) of \$45, \$(107), \$48 and \$12 | (128) | 299 | (137) | (41) |
| Comprehensive income | \$ 71,598 | \$ 68,466 | \$ 165,374 | \$ 160,604 |

See Notes to Condensed Consolidated Financial Statements.

Table of Contents**WILLIAMS-SONOMA, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

(Unaudited)

| | October 29, 2017 | January 29, 2017 | October 30, 2016 |
|--|---------------------|---------------------|---------------------|
| <i>In thousands, except per share amounts</i> | | | |
| ASSETS | | | |
| Current assets | | | |
| Cash and cash equivalents | \$ 90,779 | \$ 213,713 | \$ 75,381 |
| Accounts receivable, net | 92,282 | 88,803 | 96,386 |
| Merchandise inventories, net | 1,176,941 | 977,505 | 1,063,747 |
| Prepaid catalog expenses | 22,992 | 23,625 | 25,329 |
| Prepaid expenses | 65,326 | 52,882 | 74,195 |
| Other assets | 12,141 | 10,652 | 12,176 |
| Total current assets | 1,460,461 | 1,367,180 | 1,347,214 |
| Property and equipment, net | 931,131 | 923,283 | 918,020 |
| Deferred income taxes, net | 131,793 | 135,238 | 136,558 |
| Other assets, net | 56,999 | 51,178 | 51,540 |
| Total assets | \$ 2,580,384 | \$ 2,476,879 | \$ 2,453,332 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | | |
| Current liabilities | | | |
| Accounts payable | \$ 470,783 | \$ 453,710 | \$ 450,144 |
| Accrued salaries, benefits and other liabilities | 103,349 | 130,187 | 111,445 |
| Customer deposits | 288,569 | 294,276 | 289,737 |
| Borrowings under revolving line of credit | 170,000 | | 125,000 |
| Income taxes payable | 48,865 | 23,245 | 1,122 |
| Other liabilities | 55,985 | 59,838 | 53,423 |
| Total current liabilities | 1,137,551 | 961,256 | 1,030,871 |
| Deferred rent and lease incentives | 195,220 | 196,188 | 192,948 |
| Other long-term obligations | 75,439 | 71,215 | 70,031 |
| Total liabilities | 1,408,210 | 1,228,659 | 1,293,850 |
| Commitments and contingencies | See Note F | | |
| Stockholders equity | | | |
| Preferred stock: \$.01 par value; 7,500 shares authorized; none issued | | | |
| Common stock: \$.01 par value; 253,125 shares authorized; 84,478, 87,325 and 88,014 shares issued and outstanding at October 29, 2017, January 29, 2017 and October 30, 2016, respectively | 845 | 873 | 881 |
| Additional paid-in capital | 557,198 | 556,928 | 547,513 |
| Retained earnings | 623,170 | 701,702 | 623,243 |
| Accumulated other comprehensive loss | (8,314) | (9,903) | (10,772) |
| Treasury stock, at cost: 11, 20 and 20 shares as of October 29, 2017, January 29, 2017 and October 30, 2016, respectively | (725) | (1,380) | (1,383) |
| Total stockholders equity | 1,172,174 | 1,248,220 | 1,159,482 |

| | | | |
|--|--------------|--------------|--------------|
| Total liabilities and stockholders' equity | \$ 2,580,384 | \$ 2,476,879 | \$ 2,453,332 |
|--|--------------|--------------|--------------|

See Notes to Condensed Consolidated Financial Statements.

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WILLIAMS-SONOMA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

| | Thirty-nine Weeks Ended | |
|---|----------------------------|---------------------|
| | October 29, 2017 | October 30, 2016 |
| <i>In thousands</i> | | |
| Cash flows from operating activities: | | |
| Net earnings | \$ 163,785 | \$ 160,760 |
| Adjustments to reconcile net earnings to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 135,473 | 127,745 |
| Loss on disposal/impairment of assets | 1,299 | 1,852 |
| Amortization of deferred lease incentives | (18,987) | (18,789) |
| Deferred income taxes | (11,884) | (14,461) |
| Tax benefit related to stock-based awards | 15,439 | 23,571 |
| Excess tax benefit related to stock-based awards | | (4,817) |
| Stock-based compensation expense | 30,164 | 37,975 |
| Other | (416) | (647) |
| Changes in: | | |
| Accounts receivable | (2,341) | (17,400) |
| Merchandise inventories | (197,757) | (82,410) |
| Prepaid catalog expenses | 633 | 3,591 |
| Prepaid expenses and other assets | (20,001) | (29,205) |
| Accounts payable | 7,544 | (17,403) |
| Accrued salaries, benefits and other liabilities | (26,883) | (507) |
| Customer deposits | (5,815) | (7,445) |
| Deferred rent and lease incentives | 17,000 | 25,969 |
| Income taxes payable | 25,677 | (65,915) |
| Net cash provided by operating activities | 112,930 | 122,464 |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | (135,821) | (127,169) |
| Other | 458 | 370 |
| Net cash used in investing activities | (135,363) | (126,799) |
| Cash flows from financing activities: | | |
| Borrowings under revolving line of credit | 170,000 | 125,000 |
| Repurchases of common stock | (154,321) | (115,167) |
| Payment of dividends | (101,928) | (100,854) |
| Tax withholdings related to stock-based awards | (14,836) | (26,518) |
| Excess tax benefit related to stock-based awards | | 4,817 |
| Proceeds related to stock-based awards | | 1,532 |
| Other | (20) | (48) |

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| | | |
|---|-----------|-----------|
| Net cash used in financing activities | (101,105) | (111,238) |
| Effect of exchange rates on cash and cash equivalents | 604 | (2,693) |
| Net decrease in cash and cash equivalents | (122,934) | (118,266) |
| Cash and cash equivalents at beginning of period | 213,713 | 193,647 |
| Cash and cash equivalents at end of period | \$ 90,779 | \$ 75,381 |

See Notes to Condensed Consolidated Financial Statements.

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WILLIAMS-SONOMA, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE A. FINANCIAL STATEMENTS - BASIS OF PRESENTATION

These financial statements include Williams-Sonoma, Inc. and its wholly owned subsidiaries (we, us or our). The Condensed Consolidated Balance Sheets as of October 29, 2017 and October 30, 2016, the Condensed Consolidated Statements of Earnings, the Condensed Consolidated Statements of Comprehensive Income for the thirteen and thirty-nine weeks then ended, and the Condensed Consolidated Statements of Cash Flows for the thirty-nine weeks then ended, have been prepared by us, without audit. In our opinion, the financial statements include all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position at the balance sheet dates and the results of operations for the thirteen and thirty-nine weeks then ended. Intercompany transactions and accounts have been eliminated. The balance sheet as of January 29, 2017, presented herein, has been derived from our audited Consolidated Balance Sheet included in our Annual Report on Form 10-K for the fiscal year ended January 29, 2017.

The results of operations for the thirteen and thirty-nine weeks ended October 29, 2017 are not necessarily indicative of the operating results of the full year.

Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) have been omitted. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended January 29, 2017.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*, to clarify the principles of recognizing revenue and create common revenue recognition guidance between U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards. In addition, in March 2016, the FASB issued ASU 2016-08, *Revenue from Contracts with Customers: Principal versus Agent Considerations*. The amendments are intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations. The FASB also issued ASU 2016-10, *Identifying Performance Obligations and Licensing* in April 2016, which amends certain aspects of ASU 2014-09 for identifying performance obligations and the implementation guidance on licensing. These ASUs are effective retrospectively for fiscal years and interim periods within those years beginning after December 15, 2017. We are currently assessing the impact of these ASUs on our Consolidated Financial Statements and related internal controls over financial reporting. Although we do not expect that the adoption of these standards will result in a material change to our Consolidated Financial Statements, we expect the adoption will result in an acceleration in the timing of revenue recognition for certain merchandise shipped to the customer as well as an acceleration in the timing of recognizing breakage income associated with our gift cards. We also expect to recognize advertising expense related to direct response advertising as incurred. We are currently evaluating the classification of income earned in connection with our private label and co-branded credit cards as well as the expanded disclosures required under the new guidance. We will adopt these ASUs on a modified retrospective basis beginning in the first quarter of fiscal 2018.

In February 2016, the FASB issued ASU 2016-02, *Leases*, which will require lessees to recognize a right-of-use asset and a lease liability for virtually all of their leases (other than short-term leases). This ASU is effective for fiscal years and interim periods within those years beginning after December 15, 2018. We are currently assessing the impact of this ASU on our Consolidated Financial Statements, but expect that it will result in a substantial increase in our long-term assets and liabilities.

In March 2016, the FASB issued ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting*, which simplifies the accounting for share-based payment transactions (including the accounting for income taxes and forfeitures, among other areas). The ASU requires entities to, among other things, recognize all excess tax benefits and deficiencies in the income statement, as a benefit or expense within income taxes, in the period in which they occur. The ASU also allows an entity to make an accounting policy election to either estimate expected forfeitures or account for them as they occur. We adopted this ASU in the first quarter of fiscal 2017, and as a result, we no longer classify excess tax benefits related to stock-based awards as a financing cash inflow and an operating cash outflow. These classification requirements were adopted prospectively and, as such, our Condensed Consolidated Statement of Cash Flows for the thirty-nine weeks ended October 30, 2016 has not been retrospectively adjusted. We continue to estimate expected forfeitures.

In October 2016, the FASB issued ASU 2016-16, *Intra-Entity Transfers of Assets Other than Inventory*. The amendments remove the prohibition against the recognition of current and deferred income tax effects of intra-entity transfers of assets other than inventory until the asset has been sold to an outside party. This ASU is effective for fiscal years and interim periods within those years beginning after December 15, 2017. We do not expect the adoption of this ASU to have a material impact on our financial condition, results of operations or cash flows.

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In August 2017, the FASB issued ASU 2017-12, *Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities* (Topic 815), which expands and refines hedge accounting for both non-financial and financial risk components and aligns the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. The guidance also makes certain targeted improvements to simplify the application of hedge accounting guidance and ease the administrative burden of hedge documentation requirements and assessing hedge effectiveness. This ASU is effective for the Company in the first quarter of fiscal 2019 and early adoption is permitted. Entities should apply the guidance to existing cash flow and net investment hedge relationships using a modified retrospective approach with a cumulative effect adjustment recorded to opening retained earnings on the date of adoption. The guidance also provides transition relief to make it easier for entities to apply certain amendments to existing hedges where the hedge documentation needs to be modified. This standard is not expected to have a significant effect on our accounting policies or on our consolidated financial statements and related disclosures.

NOTE B. BORROWING ARRANGEMENTS*Credit Facility*

We have a \$500,000,000 unsecured revolving line of credit (credit facility) that may be used to borrow revolving loans or request the issuance of letters of credit. We may, upon notice to the administrative agent, request existing or new lenders to increase the credit facility by up to \$250,000,000, at such lenders option, to provide for a total of \$750,000,000 of unsecured revolving credit. As of October 29, 2017, we were in compliance with our financial covenants under the credit facility and, based on current projections, we expect to remain in compliance throughout the next 12 months. The credit facility matures on November 19, 2019, at which time all outstanding borrowings must be repaid and all outstanding letters of credit must be cash collateralized.

We may elect interest rates calculated at (i) Bank of America s prime rate (or, if greater, the average rate on overnight federal funds plus one-half of one percent, or a rate based on LIBOR plus one percent) plus a margin based on our leverage ratio or (ii) LIBOR plus a margin based on our leverage ratio. During the third quarter of fiscal 2017, we had borrowings of \$55,000,000 under the credit facility. For year-to-date fiscal 2017, we borrowed \$170,000,000 (at a weighted average interest rate of 2.25%), all of which was outstanding as of October 29, 2017. During the third quarter of fiscal 2016, we had no borrowings under the credit facility. For year-to-date 2016, we borrowed \$125,000,000 (at a weighted average interest rate of 1.55%), all of which was outstanding as of October 30, 2016. Additionally, as of October 29, 2017, \$12,782,000 in issued but undrawn standby letters of credit was outstanding under the credit facility. The standby letters of credit were issued to secure the liabilities associated with workers compensation and other insurance programs.

Letter of Credit Facilities

We have three unsecured letter of credit reimbursement facilities for a total of \$70,000,000, each of which matures on August 25, 2018. The letter of credit facilities contain covenants that are consistent with our unsecured revolving line of credit. Interest on unreimbursed amounts under the letter of credit facilities accrues at the lender s prime rate (or, if greater, the average rate on overnight federal funds plus one-half of one percent) plus 2.0%. As of October 29, 2017, an aggregate of \$8,392,000 was outstanding under the letter of credit facilities, which represents only a future commitment to fund inventory purchases to which we had not taken legal title. The latest expiration possible for any future letters of credit issued under the facilities is January 22, 2019.

NOTE C. STOCK-BASED COMPENSATION*Equity Award Programs*

Our Amended and Restated 2001 Long-Term Incentive Plan (the *Plan*) provides for grants of incentive stock options, nonqualified stock options, stock-settled stock appreciation rights (collectively, *option awards*), restricted stock awards, restricted stock units (including those that are performance-based), deferred stock awards (collectively, *stock awards*) and dividend equivalents up to an aggregate of 32,310,000 shares. As of October 29, 2017, there were approximately 6,000,000 shares available for future grant. Awards may be granted under the Plan to our officers, employees and non-employee members of the board of directors (the *Board*) or those of any of our subsidiaries. Shares issued as a result of award exercises or releases are primarily funded with the issuance of new shares.

Option Awards

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

Table of Contents*Stock Awards*

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

Stock-Based Compensation Expense

During the thirteen and thirty-nine weeks ended October 29, 2017, we recognized total stock-based compensation expense, as a component of selling, general and administrative expenses, of \$7,335,000 and \$30,164,000, respectively. During the thirteen and thirty-nine weeks ended October 30, 2016, we recognized total stock-based compensation expense, as a component of selling, general and administrative expenses, of \$10,499,000 and \$37,975,000, respectively.

Stock-Settled Stock Appreciation Rights

A stock-settled stock appreciation right is an award that allows the recipient to receive common stock equal to the appreciation in the fair market value of our common stock between the grant date and the conversion date for the number of shares converted.

The following table summarizes our stock-settled stock appreciation right activity during the thirty-nine weeks ended October 29, 2017:

| | Shares |
|---|----------|
| Balance at January 29, 2017 (100% vested) | 411,710 |
| Granted | |
| Converted into common stock | (79,331) |
| Cancelled | |
| Balance at October 29, 2017 (100% vested) | 332,379 |

Restricted Stock Units

The following table summarizes our restricted stock unit activity during the thirty-nine weeks ended October 29, 2017:

| | Shares |
|-----------------------------|-----------|
| Balance at January 29, 2017 | 2,232,486 |
| Granted | 1,486,395 |
| Released | (636,686) |
| Cancelled | (688,354) |

| | |
|--|-----------|
| Balance at October 29, 2017 | 2,393,841 |
| Vested plus expected to vest at October 29, 2017 | 1,710,333 |

Table of Contents**NOTE D. EARNINGS PER SHARE**

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

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

| | Net Earnings | Weighted Average Shares | Earnings Per Share |
|---|--------------|----------------------------|-----------------------|
| <i>In thousands, except per share amounts</i> | | | |
| Thirteen weeks ended October 29, 2017 | | | |
| Basic | \$ 71,313 | 84,940 | \$ 0.84 |
| Effect of dilutive stock-based awards | | 444 | |
| Diluted | \$ 71,313 | 85,384 | \$ 0.84 |
| Thirteen weeks ended October 30, 2016 | | | |
| Basic | \$ 69,378 | 88,382 | \$ 0.78 |
| Effect of dilutive stock-based awards | | 762 | |
| Diluted | \$ 69,378 | 89,144 | \$ 0.78 |
| Thirty-nine weeks ended October 29, 2017 | | | |
| Basic | \$ 163,785 | 86,111 | \$ 1.90 |
| Effect of dilutive stock-based awards | | 471 | |
| Diluted | \$ 163,785 | 86,582 | \$ 1.89 |
| Thirty-nine weeks ended October 30, 2016 | | | |
| Basic | \$ 160,760 | 88,906 | \$ 1.81 |
| Effect of dilutive stock-based awards | | 858 | |
| Diluted | \$ 160,760 | 89,764 | \$ 1.79 |

Stock-based awards of 994,000 and 1,052,000 were excluded from the computation of diluted earnings per share for the thirteen and thirty-nine weeks ended October 29, 2017, respectively, as their inclusion would be anti-dilutive. Stock-based awards of 610,000 and 540,000 were excluded from the computation of diluted earnings per share for the thirteen and thirty-nine weeks ended October 30, 2016, respectively, as their inclusion would be anti-dilutive.

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We have two reportable segments, e-commerce and retail. The e-commerce segment has the following merchandise strategies: Williams Sonoma, Pottery Barn, Pottery Barn Kids, West Elm, PBteen, Williams Sonoma Home, Rejuvenation and Mark and Graham, which sell our products through our e-commerce websites and direct mail catalogs. Our e-commerce merchandise strategies are operating segments, which have been aggregated into one reportable segment, e-commerce. The retail segment, which includes our franchise operations, has the following merchandise strategies: Williams Sonoma, Pottery Barn, Pottery Barn Kids, West Elm and Rejuvenation, which sell our products through our retail stores. Our retail merchandise strategies are operating segments, which have been aggregated into one reportable segment, retail. Management's expectation is that the overall economic characteristics of each of our operating segments will be similar over time based on management's judgment that the operating segments have had similar historical economic characteristics and are expected to have similar long-term financial performance in the future.

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

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

Income taxes are calculated at an entity level and are not allocated to our reportable segments.

Segment Information

| <i>In thousands</i> | E-commerce | Retail | Unallocated | Total |
|---|------------|------------|-------------|--------------|
| Thirteen weeks ended October 29, 2017 | | | | |
| Net revenues ¹ | \$ 690,045 | \$ 609,291 | \$ | \$ 1,299,336 |
| Depreciation and amortization expense | 6,870 | 22,555 | 16,000 | 45,425 |
| Operating income (loss) | 142,865 | 42,804 | (74,856) | 110,813 |
| Capital expenditures | 13,184 | 22,066 | 17,844 | 53,094 |
| Thirteen weeks ended October 30, 2016 | | | | |
| Net revenues ¹ | \$ 648,743 | \$ 596,642 | \$ | \$ 1,245,385 |
| Depreciation and amortization expense | 7,812 | 21,676 | 14,888 | 44,376 |
| Operating income (loss) ² | 150,164 | 47,080 | (87,265) | 109,979 |
| Capital expenditures | 5,231 | 25,820 | 18,241 | 49,292 |
| Thirty-nine weeks ended October 29, 2017 | | | | |

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| | | | | |
|--|--------------|--------------|-----------|--------------|
| Net revenues ¹ | \$ 1,901,348 | \$ 1,711,101 | \$ | \$ 3,612,449 |
| Depreciation and amortization expense | 20,625 | 67,282 | 47,566 | 135,473 |
| Operating income (loss) ² | 410,008 | 99,110 | (254,247) | 254,871 |
| Assets ³ | 732,842 | 1,156,117 | 691,425 | 2,580,384 |
| Capital expenditures | 24,173 | 61,851 | 49,797 | 135,821 |
| Thirty-nine weeks ended October 30, 2016 | | | | |
| Net revenues ¹ | \$ 1,824,660 | \$ 1,677,571 | \$ | \$ 3,502,231 |
| Depreciation and amortization expense | 23,415 | 63,764 | 40,566 | 127,745 |
| Operating income (loss) ² | 414,442 | 110,422 | (268,084) | 256,780 |
| Assets ³ | 664,105 | 1,118,913 | 670,314 | 2,453,332 |
| Capital expenditures | 13,673 | 64,699 | 48,797 | 127,169 |

¹ Includes net revenues related to our international operations (including our operations in Canada, Australia, the United Kingdom and our franchise businesses) of approximately \$84.1 million and \$82.8 million for the thirteen weeks ended October 29, 2017 and October 30, 2016, respectively, and \$234.1 million and \$232.5 million for the thirty-nine weeks ended October 29, 2017 and October 30, 2016, respectively.

² Includes \$5.7 million of severance-related charges for the thirty-nine weeks ended October 29, 2017 and \$1.2 million and \$14.4 million of severance-related charges for the thirteen and thirty-nine weeks ended October 30, 2016, respectively, primarily in our corporate functions, which is recorded in selling, general and administrative expenses within the unallocated segment.

³ Includes long-term assets related to our international operations of approximately \$58.5 million and \$59.2 million as of October 29, 2017 and October 30, 2016, respectively.

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NOTE F. COMMITMENTS AND CONTINGENCIES

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

NOTE G. STOCK REPURCHASE PROGRAM AND DIVIDENDS

Stock Repurchase Program

During the thirteen weeks ended October 29, 2017, we repurchased 1,301,373 shares of our common stock at an average cost of \$46.84 per share for a total cost of approximately \$60,960,000. During the thirty-nine weeks ended October 29, 2017, we repurchased 3,226,297 shares of our common stock at an average cost of \$47.83 per share for a total cost of approximately \$154,321,000. As of October 29, 2017, we held treasury stock of approximately \$725,000 that represents the cost of shares available for issuance intended to satisfy future stock-based award settlements in certain foreign jurisdictions.

During the thirteen weeks ended October 30, 2016, we repurchased 771,327 shares of our common stock at an average cost of \$50.56 per share for a total cost of approximately \$39,001,000. During the thirty-nine weeks ended October 30, 2016, we repurchased 2,164,473 shares of our common stock at an average cost of \$53.21 per share for a total cost of approximately \$115,167,000.

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

Dividends

We declared cash dividends of \$0.39 and \$0.37 per common share during the thirteen weeks ended October 29, 2017 and October 30, 2016, respectively. We declared cash dividends of \$1.17 and \$1.11 per common share during the thirty-nine weeks ended October 29, 2017 and October 30, 2016, respectively. Our quarterly cash dividend may be limited or terminated at any time.

NOTE H. DERIVATIVE FINANCIAL INSTRUMENTS

We have retail and/or e-commerce businesses in Canada, Australia and the United Kingdom, and operations throughout Asia and Europe, which expose us to market risk associated with foreign currency exchange rate fluctuations. Substantially all of our purchases and sales are denominated in U.S. dollars, which limits our exposure to

this risk. However, some of our foreign operations have a functional currency other than the U.S. dollar. To mitigate this risk, we hedge a portion of our foreign currency exposure with foreign currency forward contracts in accordance with our risk management policies. We do not enter into such contracts for speculative purposes. The assets or liabilities associated with the derivative instruments are measured at fair value and recorded in either other current or long-term assets or other current or long-term liabilities. As discussed below, the accounting for gains and losses resulting from changes in fair value depends on whether the derivative instrument is designated as a hedge and qualifies for hedge accounting in accordance with the FASB Accounting Standards Codification (ASC) 815, *Derivatives and Hedging*.

Cash Flow Hedges

We enter into foreign currency forward contracts designated as cash flow hedges (to sell Canadian dollars and purchase U.S. dollars) for forecasted inventory purchases in U.S. dollars by our foreign subsidiaries. These hedges have terms of up to 18 months. All hedging relationships are formally documented, and the forward contracts are designed to mitigate foreign currency exchange risk on hedged transactions. We record the effective portion of changes in the fair value of our cash flow hedges in other comprehensive income (OCI) until the earlier of when the hedged forecasted inventory purchase occurs or the respective contract reaches maturity. Subsequently, as the inventory is sold to the customer, we reclassify amounts previously recorded in OCI to cost of goods sold. Changes in the fair value of the forward contract related to interest charges (or forward points) are excluded from the assessment and measurement of hedge effectiveness and are recorded immediately in selling, general and administrative expenses. Based on the rates in effect as of October 29, 2017, we expect to reclassify a net pre-tax loss of approximately \$301,000 from OCI to cost of goods sold over the next 12 months.

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We also enter into non-designated foreign currency forward contracts (to sell Australian dollars and purchase U.S. dollars) to reduce the exchange risk associated with our assets and liabilities denominated in a foreign currency. Any foreign exchange gains or losses related to these contracts are recognized in selling, general and administrative expenses.

As of October 29, 2017 and October 30, 2016, we had foreign currency forward contracts outstanding (in U.S. dollars) with notional values as follows:

| <i>In thousands</i> | October 29, 2017 | October 30, 2016 |
|--|------------------|------------------|
| Contracts designated as cash flow hedges | \$ 23,000 | \$ 29,000 |
| Contracts not designated as cash flow hedges | \$ 48,000 | \$ 46,000 |

Hedge effectiveness is evaluated prospectively at inception, on an ongoing basis, as well as retrospectively using regression analysis. Any measurable ineffectiveness of the hedge is recorded in selling, general and administrative expenses. No gain or loss was recognized for cash flow hedges due to hedge ineffectiveness and all hedges were deemed effective for assessment purposes for the thirteen and thirty-nine weeks ended October 29, 2017 and October 30, 2016.

The effect of derivative instruments in our Condensed Consolidated Financial Statements during the thirteen and thirty-nine weeks ended October 29, 2017 and October 30, 2016, pre-tax, was as follows:

| <i>In thousands</i> | Thirteen Weeks Ended October 29, 2017 | Thirteen Weeks Ended October 30, 2016 | Thirty-nine Weeks Ended October 29, 2017 | Thirty-nine Weeks Ended October 30, 2016 |
|--|---------------------------------------|---------------------------------------|--|--|
| Net gain (loss) recognized in OCI | \$ 506 | \$ 704 | \$ (190) | \$ (795) |
| Net gain (loss) reclassified from OCI into cost of goods sold | \$ 173 | \$ (406) | \$ 185 | \$ 53 |
| Net foreign exchange gain (loss) recognized in selling, general and administrative expenses: | | | | |
| Instruments designated as cash flow hedges ¹ | \$ 20 | \$ (22) | \$ 75 | \$ (12) |
| Instruments not designated or de-designated | \$ 1,752 | \$ (566) | \$ (1,096) | \$ (3,599) |

¹ Changes in fair value of the forward contract related to interest charges (or forward points).

The fair values of our derivative financial instruments are presented below according to their classification in our Condensed Consolidated Balance Sheets. All fair values were measured using Level 2 inputs as defined by the fair value hierarchy described in Note I.

| <i>In thousands</i> | October 29, 2017 | October 30, 2016 |
|---|------------------|------------------|
| Derivatives designated as cash flow hedges: | | |
| Other current assets | \$ 161 | \$ 653 |
| Other long-term assets | \$ 25 | \$ 176 |
| Other current liabilities | \$ (131) | \$ (328) |

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| | | | | |
|--|----|------|----|-----|
| Other long-term liabilities | \$ | (11) | \$ | |
| Derivatives not designated as hedging instruments: | | | | |
| Other current assets | \$ | 209 | \$ | 314 |

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

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NOTE I. FAIR VALUE MEASUREMENTS

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

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

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

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

Level 3: inputs which include unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the underlying asset or liability.

The fair values of our cash and cash equivalents are based on Level 1 inputs, which include quoted prices in active markets for identical assets.

Foreign Currency Derivatives and Hedging Instruments

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

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

Property and Equipment

We review the carrying value of all long-lived assets for impairment, primarily at an individual store level, whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. We measure these assets at fair value on a nonrecurring basis using Level 3 inputs as defined in the fair value hierarchy. The fair value is based on the present value of estimated future cash flows using a discount rate that approximates our weighted average cost of capital.

There were no transfers between Level 1, 2 or 3 categories during the thirteen and thirty-nine weeks ended October 29, 2017 or

October 30, 2016.

Table of Contents**NOTE J. ACCUMULATED OTHER COMPREHENSIVE INCOME**

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

| <i>In thousands</i> | Foreign Currency Translation | Cash Flow Hedges | Accumulated Other Comprehensive Income (Loss) |
|---|---------------------------------|---------------------|--|
| Balance at January 29, 2017 | \$ (9,957) | \$ 54 | \$ (9,903) |
| Foreign currency translation adjustments | (1,566) | | (1,566) |
| Change in fair value of derivative financial instruments | | 655 | 655 |
| Reclassification adjustment for realized (gain) loss on derivative financial instruments ¹ | | (16) | (16) |
| Other comprehensive income (loss) | (1,566) | 639 | (927) |
| Balance at April 30, 2017 | (11,523) | 693 | (10,830) |
| Foreign currency translation adjustments | 3,390 | | 3,390 |
| Change in fair value of derivative financial instruments | | (1,166) | (1,166) |
| Reclassification adjustment for realized (gain) loss on derivative financial instruments ¹ | | 7 | 7 |
| Other comprehensive income (loss) | 3,390 | (1,159) | 2,231 |
| Balance at July 30, 2017 | (8,133) | (466) | (8,599) |
| Foreign currency translation adjustments | 40 | | 40 |
| Change in fair value of derivative financial instruments | | 373 | 373 |
| Reclassification adjustment for realized (gain) loss on derivative financial instruments ¹ | | (128) | (128) |
| Other comprehensive income (loss) | 40 | 245 | 285 |
| Balance at October 29, 2017 | \$ (8,093) | \$ (221) | \$ (8,314) |
| Balance at January 31, 2016 | \$ (11,480) | \$ 864 | \$ (10,616) |
| Foreign currency translation adjustments | 5,208 | | 5,208 |
| Change in fair value of derivative financial instruments | | (2,165) | (2,165) |
| Reclassification adjustment for realized (gain) loss on derivative financial instruments ¹ | | (302) | (302) |
| Other comprehensive income (loss) | 5,208 | (2,467) | 2,741 |
| Balance at May 1, 2016 | (6,272) | (1,603) | (7,875) |
| Foreign currency translation adjustments | (3,005) | | (3,005) |
| Change in fair value of derivative financial instruments | | 1,058 | 1,058 |
| Reclassification adjustment for realized (gain) loss on derivative financial instruments ¹ | | (38) | (38) |
| Other comprehensive income (loss) | (3,005) | 1,020 | (1,985) |
| Balance at July 31, 2016 | (9,277) | (583) | (9,860) |
| Foreign currency translation adjustments | (1,731) | | (1,731) |
| Change in fair value of derivative financial instruments | | 520 | 520 |
| Reclassification adjustment for realized (gain) loss on derivative financial instruments ¹ | | 299 | 299 |

| | | | |
|-----------------------------------|-------------|--------|-------------|
| Other comprehensive income (loss) | (1,731) | 819 | (912) |
| Balance at October 30, 2016 | \$ (11,008) | \$ 236 | \$ (10,772) |

¹ Refer to Note H for additional disclosures about reclassifications out of accumulated other comprehensive income and their corresponding effects on the respective line items in the Condensed Consolidated Statements of Earnings.

NOTE K. SUBSEQUENT EVENT

On December 1, 2017, we acquired Outward, Inc., a 3-D imaging and augmented reality platform for the home furnishings and décor industry, for all cash consideration of \$112,000,000. Outward is a wholly-owned subsidiary of Williams-Sonoma, Inc. Results of operations for Outward will be included in our consolidated financial statements from the date of acquisition.

Table of Contents**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****FORWARD-LOOKING STATEMENTS**

This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they do not fully materialize or are proven incorrect, could cause our business and results of operations to differ materially from those expressed or implied by such forward-looking statements. Such forward-looking statements include statements related to: our beliefs regarding the resolution of current lawsuits, claims and proceedings; our stock repurchase program; our expectations regarding our cash flow hedges and foreign currency risks; our planned use of cash; our compliance with the financial covenants contained in our credit facilities; our belief that our cash on-hand, in addition to our available credit facilities, will provide adequate liquidity for our business operations over the next 12 months; our expectations regarding the amendment and extension of our credit facility and the entry into a term loan; our beliefs regarding our exposure to foreign currency exchange rate fluctuations; and our beliefs regarding seasonal patterns associated with our business, as well as statements of belief and statements of assumptions underlying any of the foregoing. You can identify these and other forward-looking statements by the use of words such as may, should, expects, plans, anticipates, believes, estimates, potential, continue, or the negative of such terms, or other comparable terminology. The risks, uncertainties and assumptions referred to above that could cause our results to differ materially from the results expressed or implied by such forward-looking statements include, but are not limited to, those discussed under the heading Risk Factors in this document and our Annual Report on Form 10-K for the fiscal year ended January 29, 2017, and the risks, uncertainties and assumptions discussed from time to time in our other public filings and public announcements. All forward-looking statements included in this document are based on information available to us as of the date hereof, and we assume no obligation to update these forward-looking statements.

OVERVIEW

Williams-Sonoma, Inc. is a specialty retailer of high-quality products for the home. These products, representing distinct merchandise strategies Williams Sonoma, Pottery Barn, Pottery Barn Kids, West Elm, PBteen, Williams Sonoma Home, Rejuvenation, and Mark and Graham are marketed through e-commerce websites, direct mail catalogs and 636 stores. We operate in the U.S., Puerto Rico, Canada, Australia and the United Kingdom, offer international shipping to customers worldwide, and have unaffiliated franchisees that operate stores in the Middle East, the Philippines and South Korea, and stores and e-commerce websites in Mexico.

The following discussion and analysis of financial condition, results of operations, and liquidity and capital resources for the thirteen weeks ended October 29, 2017 (third quarter of fiscal 2017), as compared to the thirteen weeks ended October 30, 2016 (third quarter of fiscal 2016) and the thirty-nine weeks ended October 29, 2017 (year-to-date fiscal 2017), as compared to the thirty-nine weeks ended October 30, 2016 (year-to-date fiscal 2016), should be read in conjunction with our Condensed Consolidated Financial Statements and the notes thereto.

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

Third Quarter of Fiscal 2017 Financial Results

Net revenues in the third quarter of fiscal 2017 increased by \$53,951,000, or 4.3%, compared to the third quarter of fiscal 2016, with comparable brand revenue growth of 3.3%. The increase in net revenues was driven by a 6.4% increase in our e-commerce net revenues (primarily driven by West Elm, Williams Sonoma and our newer businesses, Rejuvenation and Mark and Graham), and a 2.1% increase in retail net revenues (primarily driven by West Elm and

Pottery Barn), with particular strength in furniture. Net revenue growth in the third quarter of fiscal 2017 was also due to a 1.4% increase in store leased square footage compared to the third quarter of fiscal 2016 primarily due to 1 net new store. Additionally, during the third quarter of fiscal 2017, net revenue growth was negatively impacted by lost sales from the hurricanes in Florida, Texas and Puerto Rico.

Despite this lost sales impact from the hurricanes, we saw net revenue growth in key categories across our brands. In Pottery Barn, growth was primarily due to our bedroom, decorating and upholstery businesses. In Williams Sonoma, growth was driven by strength in our electrics, tabletop and housewares categories as well as continued growth in Williams Sonoma Home. In West Elm, growth was driven by furniture, tabletop and lighting. In Pottery Barn Kids, growth was driven by our furniture and accessory categories. And, in PBteen, we saw improvement across all major categories, with particular strength in key furniture and accessory categories, as well as our back to school and dorm offerings.

In the third quarter of fiscal 2017, diluted earnings per share was \$0.84 versus \$0.78 in the third quarter of fiscal 2016. We also returned \$94,691,000 to our stockholders through stock repurchases and dividends.

Table of Contents**NET REVENUES**

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

| <i>In thousands</i> | Thirteen Weeks Ended | | | | Thirty-nine Weeks Ended | | | |
|-------------------------|----------------------|---------|--------------|---------|-------------------------|---------|--------------|---------|
| | October 29, | | October 30, | | October 29, | | October 30, | |
| | 2017 | % Total | 2016 | % Total | 2017 | % Total | 2016 | % Total |
| E-commerce net revenues | \$ 690,045 | 53.1% | \$ 648,743 | 52.1% | \$ 1,901,348 | 52.6% | \$ 1,824,660 | 52.1% |
| Retail net revenues | 609,291 | 46.9% | 596,642 | 47.9% | 1,711,101 | 47.4% | 1,677,571 | 47.9% |
| Net revenues | \$ 1,299,336 | 100.0% | \$ 1,245,385 | 100.0% | \$ 3,612,449 | 100.0% | \$ 3,502,231 | 100.0% |

Net revenues in the third quarter of fiscal 2017 increased by \$53,951,000, or 4.3%, compared to the third quarter of fiscal 2016, with comparable brand revenue growth of 3.3%. The increase in net revenues was driven by a 6.4% increase in our e-commerce net revenues (primarily driven by West Elm, Williams Sonoma and our newer businesses, Rejuvenation and Mark and Graham), and a 2.1% increase in retail net revenues (primarily driven by West Elm and Pottery Barn), with particular strength in furniture. Net revenue growth in the third quarter of fiscal 2017 was also due to a 1.4% increase in store leased square footage compared to the third quarter of fiscal 2016 primarily due to 1 net new store. Additionally, during the third quarter of fiscal 2017, net revenue growth was negatively impacted by lost sales from the hurricanes in Florida, Texas and Puerto Rico.

Net revenues for year-to-date fiscal 2017 increased by \$110,218,000 or 3.1%, compared to year-to-date fiscal 2016, with comparable brand revenue growth of 2.1%. The increase in net revenues was driven by a 4.2% increase in our e-commerce net revenues (primarily driven by West Elm, Williams Sonoma and our newer businesses, Rejuvenation and Mark and Graham) and a 2.0% increase in our retail net revenues (primarily driven by West Elm and Pottery Barn), with particular strength in furniture. Net revenue growth for year-to-date fiscal 2017 was also due to a 1.4% increase in store leased square footage compared to year-to-date fiscal 2016 primarily due to 1 net new store. Additionally, during the third quarter of fiscal 2017, net revenue growth was negatively impacted by lost sales from the hurricanes in Florida, Texas and Puerto Rico.

Comparable Brand Revenue

Comparable brand revenue includes retail comparable store sales and e-commerce sales, as well as shipping fees, sales returns and other discounts associated with current period sales. Comparable stores are defined as permanent stores where gross square footage did not change by more than 20% in the previous 12 months and which have been open for at least 12 consecutive months without closure for seven or more consecutive days. Outlet comparable store net revenues are included in their respective brands. Sales to our international franchisees are excluded from comparable brand revenue as their stores and e-commerce websites are not operated by us. Sales from certain operations are also excluded until such time that we believe those sales to be meaningful to evaluating performance. Additionally, comparable brand revenue growth for newer concepts is not separately disclosed until such time that we believe those sales to be meaningful to evaluating the performance of the brand.

| | Thirteen Weeks Ended | | Thirty-nine Weeks Ended | |
|--|----------------------|-------------|-------------------------|-------------|
| | October 29, | October 30, | October 29, | October 30, |
| <i>Comparable brand revenue growth (decline)</i> | 2017 | 2016 | 2017 | 2016 |
| Pottery Barn | (0.3%) | (4.6%) | (0.2%) | (3.2%) |
| Williams Sonoma | 2.3% | 0.1% | 2.5% | 1.2% |
| West Elm | 11.5% | 12.0% | 9.4% | 15.4% |
| Pottery Barn Kids | 0.1% | (1.0%) | (3.0%) | 0.2% |
| PBteen | 3.0% | (10.9%) | (2.9%) | (5.5%) |
| Total ¹ | 3.3% | (0.4%) | 2.1% | 1.4% |

¹ Total comparable brand revenue growth includes the results of Rejuvenation and Mark and Graham.

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| | July 30, | | Store Count | | Average Leased Square Footage Per Store | |
|--|---------------|-----------------------|------------------|------------------|---|------------------|
| | 2017 Openings | Closings ¹ | October 29, 2017 | October 30, 2016 | October 29, 2017 | October 30, 2016 |
| Williams Sonoma | 234 | 1 (2) | 233 | 241 | 6,700 | 6,600 |
| Pottery Barn | 204 | 1 (3) | 202 | 202 | 13,900 | 13,800 |
| West Elm | 101 | 5 (1) | 105 | 97 | 13,100 | 13,300 |
| Pottery Barn Kids | 88 | | 88 | 89 | 7,400 | 7,500 |
| Rejuvenation | 8 | | 8 | 6 | 8,800 | 9,300 |
| Total | 635 | 7 (6) | 636 | 635 | 10,200 | 10,000 |
| Store selling square footage at period-end | | | | | 4,031,000 | 3,966,000 |
| Store leased square footage at period-end | | | | | 6,468,000 | 6,381,000 |

¹ Third quarter of fiscal 2017 closings include two Williams Sonoma, two Pottery Barn and one West Elm temporary closures in Puerto Rico and Florida due to hurricanes in these areas. These stores are expected to reopen during the fourth quarter of fiscal 2017.

COST OF GOODS SOLD

| | Thirteen Weeks Ended | | | | Thirty-nine Weeks Ended | | | |
|---------------------------------|----------------------|-------|------------------|-------|-------------------------|-------|------------------|-------|
| | October 29, 2017 | % Net | October 30, 2016 | % Net | October 29, 2017 | % Net | October 30, 2016 | % Net |
| <i>In thousands</i> | 2017 Revenues | | 2016 Revenues | | 2017 Revenues | | 2016 Revenues | |
| Cost of goods sold ¹ | \$ 832,269 | 64.1% | \$ 787,162 | 63.2% | \$ 2,326,911 | 64.4% | \$ 2,240,952 | 64.0% |

¹ Includes total occupancy expenses of \$171,161,000 and \$168,020,000 for the third quarter of fiscal 2017 and the third quarter of fiscal 2016, respectively, and \$507,013,000 and \$494,741,000 for year-to-date fiscal 2017 and year-to-date fiscal 2016, respectively.

Cost of goods sold includes cost of goods, occupancy expenses and shipping costs. Cost of goods consists of cost of merchandise, inbound freight expenses, freight-to-store expenses and other inventory related costs such as shrinkage, damages and replacements. Occupancy expenses consist of rent, depreciation and other occupancy costs, including common area maintenance, property taxes and utilities. Shipping costs consist of third-party delivery services and shipping materials.

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

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

Third Quarter of Fiscal 2017 vs. Third Quarter of Fiscal 2016

Cost of goods sold increased by \$45,107,000, or 5.7%, in the third quarter of fiscal 2017 compared to the third quarter of fiscal 2016. Cost of goods sold as a percentage of net revenues increased to 64.1% in the third quarter of fiscal 2017 from 63.2% in the third quarter of fiscal 2016. This increase was primarily driven by lower merchandise margins, higher shipping costs and reduced shipping income, partially offset by reduced fulfillment-related costs in our supply chain and the leverage of occupancy costs.

In the e-commerce channel, cost of goods sold as a percentage of net revenues increased in the third quarter of fiscal 2017 compared to the third quarter of fiscal 2016 driven by lower merchandise margins, higher shipping costs, and reduced shipping income, partially offset by reduced fulfillment-related costs in our supply chain and a reduction in occupancy costs.

In the retail channel, cost of goods sold as a percentage of net revenues increased in the third quarter of fiscal 2017 compared to the third quarter of fiscal 2016 primarily driven by lower selling margins.

Year-to-Date Fiscal 2017 vs. Year-to-Date Fiscal 2016

Cost of goods sold increased by \$85,959,000, or 3.8%, year-to-date fiscal 2017 compared to year-to-date fiscal 2016. Cost of goods sold as a percentage of net revenues increased to 64.4% year-to-date fiscal 2017 from 64.0% year-to-date fiscal 2016. This increase was driven by lower merchandise margins, reduced shipping income, and higher shipping costs, partially offset by reduced fulfillment-related costs in our supply chain.

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In the e-commerce channel, cost of goods sold as a percentage of net revenues increased year-to-date fiscal 2017 compared to year-to-date fiscal 2016 primarily driven by lower merchandise margins and reduced shipping income, partially offset by reduced fulfillment-related costs in our supply chain and a reduction in occupancy costs.

In the retail channel, cost of goods sold as a percentage of net revenues increased year-to-date fiscal 2017 compared to year-to-date fiscal 2016 primarily driven by higher occupancy costs to support our growth initiatives as well as lower selling margins.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

| | Thirteen Weeks Ended | | | | Thirty-nine Weeks Ended | | | |
|--|----------------------|-------|---------------|-------|-------------------------|-------|---------------|-------|
| | October 29, | % Net | October 30, | % Net | October 29, | % Net | October 30, | % Net |
| <i>In thousands</i> | 2017 Revenues | | 2016 Revenues | | 2017 Revenues | | 2016 Revenues | |
| Selling, general and administrative expenses | \$ 356,254 | 27.4% | \$ 348,244 | 28.0% | \$ 1,030,667 | 28.5% | \$ 1,004,499 | 28.7% |

Selling, general and administrative expenses consist of non-occupancy related costs associated with our retail stores, distribution and manufacturing facilities, customer care centers, supply chain operations (buying, receiving and inspection) and corporate administrative functions. These costs include employment, advertising, third-party credit card processing and other general expenses.

We experience differing employment and advertising costs as a percentage of net revenues within the retail and e-commerce channels due to their distinct distribution and marketing strategies. Employment costs represent a greater percentage of net revenues within the retail channel as compared to the e-commerce channel. However, advertising expenses are higher within the e-commerce channel than in the retail channel.

Third Quarter of Fiscal 2017 vs. Third Quarter of Fiscal 2016

Selling, general and administrative expenses increased by \$8,010,000, or 2.3%, in the third quarter of fiscal 2017 compared to the third quarter of fiscal 2016. Selling, general and administrative expenses as a percentage of net revenues decreased to 27.4% in the third quarter of fiscal 2017 compared to 28.0% in the third quarter of fiscal 2016. This decrease as a percentage of net revenues was primarily due to lower employment costs within the unallocated segment, partially offset by higher digital advertising costs resulting from our focus on new customer acquisition.

In the e-commerce channel, selling, general and administrative expenses as a percentage of net revenues increased in the third quarter of fiscal 2017 compared to the third quarter of fiscal 2016 primarily driven by higher digital advertising costs.

In the retail channel, selling, general and administrative expenses as a percentage of net revenues increased in the third quarter of fiscal 2017 compared to the third quarter of fiscal 2016 primarily driven by an increase in employment costs to support our growth initiatives.

Year-to-Date Fiscal 2017 vs. Year-to-Date Fiscal 2016

Selling, general and administrative expenses increased by \$26,168,000, or 2.6%, year-to-date fiscal 2017 compared to year-to-date fiscal 2016. Selling, general and administrative expenses as a percentage of net revenues decreased to

28.5% year-to-date fiscal 2017 compared to 28.7% year-to-date fiscal 2016. This decrease as a percentage of net revenues was primarily due to lower employment costs within the unallocated segment, partially offset by higher digital advertising costs resulting from our focus on new customer acquisition.

In the e-commerce channel, selling, general and administrative expenses as a percentage of net revenues increased year-to-date fiscal 2017 compared to year-to-date fiscal 2016 primarily driven by higher digital advertising costs, partially offset by the leverage of employment costs.

In the retail channel, selling, general and administrative expenses as a percentage of net revenues increased year-to-date fiscal 2017 compared to year-to-date fiscal 2016 primarily driven by an increase in employment costs to support our growth initiatives.

Table of Contents**INCOME TAXES**

The effective tax rate was 35.5% for year-to-date fiscal 2017 and 37.3% for year-to-date fiscal 2016. The year-over-year tax rate improvement was primarily driven by the overall mix and level of earnings, as well as the incremental benefits we are seeing from improved profitability across our international operations, which are taxed at a lower tax rate.

LIQUIDITY AND CAPITAL RESOURCES

As of October 29, 2017, we held \$90,779,000 in cash and cash equivalents, the majority of which was held in demand deposit accounts and money market funds, of which \$58,614,000 was held by our foreign subsidiaries. As is consistent within our industry, our cash balances are seasonal in nature, with the fourth quarter historically representing a significantly higher level of cash than other periods.

In fiscal 2017, we plan to use our cash resources to fund our inventory and inventory related purchases, advertising and marketing initiatives, property and equipment purchases, stock repurchases and dividend payments. In addition to our cash balances on hand, we have a \$500,000,000 unsecured revolving line of credit (credit facility) that may be used to borrow revolving loans or to request the issuance of letters of credit. We may, upon notice to the administrative agent, request existing or new lenders to increase the credit facility by up to \$250,000,000, at such lenders option, to provide for a total of \$750,000,000 of unsecured revolving credit. For year-to-date fiscal 2017, we borrowed \$170,000,000 under the credit facility, all of which was outstanding as of October 29, 2017. For year-to-date fiscal 2016, we borrowed \$125,000,000 under the credit facility, all of which was outstanding as of October 30, 2016. During the fourth quarter, we expect to amend and extend our credit facility and, in conjunction with the amendment, enter into a \$300,000,000 term loan.

As of October 29, 2017, issued but undrawn standby letters of credit totaling \$12,782,000 were outstanding under the credit facility. Additionally, as of October 29, 2017, we had three unsecured letter of credit reimbursement facilities for a total of \$70,000,000, of which \$8,392,000 was outstanding. These letter of credit facilities represent only a future commitment to fund inventory purchases to which we had not taken legal title. We are currently in compliance with all of our financial covenants under the credit facility and the three unsecured letter of credit reimbursement facilities and, based on our current projections, we expect to remain in compliance throughout the next 12 months. We believe our cash on hand, in addition to our available credit facilities, will provide adequate liquidity for our business operations over the next 12 months.

Cash Flows from Operating Activities

For year-to-date fiscal 2017, net cash provided by operating activities was \$112,930,000 compared to \$122,464,000 for year-to-date fiscal 2016. For year-to-date fiscal 2017, net cash provided by operating activities was primarily attributable to net earnings adjusted for non-cash items, partially offset by merchandise inventories. Net cash provided by operating activities decreased compared to year-to-date fiscal 2016 primarily due to an increase in merchandise inventories partially offset by a decrease in payments related to income taxes.

Cash Flows from Investing Activities

For year-to-date fiscal 2017, net cash used in investing activities was \$135,363,000 compared to \$126,799,000 for year-to-date fiscal 2016, and was primarily attributable to purchases of property and equipment. Net cash used in investing activities increased compared to year-to-date fiscal 2016 primarily due to an increase in purchases of property and equipment.

Cash Flows from Financing Activities

For year-to-date fiscal 2017, net cash used in financing activities was \$101,105,000 compared to \$111,238,000 for year-to-date fiscal 2016. For year-to-date fiscal 2017, net cash used in financing activities was primarily attributable to repurchases of common stock and the payment of dividends, partially offset by borrowings under our revolving line of credit. Net cash used in financing activities decreased compared to year-to-date fiscal 2016 primarily due an increase in borrowings under our revolving line of credit, partially offset by an increase in repurchases of common stock.

Stock Repurchase Program and Dividends

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

Critical Accounting Policies

Management's Discussion and Analysis of Financial Condition and Results of Operations is based on our Condensed Consolidated Financial Statements, which have been prepared in accordance with U.S. GAAP. The preparation of these Condensed Consolidated Financial Statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosures of contingent assets and liabilities. These estimates and assumptions are evaluated on an ongoing basis and are based on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results could differ significantly from these estimates. During the third quarter of fiscal 2017, there have been no significant changes to the critical accounting policies discussed in our Annual Report on Form 10-K for the fiscal year ended January 29, 2017.

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Seasonality

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Interest Rate Risk

Our revolving line of credit has a variable interest rate which, when drawn upon, subjects us to risks associated with changes in that interest rate. As of October 29, 2017, we had borrowings of \$170,000,000 outstanding under the credit facility. A hypothetical increase or decrease of one percentage point on our existing variable rate debt instrument would not materially affect our results of operations or cash flows.

In addition, we have fixed and variable income investments consisting of short-term investments classified as cash and cash equivalents, which are also affected by changes in market interest rates. As of October 29, 2017, our investments, made primarily in demand deposit accounts and money market funds, are stated at cost and approximate their fair values.

Foreign Currency Risks

We purchase a significant amount of inventory from vendors outside of the U.S. in transactions that are denominated in U.S. dollars. Approximately 1% of our international purchase transactions are in currencies other than the U.S. dollar, primarily the euro. Any foreign currency impact related to these international purchase transactions was not significant to us during the third quarter of fiscal 2017 or the third quarter of fiscal 2016. Since we pay for the majority of our international purchases in U.S. dollars, however, a decline in the U.S. dollar relative to other foreign currencies would subject us to risks associated with increased purchasing costs from our vendors in their effort to offset any lost profits associated with any currency devaluation. We cannot predict with certainty the effect these increased costs may have on our financial statements or results of operations.

In addition, our retail and/or e-commerce businesses in Canada, Australia and the United Kingdom, and our operations throughout Asia and Europe, expose us to market risk associated with foreign currency exchange rate fluctuations. Substantially all of our purchases and sales are denominated in U.S. dollars, which limits our exposure to this risk. However, some of our foreign operations have a functional currency other than the U.S. dollar. While the impact of foreign currency exchange rate fluctuations was not material to us in the third quarter of fiscal 2017 or the third quarter of fiscal 2016, we have continued to see volatility in the exchange rates in the countries in which we do business. As we continue to expand globally, the foreign currency exchange risk related to our foreign operations may increase. To mitigate this risk, we hedge a portion of our foreign currency exposure with foreign currency forward contracts in accordance with our risk management policies (see Note H to our Condensed Consolidated Financial

Statements).

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of October 29, 2017, an evaluation was performed by management, with the participation of our Chief Executive Officer (CEO) and our Chief Financial Officer (CFO), of the effectiveness of our disclosure controls and procedures. Based on that evaluation, our management, including our CEO and CFO, concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow for timely discussions regarding required disclosures, and that such information is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission.

Changes in Internal Control Over Financial Reporting

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

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PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

See Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended January 29, 2017 for a description of the risks and uncertainties associated with our business. There were no material changes to such risk factors in the current quarterly reporting period.

Table of Contents**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

The following table provides information as of October 29, 2017 with respect to shares of common stock we repurchased during the third quarter of fiscal 2017 under our \$500,000,000 stock repurchase authorization. For additional information, please see Note G to our Condensed Consolidated Financial Statements within Part I of this Form 10-Q.

| Fiscal period | | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares That May Yet Be Purchased | |
|--------------------|--------------------|--|---------------------------------|---|---|
| | | | | Shares Purchased as Part of a Publicly Announced Program | Maximum Dollar Value Under the Program |
| July 31, 2017 | August 27, 2017 | 651,169 | \$ 44.94 | 651,169 | \$ 287,953,000 |
| August 28, 2017 | September 24, 2017 | 357,462 | \$ 46.87 | 357,462 | \$ 271,200,000 |
| September 25, 2017 | October 29, 2017 | 292,742 | \$ 51.05 | 292,742 | \$ 256,257,000 |
| Total | | 1,301,373 | \$ 46.84 | 1,301,373 | \$ 256,257,000 |

¹ Excludes shares withheld for employee taxes upon vesting of stock-based awards.

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

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

Table of Contents**ITEM 6. EXHIBITS**

(a) Exhibits

Exhibit

| Number | Exhibit Description |
|----------|--|
| 10.1* | <u>Fourth Amendment to Reimbursement Agreement between Williams-Sonoma, Inc., Williams-Sonoma Singapore Pte. Ltd., and Bank of America, N.A., dated as of August 25, 2017</u> |
| 10.2* | <u>Fourth Amendment to Reimbursement Agreement between Williams-Sonoma, Inc., Williams-Sonoma Singapore Pte. Ltd., and Wells Fargo Bank, N.A., dated as of August 25, 2017</u> |
| 10.3* | <u>Fourth Amendment to Reimbursement Agreement between Williams-Sonoma, Inc., Williams-Sonoma Singapore Pte. Ltd., and U.S. Bank National Association, dated as of August 25, 2017</u> |
| 31.1* | <u>Certification of Chief Executive Officer, pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended</u> |
| 31.2* | <u>Certification of Chief Financial Officer, pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended</u> |
| 32.1* | <u>Certification of Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u> |
| 32.2* | <u>Certification of Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u> |
| 101.INS* | XBRL Instance Document |
| 101.SCH* | XBRL Taxonomy Extension Schema Document |
| 101.CAL* | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF* | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB* | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE* | XBRL Taxonomy Extension Presentation Linkbase Document |

* Filed herewith.

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SIGNATURE

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

WILLIAMS-SONOMA, INC.

By: /s/ Julie P. Whalen
Julie P. Whalen
Chief Financial Officer

Date: December 6, 2017