

WILLIAMS SONOMA INC  
Form 10-K  
April 04, 2019  
Table of Contents

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

**FORM 10-K**

(Mark One):

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

For the fiscal year ended February 3, 2019.

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-14077

**WILLIAMS-SONOMA, INC.**

(Exact name of registrant as specified in its charter)

|  |  |
|--|--|
| <b>Delaware</b><br>(State or other jurisdiction of<br>incorporation or organization)       | <b>94-2203880</b><br>(I.R.S. Employer<br>Identification No.) |
| <b>3250 Van Ness Avenue, San Francisco, CA</b><br>(Address of principal executive offices) | <b>94109</b><br>(Zip Code)                                   |
| Registrant's telephone number, including area code: (415) 421-7900                         |  |

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

|  |  |
|--|--|
| Common Stock, \$.01 par value<br>(Title of class)                | New York Stock Exchange, Inc.<br>(Name of each exchange on which registered) |
| Securities registered pursuant to Section 12(g) of the Act: None |  |

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

|                           |                         |                       |
|---------------------------|-------------------------|-----------------------|
| Large accelerated filer   | Accelerated filer       | Non-accelerated filer |
| Smaller reporting company | Emerging growth company |                       |

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

Edgar Filing: WILLIAMS SONOMA INC - Form 10-K

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

As of July 29, 2018, the approximate aggregate market value of the registrant's common stock held by non-affiliates was \$4,678,185,000. It is assumed for purposes of this computation that an affiliate includes all persons as of July 29, 2018 listed as executive officers and directors with the Securities and Exchange Commission. This aggregate market value includes all shares held in the Williams-Sonoma, Inc. Stock Fund within the registrant's 401(k) Plan.

As of March 31, 2019, 78,563,968 shares of the registrant's common stock were outstanding.

**Table of Contents**

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of our definitive Proxy Statement for the 2019 Annual Meeting of Stockholders, also referred to in this Annual Report on Form 10-K as our Proxy Statement, which will be filed with the Securities and Exchange Commission, or SEC, have been incorporated in Part III hereof.

**FORWARD-LOOKING STATEMENTS**

This Annual Report on Form 10-K and the letter to stockholders contained in this Annual Report contain forward-looking statements within the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 that involve risks and uncertainties, as well as assumptions that, if they do not fully materialize or prove incorrect, could cause our business and operating results to differ materially from those expressed or implied by such forward-looking statements. Such forward-looking statements include, without limitation, statements related to: projections of earnings, revenues, growth and other financial items; the strength of our business and our brands; our ability to execute strategic priorities and growth initiatives regarding digital leadership, product and technology innovation, cross-brand initiatives, retail transformation and operational excellence; our beliefs about our competitive advantages and areas of potential future growth in the market; our ability to drive long-term sustainable returns; the plans, strategies, initiatives and objectives of management for future operations; our brands, products and related initiatives, including our ability to introduce new brands, brand extensions, products and product lines and bring in new customers; our belief that our e-commerce websites and direct-mail catalogs act as a cost-efficient means of testing market acceptance of new products and new brands; the complementary nature of our e-commerce and retail channels; our marketing efforts; our acquisition of Outward, Inc., including the valuation of intangible assets acquired; our global business and expansion efforts, including franchise, other third-party arrangements and company-owned operations; our ability to attract new customers; the seasonal variations in demand; our ability to recruit, retain and motivate skilled personnel; our belief in the reasonableness of the steps taken to protect the security and confidentiality of the information we collect; our belief in the adequacy of our facilities and the availability of suitable additional or substitute space; our belief in the ultimate resolution of current legal proceedings; the payment of dividends; our stock repurchase program; our capital allocation strategy in fiscal 2019; our planned use of cash in fiscal 2019; our compliance with financial covenants; our belief that our cash on hand and available credit facilities will provide adequate liquidity for our business operations over the next 12 months; the impact of the 2017 Tax Cuts and Jobs Act; the impact of tariffs on our business and our results of operations; our belief regarding the effects of potential losses under our indemnification obligations; the impact of inflation; the effects of changes in our inventory reserves; the impact of new accounting pronouncements; and 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 will, may, should, expects, plans, anticipates, believes, estimates, predicts, intends, pote 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 Item 1A hereto 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.

**Table of Contents**

**WILLIAMS-SONOMA, INC.**

**ANNUAL REPORT ON FORM 10-K**

**FISCAL YEAR ENDED FEBRUARY 3, 2019**

**TABLE OF CONTENTS**

|   | <b>PAGE</b> |
|---|-------------|
| <b>PART I</b>   |             |
| Item 1. <u>Business</u>   | 3           |
| Item 1A. <u>Risk Factors</u>  | 6           |
| Item 1B. <u>Unresolved Staff Comments</u>   | 22          |
| Item 2. <u>Properties</u>   | 22          |
| Item 3. <u>Legal Proceedings</u>  | 23          |
| Item 4. <u>Mine Safety Disclosures</u>  | 23          |
| <b>PART II</b>  |             |
| Item 5. <u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | 24          |
| Item 6. <u>Selected Financial Data</u>  | 26          |
| Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                        | 27          |
| Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>  | 39          |
| Item 8. <u>Financial Statements and Supplementary Data</u>  | 40          |
| Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>                         | 67          |
| Item 9A. <u>Controls and Procedures</u>   | 67          |
| Item 9B. <u>Other Information</u>   | 68          |
| <b>PART III</b>   |             |
| Item 10. <u>Directors, Executive Officers and Corporate Governance</u>  | 69          |
| Item 11. <u>Executive Compensation</u>  | 69          |
| Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>              | 69          |
| Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>                                   | 69          |
| Item 14. <u>Principal Accountant Fees and Services</u>  | 69          |
| <b>PART IV</b>  |             |
| Item 15. <u>Exhibits and Financial Statement Schedules</u>  | 70          |
| Item 16. <u>Form 10-K Summary</u>   | 75          |

**Table of Contents**

**PART I**

**ITEM 1. BUSINESS  
OVERVIEW**

Williams-Sonoma, Inc., incorporated in 1973, is a multi-channel specialty retailer of high quality products for the home.

In 1956, our founder, Chuck Williams, turned a passion for cooking and eating with friends into a small business with a big idea. He opened a store in Sonoma, California, to sell the French cookware that intrigued him while visiting Europe but that could not be found in America. Chuck's business, which set a standard for customer service, took off and helped fuel a revolution in American cooking and entertaining that continues today.

In the decades that followed, the quality of our products, our ability to identify new opportunities in the market and our people-first approach to business have facilitated our expansion beyond the kitchen into nearly every area of the home. Growth across the Williams-Sonoma, Inc. portfolio has been fueled by three areas of strategic investment: brand experimentation and innovation, for a best-in-class approach to multi-channel retail experiences; operational excellence across the enterprise, from quality product and sourcing, to efficient manufacturing and supply chain; and culture and corporate social responsibility, from commitments to foster women in leadership and embrace diversity, to a healthy impact on our community and environment.

Today, Williams-Sonoma, Inc. is one of the United States' largest e-commerce retailers with some of the best known and most beloved brands in home furnishings. We operate in the U.S., Puerto Rico, Canada, Australia and the United Kingdom and offer international shipping to customers worldwide. Our unaffiliated franchisees operate stores in the Middle East, the Philippines, Mexico and South Korea, as well as e-commerce websites in certain locations.

*Williams Sonoma*

From the beginning, our namesake brand, Williams Sonoma, has been bringing people together around food. A leading specialty retailer of high-quality products for the kitchen and home, the brand seeks to provide world-class service and an engaging customer experience. Williams Sonoma products include everything for cooking, dining and entertaining, including: cookware, tools, electrics, cutlery, tabletop and bar, outdoor, furniture and a vast library of cookbooks. The brand also includes Williams Sonoma Home, a premium concept that offers classic home furnishings and decorative accessories, extending the Williams Sonoma lifestyle beyond the kitchen into every room of the home.

*Pottery Barn*

Established in 1949 and acquired by Williams-Sonoma, Inc. in 1986, Pottery Barn is a premier multi-channel home furnishings retailer. The brand was founded on the idea that home furnishings should be exceptional in comfort, quality, style and value. Pottery Barn's stores, website, and catalogs are specially designed to make shopping an enjoyable experience, with inspirational lifestyle displays dedicated to every space in the home. Pottery Barn products include furniture, bedding, bathroom accessories, rugs, curtains, lighting, tabletop, outdoor and decorative accessories.

*Pottery Barn Kids*

Launched in 1999, Pottery Barn Kids serves as an inspirational destination for creating childhood memories by decorating nurseries, bedrooms and play spaces. Pottery Barn Kids offers exclusive, innovative and high-quality products designed specifically for creating magical spaces where children can play, laugh, learn and grow.

*West Elm*

Born in Brooklyn in 2002, West Elm is dedicated to transforming people's lives and spaces through creativity, style and purpose. West Elm creates unique, modern and affordable home decor and curate a global selection of local, ethically-sourced and Fair Trade Certified products, available online and in our stores worldwide.

## **Table of Contents**

### *PBteen*

Launched in 2003, PBteen is the first home concept to focus exclusively on the teen market. The brand offers a complete line of furniture, bedding, lighting, decorative accents and more for teen bedrooms, dorm rooms, study spaces and lounges. PBteen's innovative products are specifically designed to help teens create a comfortable and stylish room that reflects their own individual aesthetic.

### *Rejuvenation*

Rejuvenation, founded in 1977 with a passion for timeless design and quality craftsmanship, was acquired by Williams-Sonoma, Inc. in 2011. With design, manufacturing and distribution facilities in Portland, Oregon, Rejuvenation offers a wide assortment of made-to-order lighting, hardware, furniture and home décor inspired by history, designed for today and made to last for years to come.

### *Mark and Graham*

Launched in 2012, Mark and Graham is designed to be a premier destination for personalized gift buying. With over 100 monograms and font types to choose from, a Mark and Graham purchase is uniquely personal. The brand's product lines include women's and men's accessories, small leather goods, jewelry, key item apparel, paper, entertaining and bar, home décor and seasonal items.

### *Outward*

In 2017, we acquired Outward, Inc., a 3-D imaging and augmented reality platform for the home furnishings and décor industry. Headquartered in San Jose, California, Outward's technology enables scalable applications in product visualization, digital room design and augmented and virtual reality.

## **E-COMMERCE OPERATIONS**

As of February 3, 2019, the e-commerce channel had 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. We offer shipping from many of our brands to countries worldwide, while our catalogs reach customers throughout the U.S. The e-commerce channel complements the retail channel by building brand awareness and acting as an effective advertising vehicle. In addition, we believe that our e-commerce websites and our direct-mail catalogs act as a cost-efficient means of testing market acceptance of new products and new brands. Leveraging these insights and our multi-channel positioning, our marketing efforts, including digital advertising and the circulation of catalogs, are targeted toward driving sales to each of our channels. Consistent with our published privacy policies, we send our catalogs to addresses from our proprietary customer list, as well as to addresses from lists of other mail order direct marketers, magazines and companies with which we establish a business relationship. In accordance with prevailing industry practice and our privacy policies, we may also rent our list to select mailers. Our customer mailings are continually updated to include new prospects and to eliminate non-responders.

Detailed financial information about the e-commerce channel is found in Note K to our Consolidated Financial Statements.

## **RETAIL STORES**



As of February 3, 2019, the retail channel had the following merchandise strategies: Williams Sonoma, Pottery Barn, Pottery Barn Kids, West Elm and Rejuvenation, which operate 625 stores, comprising 579 stores in 43 states, Washington, D.C. and Puerto Rico, 24 stores in Canada, 19 stores in Australia and 3 stores in the United Kingdom. We also have multi-year franchise agreements with third parties in the Middle East, the Philippines, Mexico and South Korea that currently operate 108 franchised stores as well as e-commerce websites in certain locations. The retail channel complements the e-commerce channel by building brand awareness and attracting new customers to our brands. Our retail stores serve as billboards for our brands, which we believe inspires our customers to also shop online and through our catalogs.

## **Table of Contents**

Detailed financial information about the retail channel is found in Note K to our Consolidated Financial Statements.

## **SUPPLIERS**

We purchase most of our merchandise from numerous foreign and domestic manufacturers and importers, the largest of which accounted for approximately 2% of our purchases during fiscal 2018. Approximately 66% of our merchandise purchases in fiscal 2018 were sourced from foreign vendors, predominantly in Asia and Europe. Substantially all of these purchases were negotiated and paid for in U.S. dollars. In addition, we manufacture merchandise, primarily upholstered furniture and lighting, at our facilities located in North Carolina, California, Oregon and Mississippi.

## **COMPETITION AND SEASONALITY**

The specialty e-commerce and retail businesses are highly competitive. Our specialty retail stores, e-commerce websites and direct-mail catalogs compete with other retailers, including large department stores, discount retailers, other specialty retailers offering home-centered assortments, other e-commerce websites and other direct-mail catalogs. The substantial sales growth in the direct-to-customer industry within the last decade, particularly in e-commerce, has encouraged the entry of many new competitors, including discount retailers selling similar products at reduced prices, new business models and an increase in competition from established companies. We compete on the basis of our brand authority, the quality of our merchandise, service to our customers, our proprietary customer list, our e-commerce websites and our marketing capabilities, as well as the location and appearance of our stores. We believe that we compare favorably with many of our current competitors with respect to some or all of these factors.

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.

## **EMPLOYEES**

As of February 3, 2019, we had approximately 28,200 employees, of whom approximately 11,400 were full-time. In preparation for and during our fiscal 2018 holiday selling season, we hired approximately 8,300 temporary employees primarily in our retail stores, customer care centers and distribution facilities.

## **INTELLECTUAL PROPERTY**

As of February 3, 2019, we own and/or have applied to register 146 separate trademarks and service marks. We own and/or have applied to register our key brand names as trademarks in the U.S. as well as 94 additional jurisdictions. Generally, exclusive rights to the trademarks and service marks are held by Williams-Sonoma, Inc. and are used by our subsidiaries and franchisees under a license. These marks include our core brand names as well as brand names for selected products and services. The core brand names in particular, including Williams Sonoma, Pottery Barn, pottery barn kids, PBteen, west elm, Williams Sonoma Home, Rejuvenation and Mark and Graham are of material importance to us. Trademarks are generally valid as long as they are in use and/or their registrations are properly maintained, and they have not been found to have become generic. Trademark registrations can generally be renewed indefinitely so long as the marks are in use. We also own numerous copyrights and trade dress rights for our products, product packaging, catalogs, books, house publications, website designs and store designs, among other things, which are used

by our subsidiaries and franchisees under a license. We hold patents on certain product functions, product designs and proprietary technology. Patents are generally valid for 14 to 20 years as long as their registrations are properly maintained. In addition, we have registered and maintain numerous Internet domain names, including williams-sonoma.com, potterybarn.com, potterybarnkids.com,

## **Table of Contents**

pbteen.com, westelm.com, wshome.com, williams-sonomainc.com, rejuvenation.com and markandgraham.com. Collectively, the trademarks, patents, copyrights, trade dress rights and domain names that we hold are of material importance to us.

## **AVAILABLE INFORMATION**

We file annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy and information statements and amendments to reports filed or furnished pursuant to Sections 13(a), 14 and 15(d) of the Securities Exchange Act of 1934, as amended. The SEC maintains a website at [www.sec.gov](http://www.sec.gov) that contains reports, proxy and information statements and other information regarding Williams-Sonoma, Inc. and other companies that file materials electronically with the SEC. Our annual reports, Forms 10-K, Forms 10-Q, Forms 8-K and proxy and information statements are also available, free of charge, on our website at [www.williams-sonomainc.com](http://www.williams-sonomainc.com).

Investors and others should note that we announce material financial and operational information to our investors using our Investor Relations website (<http://ir.williams-sonomainc.com>), press releases, SEC filings and public conference calls and webcasts. Information on our website is not, and will not be deemed, a part of this report or incorporated into any other filings we make with the SEC.

## **ITEM 1A. RISK FACTORS**

A description of the risks and uncertainties associated with our business is set forth below. You should carefully consider such risks and uncertainties, together with the other information contained in this report and in our other public filings. If any of such risks and uncertainties actually occurs, our business, financial condition or operating results could differ materially from the plans, projections and other forward-looking statements included in the section titled Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this report and in our other public filings. In addition, if any of the following risks and uncertainties, or if any other risks and uncertainties, actually occurs, our business, financial condition or operating results could be harmed substantially, which could cause the market price of our stock to decline, perhaps significantly.

*Declines in general economic conditions, and the resulting impact on consumer confidence and consumer spending, could adversely impact our results of operations.*

Our financial performance is subject to declines in general economic conditions and the impact of such economic conditions on levels of consumer confidence and consumer spending. Consumer confidence and consumer spending may deteriorate significantly, and could remain depressed for an extended period of time. Consumer purchases of discretionary items, including our merchandise, generally decline during periods when disposable income is limited, unemployment rates increase or there is economic uncertainty. An uncertain economic environment could also cause our vendors to go out of business or our banks to discontinue lending to us or our vendors, or it could cause us to undergo restructurings, any of which would adversely impact our business and operating results.

*We are unable to control many of the factors affecting consumer spending, and declines in consumer spending on home furnishings and kitchen products in general could reduce demand for our products.*

Our business depends on consumer demand for our products and, consequently, is sensitive to a number of factors that influence consumer spending, including general economic conditions, consumer disposable income, fuel prices, recession and fears of recession, unemployment, war and fears of war, inclement weather, availability of consumer credit, consumer debt levels, conditions in the housing market, interest rates, sales tax rates and rate increases,

inflation, consumer confidence in future economic and political conditions, and consumer perceptions of personal well-being and security. In particular, past economic downturns have led to decreased discretionary spending, which adversely impacted our business. In addition, periods of decreased home purchases typically lead to decreased consumer spending on home products. These factors have affected, and may in the future affect, our various brands and channels differently. Adverse changes in factors affecting discretionary consumer spending have reduced and may in the future reduce consumer demand for our products, thus reducing our sales and harming our business and operating results.

## Table of Contents

*If we are unable to identify and analyze factors affecting our business, anticipate changing consumer preferences and buying trends, and manage our inventory commensurate with customer demand, our sales levels and operating results may decline.*

Our success depends, in large part, upon our ability to identify and analyze factors affecting our business and to anticipate and respond in a timely manner to changing merchandise trends and customer demands in order to maintain and attract customers. For example, in the specialty home products business, style and color trends are constantly evolving. As a result, consumer preferences cannot be predicted with certainty and may change between selling seasons. We must be able to stay current with preferences and trends in our brands and address the customer tastes for each of our target customer demographics. Additionally, changes in customer preferences and buying trends may also affect our brands differently. We must also be able to identify and adjust the customer offerings in our brands to cater to customer demands. For example, a change in customer preferences for children's room furnishings may not correlate to a similar change in buying trends for other home furnishings. If we misjudge either the market for our merchandise or our customers' purchasing habits, our sales may decline significantly or may be delayed while we work to fill related backorders. Alternatively, we may be required to mark down certain products to sell any excess inventory or to sell such inventory through our outlet stores or other liquidation channels at prices which are significantly lower than our retail prices, any of which would negatively impact our business and operating results.

In addition, we must manage our inventory effectively and commensurate with customer demand. Much of our inventory is sourced from vendors located outside of the U.S. Thus, we usually must order merchandise, and enter into contracts for the purchase and manufacturing of such merchandise, up to twelve months and generally multiple seasons in advance of the applicable selling season and frequently before trends are known. The extended lead times for many of our purchases may make it difficult for us to respond rapidly to new or changing trends. Our vendors also may not have the capacity to handle our demands or may go out of business in times of economic crisis. In addition, the seasonal nature of the specialty home products business requires us to carry a significant amount of inventory prior to peak selling season. As a result, we are vulnerable to demand and pricing shifts and to misjudgments in the selection and timing of merchandise purchases. If we do not accurately predict our customers' preferences and acceptance levels of our products, our inventory levels will not be appropriate, and our business and operating results may be negatively impacted.

There is also increased focus, including by governmental and non-governmental organizations, investors, customers, consumers and other stakeholders, on sustainability matters. Our reputation could be damaged if we do not (or are perceived not to) act responsibly with respect to any sustainability matters, which could negatively impact our business and results of operations.

*We may be exposed to cybersecurity risks and costs associated with credit card fraud, identity theft and business interruption that could cause us to incur unexpected expenses and loss of revenue.*

A significant portion of our customer orders are placed through our e-commerce websites or through our customer care centers. In addition, a significant portion of sales made through our retail channel require the collection of certain customer data, such as credit card information. In order for our sales channels to function successfully, we, our banking and authorizations partners, and other parties involved in processing customer transactions must be able to transmit confidential information, including credit card information and other personal information of our customers, securely over public and private networks. Third parties may have or develop the technology or knowledge to breach, disable, disrupt or interfere with our systems or processes or those of our vendors. Although we take the security of our systems and the privacy of our customers' confidential information seriously, and we believe we take reasonable steps to protect the security and confidentiality of the information we collect, we cannot guarantee that our security measures will effectively prevent others from obtaining unauthorized access to our information and our customers

information. The techniques used to obtain unauthorized access to systems change frequently and are not often recognized until after they have been launched. Any person who circumvents our security measures could destroy or steal valuable information or disrupt our operations. Any security breach could cause consumers to lose confidence in the security of our information systems, including our e-commerce websites or stores, and choose not to purchase from us. Any

## Table of Contents

security breach could also expose us to risks of data loss, litigation, regulatory investigations and other significant liabilities. Such a breach could also seriously disrupt, slow or hinder our operations and harm our reputation and customer relationships, any of which could harm our business.

In addition, states and the federal government are increasingly enacting laws and regulations to protect consumers against identity theft, and in the future we may be subject to state or federal data privacy laws, such as the California Consumer Privacy Act of 2018 (the CCPA) that will become effective in 2020. As our business expands globally, we are subject to data privacy and other similar laws in various foreign jurisdictions, such as the European Union. If we are the target of a cybersecurity attack resulting in unauthorized disclosure of our customer data, we may be required to undertake costly notification procedures. In addition, compliance with these laws will likely increase the costs of doing business, especially if we face differing regulatory requirements across multiple jurisdictions and/or a lack of adequate regulatory guidance. If we fail to implement appropriate safeguards, detect and provide prompt notice of unauthorized access as required by some of these laws, or otherwise comply with these laws, we could be subject to potential fines, claims for damages and other remedies, which could be significantly in excess of our insurance coverage and could harm our business.

*If we are unable to effectively manage our e-commerce business and digital marketing efforts, our reputation and operating results may be harmed.*

Our e-commerce channel has been our fastest growing business over the last several years and represents more than half of our sales and profits. The success of our e-commerce business depends, in part, on third parties and factors over which we have limited control. We must continually respond to changing consumer preferences and buying trends relating to e-commerce usage, including an emphasis on mobile e-commerce. Our success in e-commerce has been strengthened in part by our ability to leverage the information we have on our customers to infer customer interests and affinities such that we can personalize the experience they have with us. We also utilize digital advertising to target internet and mobile users whose behavior indicates they might be interested in our products. Current or future legislation may reduce or restrict our ability to use these techniques, which could reduce the effectiveness of our marketing efforts.

We are also vulnerable to certain additional risks and uncertainties associated with our e-commerce and mobile websites and digital marketing efforts, including: changes in required technology interfaces; website downtime and other technical failures; internet connectivity issues; costs and technical issues as we upgrade our website software; computer viruses; vendor reliability; changes in applicable federal and state regulations, such as the CCPA, and related compliance costs; security breaches; and consumer privacy concerns. We must keep up to date with competitive technology trends and opportunities that are emerging throughout the retail environment, including the use of new or improved technology, evolving creative user interfaces, and other e-commerce marketing trends such as paid search, re-targeting, loyalty programs and the proliferation of mobile usage, among others. While we endeavor to predict and invest in technology that is most relevant and beneficial to our company, such as our recent acquisition of Outward, Inc., our initiatives may not prove to be successful, may increase our costs, or may not succeed in driving sales or attracting customers. Our failure to successfully respond to these risks and uncertainties might adversely affect the sales or margin in our e-commerce business, require us to impair certain assets, and damage our reputation and brands.

*Our dependence on foreign vendors and our increased global operations subject us to a variety of risks and uncertainties that could impact our operations and financial results.*

Approximately 66% of our merchandise purchases in fiscal 2018 were sourced from foreign vendors predominantly in Asia and Europe. Our dependence on foreign vendors means that we may be affected by changes in the value of the



U.S. dollar relative to other foreign currencies. For example, any upward valuation in the Chinese yuan, the euro, or any other foreign currency against the U.S. dollar may result in higher costs to us for those goods. Although substantially all of our foreign purchases of merchandise are negotiated and paid for in U.S. dollars, declines in foreign currencies and currency exchange rates might negatively affect the profitability and business prospects of one or more of our foreign vendors. This, in turn, might cause such foreign vendors to demand higher prices for merchandise in their effort to offset any lost profits associated with any currency devaluation, delay merchandise

**Table of Contents**

shipments to us, or discontinue selling to us, any of which could ultimately reduce our sales or increase our costs. In addition, the rising cost of labor in the countries in which our foreign vendors operate has resulted in increases in our costs of doing business. Any further increases in the cost of living in such countries may result in additional increases in our costs or in our foreign vendors going out of business.

We, and our foreign vendors, are also subject to other risks and uncertainties associated with changing economic and political conditions within and outside of the U.S. These risks and uncertainties include import duties and quotas, compliance with anti-dumping regulations, work stoppages, economic uncertainties and adverse economic conditions (including inflation and recession), government regulations, employment and labor matters, wars and fears of war, political unrest, natural disasters, public health issues, regulations to address climate change and other trade restrictions. We cannot predict whether any of the countries from which our raw materials or products are sourced, or in which our products are currently manufactured or may be manufactured in the future, will be subject to trade restrictions imposed by the U.S. or foreign governments, such as the tariffs recently levied by the U.S. against China, or the likelihood, type or effect of any such restrictions. Any event causing a disruption or delay of imports from foreign vendors, including labor disputes resulting in work disruption (such as the disruptions at the U.S. West Coast ports in early 2015), the imposition of additional import restrictions, restrictions on the transfer of funds and/or increased tariffs or quotas, or both, could increase the cost, reduce the supply of merchandise available to us, or result in excess inventory if merchandise is received after the planned or appropriate selling season, all of which could adversely affect our business, financial condition and operating results. Furthermore, some or all of our foreign vendors' operations may be adversely affected by political and financial instability resulting in the disruption of trade from exporting countries, restrictions on the transfer of funds and/or other trade disruptions. In addition, an economic downturn, or failure of foreign markets, may result in financial instabilities for our foreign vendors, which may cause our foreign vendors to decrease production, discontinue selling to us, or cease operations altogether. Our global operations in Asia, Australia and Europe could also be affected by changing economic and political conditions in foreign countries, such as the decision by British voters to exit the European Union, which could have a negative effect on our business, financial condition and operating results.

Although we continue to be focused on improving our global compliance program, there remains a risk that one or more of our foreign vendors will not adhere to our global compliance standards, such as fair labor standards and the prohibition of child labor. Non-governmental organizations might attempt to create an unfavorable impression of our sourcing practices or the practices of some of our foreign vendors that could harm our image. If either of these events occurs, we could lose customer goodwill and favorable brand recognition, which could negatively affect our business and operating results.

*We depend on foreign vendors and third-party agents for timely and effective sourcing of our merchandise, and we may not be able to acquire products in sufficient quantities and at acceptable prices to meet our needs, which would impact our operations and financial results.*

Our performance depends, in part, on our ability to purchase our merchandise in sufficient quantities at competitive prices. We purchase our merchandise from numerous foreign and domestic manufacturers and importers. We generally have no contractual assurances of continued supply, pricing or access to new products, and any vendor could change the terms upon which it sells to us, discontinue selling to us, or go out of business at any time. We may not be able to acquire desired merchandise in sufficient quantities on terms acceptable to us. Better than expected sales demand may also lead to customer backorders and lower in-stock positions of our merchandise, which could negatively affect our business and operating results. In addition, our vendors may have difficulty adjusting to our changing demands and growing business.

Any inability to acquire suitable merchandise on acceptable terms or the loss of one or more of our foreign vendors or third-party agents could have a negative effect on our business and operating results because we would be missing products that we felt were important to our assortment, unless and until alternative supply arrangements are secured. We may not be able to develop relationships with new vendors or third-party agents, and products from alternative sources, if any, may be of a lesser quality and/or more expensive than those we currently purchase.

## Table of Contents

In addition, we are subject to certain risks that could limit our vendors' ability to provide us with quality merchandise on a timely basis and at prices that are commercially acceptable, including risks related to the availability of raw materials, labor disputes, work disruptions or stoppages, union organizing activities, vendor financial liquidity, inclement weather, natural disasters, public health issues, general economic and political conditions and regulations to address climate change.

*If our vendors fail to adhere to our quality control standards, we may delay a product launch or recall a product, which could damage our reputation and negatively affect our operations and financial results.*

Our vendors might not adhere to our quality control standards, and we might not identify the deficiency before merchandise ships to our stores or customers. Our vendors' failure to manufacture or import quality merchandise in a timely and effective manner could damage our reputation and brands, and could lead to an increase in customer complaints and litigation against us and an increase in our routine insurance and litigation costs. Further, any merchandise that we receive, even if it meets our quality standards, could become subject to a recall, which could damage our reputation and brands, and harm our business. Additionally, changes to the legislative or regulatory framework regarding product safety or quality may subject companies like ours to more product recalls and result in higher recall-related expenses. Any recalls or other safety issues could harm our brands' images and negatively affect our business and operating results.

*Our efforts to expand globally may not be successful and could negatively impact the value of our brands.*

We are currently growing our business and increasing our global presence by opening new stores outside of the U.S., expanding our franchise operations, and offering shipping globally through third-party vendors. In fiscal 2013, we opened our first company-owned retail stores and launched e-commerce websites outside of North America as part of our overall global expansion strategy. While our global expansion to date has been a small part of our business, we plan to continue to increase the number of stores we open both directly and through our franchise arrangements. We have limited experience with global sales, understanding consumer preferences and anticipating buying trends in different countries, and marketing to customers overseas. Moreover, global awareness of our brands and our products may not be high. Consequently, we may not be able to successfully compete with established brands in these markets and our global sales may not result in the revenues we anticipate. Also, our products may not be accepted, either due to foreign legal requirements or due to different consumer tastes and trends. If our global growth initiatives are not successful, or if we or any of our third-party vendors fail to comply with any applicable regulations or laws, we may be forced to close stores or cease operations in certain countries, which may result in significant financial harm, the value of our brands may be harmed and our future opportunities for global growth may be negatively affected. Further, the administration of our global expansion may divert management attention and require more resources than we expect. In addition, we are exposed to foreign currency exchange rate risk with respect to our operations denominated in currencies other than the U.S. dollar. Our retail stores 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. Although we use instruments to hedge certain foreign currency risks, such hedges may not succeed in offsetting all of the impact of foreign currency rate volatility and generally only delay such impact on our business and financial results. Further, because we do not hedge against all of our foreign currency exposure, our business will continue to be susceptible to foreign currency fluctuations. Our ultimate realized gain or loss with respect to currency fluctuations will generally depend on the size and type of the transactions that we enter into, the currency exchange rates associated with these exposures, changes in those rates and whether we have entered into foreign currency hedge contracts to offset these exposures. All of these factors could materially impact our results of operations, financial position and cash flows.

We have unaffiliated franchisees that operate stores in the Middle East, the Philippines, Mexico and South Korea, as well as e-commerce websites in certain locations. Under these agreements, our franchisees operate stores and/or e-commerce websites that sell goods purchased from us under our brand names. We continue to expand our franchise operations with our existing franchisees as well as seek to identify new franchise partnerships for select countries. The effect of these franchise arrangements on our business and results of

---

**Table of Contents**

operations is uncertain and will depend upon various factors, including the demand for our products in new global markets. In addition, certain aspects of our franchise arrangements are not directly within our control, such as the ability of each franchisee to meet its projections regarding store openings and sales, and the impact of exchange rate fluctuations on their business. Moreover, while the agreements we have entered into may provide us with certain termination rights, to the extent that our franchisees do not operate their stores in a manner consistent with our requirements regarding our brand identities and customer experience standards, the value of our brands could be impaired. In addition, in connection with these franchise arrangements, we have and will continue to implement certain new processes that may subject us to additional regulations and laws, such as U.S. export regulations. Failure to comply with any applicable regulations or laws could have an adverse effect on our results of operations.

*We have limited experience operating on a global basis and our failure to effectively manage the risks and challenges inherent in a global business could adversely affect our business, operating results and financial condition and growth prospects.*

We operate several retail businesses, subsidiaries and branch offices throughout Asia, Australia and Europe, which includes managing overseas employees, and may expand these overseas operations in the future. We have limited experience operating overseas subsidiaries and managing non-U.S. employees and, as a result, may encounter cultural challenges with local practices and customs that may result in harm to our reputation and the value of our brands. Our global presence exposes us to the laws and regulations of these jurisdictions, including those related to marketing, privacy, data protection, employment and product safety and testing. We may be unable to keep current with government requirements as they change from time to time. Our failure to comply with such laws and regulations may harm our reputation, adversely affect our future opportunities for growth and expansion in these countries, and harm our business and operating results.

Moreover, our global operations subject us to a variety of risks and challenges, including:

- increased management, infrastructure and legal compliance costs, including the cost of real estate and labor in those markets;
- increased financial accounting and reporting requirements and complexities;
- increased operational and tax complexities, including managing our inventory globally;
- the diversion of management attention away from our core business;
- general economic conditions, changes in diplomatic and trade relationships and political and social instability in each country or region;
- economic uncertainty around the world;
- compliance with foreign laws and regulations and the risks and costs of non-compliance with such laws and regulations;
- compliance with U.S. laws and regulations for foreign operations;
- dependence on certain third parties, including vendors and other service providers, with whom we do not have extensive experience;
- fluctuations in foreign currency exchange rates and the related effect on our financial results, and the use of foreign exchange hedging programs to mitigate such risks;
- growing cash balances in foreign jurisdictions which may be subject to repatriation restrictions;
- reduced or varied protection for intellectual property rights in some countries and practical difficulties of enforcing such rights abroad; and
- compliance with the laws of foreign taxing jurisdictions and the overlapping of different tax regimes.

Any of these risks could adversely affect our global operations, reduce our revenues or increase our operating costs, which in turn could adversely affect our business, operating results, financial condition and growth prospects. Some of our vendors and our franchisees also have global operations and are subject to the risks described above. Even if we are able to successfully manage the risks of our global operations, our business may be adversely affected if our vendors and franchisees are not able to successfully manage these risks.

In addition, as we continue to expand our global operations, we are subject to certain U.S. laws, including the Foreign Corrupt Practices Act, in addition to the laws of the foreign countries in which we operate. We must

## Table of Contents

ensure that our employees and third-party agents comply with these laws. If any of our overseas operations, or our employees or third-party agents, violates such laws, we could become subject to sanctions or other penalties that could negatively affect our reputation, business and operating results.

*A number of factors that affect our ability to successfully open new stores or close existing stores are beyond our control, and these factors may harm our ability to expand or contract our retail operations and harm our ability to increase our sales and profits.*

Approximately 45.7% of our net revenues are generated by our retail stores. Our ability to open additional stores or close existing stores successfully will depend upon a number of factors, including:

- general economic conditions;
- our identification of, and the availability of, suitable store locations;
- our success in negotiating new leases and amending, subleasing or terminating existing leases on acceptable terms;
- the success of other retail stores in and around our retail locations;
- our ability to secure required governmental permits and approvals;
- our hiring and training of skilled store operating personnel, especially management;
- the availability of financing on acceptable terms, if at all; and
- the financial stability of our landlords and potential landlords.

Many of these factors are beyond our control. For example, for the purpose of identifying suitable store locations, we rely, in part, on demographic surveys regarding the location of consumers in our target market segments. While we believe that the surveys and other relevant information are helpful indicators of suitable store locations, we recognize that these information sources cannot predict future consumer preferences and buying trends with complete accuracy. In addition, changes in demographics, in consumer shopping patterns, such as a reduction in mall traffic, in the types of merchandise that we sell and in the pricing of our products, may reduce the number of suitable store locations or cause formerly suitable locations to become less desirable. Further, time frames for lease negotiations and store development vary from location to location and can be subject to unforeseen delays or unexpected cancellations. We may not be able to open new stores or, if opened, operate those stores profitably. Construction and other delays in store openings could have a negative impact on our business and operating results. Additionally, we may not be able to renegotiate the terms of our current leases or close our underperforming stores on terms favorable to us, any of which could negatively impact our operating results.

*Our sales may be negatively impacted by increasing competition from companies with brands or products similar to ours.*

The specialty e-commerce and retail businesses are highly competitive. We compete with other retailers that market lines of merchandise similar to ours. We compete with national, regional and local businesses that utilize a similar retail store strategy, as well as traditional furniture stores, department stores, direct-to-consumer businesses and specialty stores. The substantial sales growth in the e-commerce industry within the last decade has encouraged the entry of many new competitors, including discount retailers selling similar products at reduced prices, new business models, and an increase in competition from established companies, many of whom are willing to spend significant funds and/or reduce pricing in order to gain market share.

The competitive challenges facing us include:



anticipating and quickly responding to changing consumer demands or preferences better than our competitors;  
maintaining favorable brand recognition and achieving customer perception of value;  
effectively marketing and competitively pricing our products to consumers in several diverse market segments;  
effectively managing and controlling our costs;  
effectively managing increasingly competitive promotional activity;  
effectively attracting new customers;

## Table of Contents

developing new innovative shopping experiences, like mobile and tablet applications that effectively engage today's digital customers;  
developing innovative, high-quality products in colors and styles that appeal to consumers of varying age groups, tastes and regions, and in ways that favorably distinguish us from our competitors; and  
effectively managing our supply chain and distribution strategies in order to provide our products to our consumers on a timely basis and minimize returns, replacements and damaged products.

In light of the many competitive challenges facing us, we may not be able to compete successfully. Increased competition could reduce our sales and harm our operating results and business.

*Our business and operating results may be harmed if we are unable to timely and effectively deliver merchandise to our stores and customers.*

If we are unable to effectively manage our inventory levels and responsiveness of our supply chain, including predicting the appropriate levels and type of inventory to stock within each of our distribution facilities, our business and operating results may be harmed. We continue to insource furniture delivery hubs in certain geographies and continue with the regionalization of our retail and e-commerce fulfillment capabilities. We are subject to risks that may disrupt our supply chain operations or regionalization efforts, such as increasing labor costs, union organizing activity and our ability to effectively locate real estate for our distribution facilities or other supply chain operations.

Further, we cannot control all of the various factors that might affect our e-commerce fulfillment rates and timely and effective merchandise delivery to our stores. We rely upon third-party carriers for our merchandise shipments and reliable data regarding the timing of those shipments, including shipments to our customers and to and from our stores. In addition, we are heavily dependent upon two carriers for the delivery of our merchandise to our customers. As a result of our dependence on all of these third-party providers, we are subject to risks, including labor disputes (such as the disruptions at the U.S. West Coast ports in early 2015), union organizing activity, inclement weather, natural disasters, the closure of such carriers' offices or a reduction in operational hours due to an economic slowdown or the inability to sufficiently ramp up operational hours during an economic recovery or upturn, availability of adequate trucking or railway providers, possible acts of terrorism or other factors affecting such carriers' ability to provide delivery services to meet our shipping needs, disruptions or increased fuel costs and costs associated with any regulations to address climate change. Failure to deliver merchandise in a timely and effective manner could damage our reputation and brands. In addition, fuel costs have been volatile and airline and other transportation companies continue to struggle to operate profitably, which could lead to increased fulfillment expenses. Any rise in fulfillment expenses could negatively affect our business and operating results.

*Our failure to successfully manage our order-taking and fulfillment operations could have a negative impact on our business and operating results.*

Our e-commerce business depends, in part, on our ability to maintain efficient and uninterrupted order-taking and fulfillment operations in our distribution facilities, our customer care centers and on our e-commerce websites. Disruptions or slowdowns in these areas could result from disruptions in telephone or network services, power outages, inadequate system capacity, system hardware or software issues, computer viruses, security breaches, human error, changes in programming, union organizing activity, insufficient or inadequate labor to fulfill the orders, disruptions in our third-party labor contracts, inefficiencies due to inventory levels and limited distribution facility space, issues with third-party order fulfillment and dropshipping, natural disasters or adverse weather conditions. Industries that are particularly seasonal, such as the home furnishings business, face a higher risk of harm from operational disruptions during peak sales seasons. These problems could result in a reduction in sales as well as increased expenses.

In addition, we face the risk that we cannot hire enough qualified employees to support our e-commerce operations, or that there will be a disruption in the workforce we hire from our third-party providers, especially during our peak season. The need to operate with fewer employees could negatively impact our customer service levels and our operations.

**Table of Contents**

*Our facilities and systems, as well as those of our vendors, are vulnerable to natural disasters and other unexpected events, any of which could result in an interruption in our business and harm our operating results.*

Our retail stores, corporate offices, distribution and manufacturing facilities, infrastructure and e-commerce operations, as well as the operations of our vendors from which we receive goods and services, are vulnerable to damage from earthquakes, tornadoes, hurricanes, fires, floods or other volatile weather, power losses, telecommunications failures, hardware and software failures, computer viruses and similar events. If any of these events result in damage to our facilities or systems, or those of our vendors, we may experience interruptions in our business until the damage is repaired, resulting in the potential loss of customers and revenues. In addition, we may incur costs in repairing any damage beyond our applicable insurance coverage.

*Our failure to successfully manage the costs and performance of our catalog mailings might have a negative impact on our business.*

Catalog mailings are an important component of our business. Postal rate increases affect the cost of our catalog mailings. We rely on discounts from the basic postal rate structure, which could be changed or discontinued at any time. Further, the U.S. Postal Service may raise rates in the future, which could negatively impact our business. The cost of paper, printing and catalog distribution also impacts our catalog business. We have consolidated all of our catalog printing work with one printer. Our dependence on one vendor subjects us to various risks if the vendor fails to perform under our agreement. Paper costs have also fluctuated significantly in the past and may continue to fluctuate in the future. We have also recently consolidated all of our paper purchasing through a single broker. Consolidation within the paper industry has reduced the number of potential suppliers capable of meeting our paper requirements, leading to increased costs. Our dependence on a single broker and/or further consolidation in the paper industry could limit our ability in the future to obtain favorable terms including price, custom paper quality, paper quantity and service. Future increases in postal rates, paper costs or printing costs could have a negative impact on our operating results to the extent that we are unable to offset such increases by raising prices, implementing more efficient printing, mailing, delivery and order fulfillment systems, or through the use of alternative direct-mail formats. In addition, if the performance of our catalogs declines, if we misjudge the correlation between our catalog circulation and net sales, or if our catalog strategy overall does not continue to be successful, our results of operations could be negatively impacted.

We have historically experienced fluctuations in our customers' response to our catalogs. Customer response to our catalogs is substantially dependent on merchandise assortment, merchandise availability and creative presentation, as well as the selection of customers to whom the catalogs are mailed, changes in mailing strategies, the size of our mailings, timing of delivery of our mailings, as well as the general retail sales environment and current domestic and global economic conditions. In addition, environmental organizations and other consumer advocacy groups may attempt to create an unfavorable impression of our paper use in catalogs and our distribution of catalogs generally, which may have a negative effect on our sales and our reputation. Further, we depend upon external vendors to print and mail our catalogs. The failure to effectively produce or distribute our catalogs could affect the timing of catalog delivery. The timing of catalog delivery has been and can be affected by postal service delays and may be impacted in the future by changes in the services provided by the post office. Any delays in the timing of catalog delivery could cause customers to forego or defer purchases, negatively impacting our business and operating results.

*Declines in our comparable brand revenues may harm our operating results and cause a decline in the market price of our common stock.*

Various factors affect comparable brand revenues, including the number, size and location of stores we open, close, remodel or expand in any period, the overall economic and general retail sales environment, consumer preferences and

buying trends, changes in sales mix among distribution channels, our ability to efficiently source and distribute products, changes in our merchandise mix, competition (including competitive promotional activity and discount retailers), current local and global economic conditions, the timing of our releases of new merchandise and promotional events, the success of marketing programs, the cannibalization of existing store sales by our new stores, changes in catalog circulation and in our e-commerce business and fluctuations in

**Table of Contents**

foreign exchange rates. Among other things, weather conditions have affected, and may continue to affect, comparable brand revenues by limiting our ability to deliver our products to our stores, altering consumer behavior, or requiring us to close certain stores temporarily, thus reducing store traffic. Even if stores are not closed, many customers may decide to avoid going to stores in bad weather. These factors have caused, and may continue to cause, our comparable brand revenue results to differ materially from prior periods and from earnings guidance we have provided. For example, the overall economic and general retail sales environment, as well as local and global economic conditions, has caused a significant decline in our comparable brand revenue results in the past.

Our comparable brand revenues have fluctuated significantly in the past on an annual, quarterly and monthly basis, and we expect that comparable brand revenues will continue to fluctuate in the future. In addition, past comparable brand revenues are not necessarily an indication of future results and comparable brand revenues may decrease in the future. Our ability to improve our comparable brand revenue results depends, in large part, on maintaining and improving our forecasting of customer demand and buying trends, selecting effective marketing techniques, effectively driving traffic to our stores, e-commerce websites and direct-mail catalogs through marketing and various promotional events, providing an appropriate mix of merchandise for our broad and diverse customer base and using effective pricing strategies. Any failure to meet the comparable brand revenue expectations of investors and securities analysts in one or more future periods could significantly reduce the market price of our common stock.

*Our failure to successfully anticipate merchandise returns might have a negative impact on our business.*

We record a reserve for merchandise returns based on historical return trends together with current product sales performance in each reporting period. If actual returns are greater than those projected and reserved for by management, additional sales returns might be recorded in the future. In addition, to the extent that returned merchandise is damaged, we often do not receive full retail value from the resale or liquidation of the merchandise. Further, the introduction of new merchandise, changes in merchandise mix, changes in consumer confidence, or other competitive and general economic conditions may cause actual returns to differ from merchandise return reserves. Any significant increase in merchandise returns that exceeds our reserves could harm our business and operating results.

*If we are unable to successfully manage the complexities associated with a multi-channel and multi-brand business, we may suffer declines in our existing business and our ability to attract new business.*

With the expansion of our e-commerce business, the development of new brands, acquired brands, and brand extensions, our overall business has become substantially more complex. The changes in our business have forced us to develop new expertise and face new challenges, risks and uncertainties. For example, we face the risk that our e-commerce business, including our catalog circulation, might cannibalize a significant portion of our retail sales or our newer brands, brand extensions and products may result in a decrease in sales of existing brands and products. While we recognize that our e-commerce sales and sales from new brands and products cannot be entirely incremental to sales through our retail channel or from existing brands and products, respectively, we seek to attract as many new customers as possible with the most relevant channels, brands and products to meet customer needs and grow our market share. We continually analyze the business results of our channels, brands and products in an effort to find opportunities to build incremental sales.

*If we are unable to introduce new brands and brand extensions successfully, or to reposition or close existing brands, our business and operating results may be negatively impacted.*

We have in the past and may in the future introduce new brands and brand extensions, reposition brands, close existing brands, or acquire new brands, especially as we continue to expand globally. Our newest brands and brand

extensions Williams Sonoma Home and Mark and Graham, and any other new brands, as well as our acquired brand, Rejuvenation, as well as our expansion into new lines of business, including our recently acquired business, Outward, our new business to business division, which targets commercial businesses across a number of verticals, including commercial furniture and hospitality, and our planned subscription-based services,

---

**Table of Contents**

may not grow as expected. The work involved with integrating new brands or businesses into our existing systems and operations could be time consuming, require significant amounts of management time and result in the diversion of substantial operational resources. Further, if we devote time and resources to new brands, acquired brands, brand extensions, brand repositioning, or new lines of business and those businesses are not as successful as we planned, then we risk damaging our overall business results or incurring impairment charges to write off any existing goodwill or intangible assets associated with previously acquired brands. As a result, we may not be able to introduce new brands in a manner that improves our overall business and/or operating results and may therefore be forced to close the brands or new lines of business, which may damage our reputation and/or negatively impact our operating results.

*We must protect and maintain our brand image and reputation.*

Our brands have wide recognition, and our success has been due in large part to our ability to maintain, enhance and protect our brand image and reputation and our customers' connection to our brands. Our continued success depends in part on our ability to adapt to a rapidly changing media environment, including our increasing reliance on social media and online dissemination of advertising campaigns. Even if we react appropriately to negative posts or comments about us and/or our brands on social media and online, our customers' perception of our brand image and our reputation could be negatively impacted. In addition, customer sentiment could be shaped by our sustainability policies and related design, sourcing and operations decisions. Failure to maintain, enhance and protect our brand image could have a material adverse effect on our results of operations.

*Any significant changes in tax, trade or other policies in the U.S. or other countries, including policies that restrict imports or increase import tariffs, could have a material adverse effect on our results of operations.*

A significant portion of our products are manufactured outside of the U.S. While the U.S. Tax Cuts and Jobs Act (the Tax Act), enacted on December 22, 2017, has not had an adverse effect on our results of operations and is not expected to have an adverse effect on our results of operations going forward, significant changes in tax, trade or other policies either in the U.S. or other countries could significantly increase our tax burden or costs of goods sold. These changes in policies may also require us to increase our prices, which could adversely affect our sales.

*Recent tariffs could result in increased prices and/or costs of goods or delays in product received from our vendors and could adversely affect our results of operations.*

Recently, the U.S. administration has enacted certain tariffs and proposed additional tariffs on many items sourced from China, including certain furniture, accessories, furniture parts, and raw materials for domestic furniture manufacturing products imported into the U.S. We may not be able to fully or substantially mitigate the impact of these tariffs, pass price increases on to our customers, or secure adequate alternative sources of products or materials. The tariffs, along with any additional tariffs or retaliatory trade restrictions implemented by other countries, could adversely affect customer sales, including potential delays in product received from our vendors, our cost of goods sold and results of operations.

*Fluctuations in our tax obligations and effective tax rate may result in volatility of our operating results.*

We are subject to income taxes in many U.S. and certain foreign jurisdictions. Our provision for income taxes is subject to volatility and could be adversely impacted by a number of factors that require significant judgment and estimation. Although we believe our estimates are reasonable, actual results may differ materially from our estimates and adversely affect our financial condition or operating results. We record income tax expense based on our estimates of future payments, which include reserves for our estimates of the additional income tax liability that is more likely than not to result from the ultimate resolution of foreign and domestic tax examinations. At any one time, many tax



years are subject to examination by various taxing jurisdictions. The results of these audits and negotiations with taxing authorities may affect the ultimate settlement of these issues. As a result, we expect that throughout the year there could be ongoing variability in our quarterly and annual effective tax rates as taxable events occur and uncertain tax positions are either evaluated or resolved.

## Table of Contents

In addition, our effective tax rate in a given financial statement period may be materially impacted by changes in the mix and level of earnings or losses in countries with differing statutory tax rates or by changes to existing laws or regulations. For example, the Tax Act has not had an adverse effect on our results of operations and is not expected to have an adverse effect on our results of operations going forward, but it will materially impact our effective tax rate.

*Our inability to obtain commercial insurance at acceptable rates or our failure to adequately reserve for self-insured exposures might increase our expenses and have a negative impact on our business.*

We believe that commercial insurance coverage is prudent in certain areas of our business for risk management. Insurance costs may increase substantially in the future and may be affected by natural disasters, fear of terrorism, financial irregularities, cybersecurity breaches and other fraud at publicly-traded companies, intervention by the government, an increase in the number of claims received by the carriers, and a decrease in the number of insurance carriers. In addition, the carriers with which we hold our policies may go out of business or be otherwise unable to fulfill their contractual obligations, or may disagree with our interpretation of the coverage or the amounts owed. In addition, for certain types or levels of risk, such as risks associated with certain natural disasters or terrorist attacks, we may determine that we cannot obtain commercial insurance at acceptable rates, if at all. Therefore, we may choose to forego or limit our purchase of relevant commercial insurance, choosing instead to self-insure one or more types or levels of risks. We are primarily self-insured for workers' compensation, employment practices liability, employee health benefits, product and other general liability claims, among others. If we suffer a substantial loss that is not covered by commercial insurance or our self-insurance reserves, the loss and related expenses could harm our business and operating results. In addition, exposures exist for which no insurance may be available and for which we have not reserved.

*Our inability or failure to protect our intellectual property would have a negative impact on our brands, reputation and operating results.*

We may not be able to effectively protect our intellectual property in the U.S. or in foreign jurisdictions, particularly as we continue to expand globally. Our trademarks, service marks, copyrights, trade dress rights, trade secrets, domain names, patents, designs and other intellectual property are valuable assets that are critical to our success. The unauthorized reproduction, theft or other misappropriation of our intellectual property could diminish the value of our brands or reputation and cause a decline in our sales. Protection of our intellectual property and maintenance of distinct branding are particularly important as they distinguish our products and services from our competitors. In addition, the costs of developing and protecting our growing intellectual property portfolio may adversely affect our operating results.

*We may be subject to legal proceedings that could result in costly litigation, require significant amounts of management time and result in the diversion of significant operational resources.*

We are involved in lawsuits, claims and proceedings incident to the ordinary course of our business. Litigation is inherently unpredictable. 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. There has been a rise in the number of lawsuits against companies like us that gather information in order to market to consumers online or through the mail and, along with other retailers, we have been named in lawsuits for gathering zip code information from our customers. We believe that we have meritorious defenses against these actions, and we will continue to vigorously defend against them. There have also been a growing number of consumer protection, data breach, and e-commerce-related patent infringement in recent years. From time to time, we have been subject to these types of lawsuits. The cost of defending against these types of claims against us or the ultimate resolution of any such claims, whether by settlement or adverse court decision, may harm our business and operating results. In addition, the

increasingly regulated business environment may result in a greater number of enforcement actions and private litigation. This could subject us to increased exposure to stockholder lawsuits. Additionally, in recent years there has been an increase in the number of employment claims and, in particular, discrimination and harassment claims. Coupled with the expansion of social media

## Table of Contents

platforms and similar devices that allow individuals access to a broad audience, these claims have had a significant negative impact on some businesses. Certain companies that have faced employment- or harassment-related lawsuits have had to terminate management or other key personnel, and have suffered reputational harm that has negatively impacted their business.

*Our operating results may be harmed by unsuccessful management of our employment, occupancy and other operating costs, and the operation and growth of our business may be harmed if we are unable to attract qualified personnel.*

To be successful, we need to manage our operating costs and continue to look for opportunities to reduce costs. We recognize that we may need to increase the number of our employees, especially during holiday selling seasons, and incur other expenses to support new brands and brand extensions and the growth of our existing brands, including the opening of new stores. In addition, the market for prime real estate is competitive, especially in San Francisco where our corporate offices are headquartered. If we are unable to make substantial adjustments to our cost structure during times of uncertainty, such as an economic downturn or during times of expansion, we may incur unnecessary expense or we may have inadequate resources to properly run our business, and our business and operating results may be negatively impacted. From time to time, we may also experience union organizing activity in currently non-union facilities, including in our stores and distribution facilities. Union organizing activity may result in work slowdowns or stoppages and higher labor costs. In addition, there appears to be a growing number of wage-and-hour lawsuits and other employment-related lawsuits against retail companies, especially in California. State, federal and global laws and regulations regarding employment change frequently and the ultimate cost of compliance cannot be precisely estimated. Further, there have been and may continue to be increases in minimum wage and health care requirements. Any changes in regulations, the imposition of additional regulations, or the enactment of any new or more stringent legislation that impacts employment and labor, trade, or health care, could have an adverse impact on our financial condition and results of operations.

We contract with various agencies to provide us with qualified personnel for our workforce. Any negative publicity regarding these agencies, such as in connection with immigration issues or employment practices, could damage our reputation, disrupt our ability to obtain needed labor or result in financial harm to our business, including the potential loss of business-related financial incentives in the jurisdictions where we operate. Although we strive to secure long-term contracts on favorable terms with our service providers and other vendors, we may not be able to avoid unexpected operating cost increases in the future, such as those associated with minimum wage increases or enhanced health care requirements. Further, we incur substantial costs to warehouse and distribute our inventory. We continue to insource furniture delivery hubs in certain geographies and continue to regionalize our retail and e-commerce fulfillment capabilities. Significant increases in our inventory levels may result in increased warehousing and distribution costs, such as costs related to additional distribution facilities, which we may not be able to lease on acceptable terms, if at all. Such increases in inventory levels may also lead to increases in costs associated with inventory that is lost, damaged or aged. Higher than expected costs, particularly if coupled with lower than expected sales, would negatively impact our business and operating results. In addition, in times of economic uncertainty, these long-term contracts may make it difficult to quickly reduce our fixed operating costs, which could negatively impact our business and operating results.

*We are undertaking certain systems changes that might disrupt our business operations.*

Our success depends, in part, on our ability to source, sell and distribute merchandise efficiently through appropriate systems and procedures. We are in the process of substantially modifying our information technology systems, which involves updating or replacing legacy systems with successor systems over the course of several years. There are inherent risks associated with replacing our core systems, including supply chain and merchandising systems

disruptions, that could affect our ability to get the correct products into the appropriate stores and delivered to customers. We may not successfully launch these new systems, or the launch of such systems may result in disruptions to our business operations. In addition, changes to any of our software

## Table of Contents

implementation strategies could result in the impairment of software-related assets. We are also subject to the risks associated with the ability of our vendors to provide information technology solutions to meet our needs. Any disruptions could negatively impact our business and operating results.

In addition, we are in the process of replacing our core financial reporting and human capital management systems with new enterprise resource planning systems to standardize our processes worldwide and adopt best-in-class capabilities. During our implementations, and as we utilize the systems going forward, we may experience periodic or prolonged disruption of our core financial and human capital operations, including our ability to complete our financial close and provide accurate financial reporting on a timely basis, and maintain our internal control compliance efforts. We may also experience errors in data and security or technical reliability issues. In order to realize the benefits of our systems, we may be required to change certain business and financial processes, which involves the risk of disruption to our operations or data errors. In addition, we are heavily reliant on third-party vendors for access to our systems and the accuracy of the functionality within the systems. If we encounter implementation or usage problems with these new systems or other related systems and infrastructure, or if the systems do not operate as intended, do not give rise to anticipated benefits, or fail to integrate properly with our other systems or software platforms, then our business, results of operations, and internal controls over financial reporting may be adversely affected.

*We outsource certain aspects of our business to third-party vendors and are in the process of insourcing certain business functions from third-party vendors, both of which subject us to risks, including disruptions in our business and increased costs.*

We outsource certain aspects of our business to third-party vendors that subject us to risks of disruptions in our business as well as increased costs. For example, we utilize outside vendors for such things as payroll processing, email and other digital marketing and various distribution facilities and delivery services. In some cases, we rely on a single vendor for such services. Accordingly, we are subject to the risks associated with their ability to successfully provide the necessary services to meet our needs. If our vendors are unable to adequately protect our data and information is lost, our ability to deliver our services is interrupted, our vendors' fees are higher than expected, or our vendors make mistakes in the execution of operations support, then our business and operating results may be negatively impacted.

In addition, we are in the process of insourcing certain aspects of our business, including certain technology services and the management of certain furniture manufacturing and delivery, and have recently completed the insourcing of the management of our global vendors, each of which were previously outsourced to third-party providers. We may also need to continue to insource other aspects of our business in the future in order to control our costs and to stay competitive. This may cause disruptions in our business and result in increased cost to us. In addition, if we are unable to perform these functions better than, or at least as well as, our third-party providers, our business may be harmed.

*If our operating and financial performance in any given period does not meet the guidance that we have provided to the public or the expectations of our investors and analysts, our stock price may decline.*

We provide public guidance on our expected operating and financial results for future periods. Beginning in fiscal 2019, we have discontinued providing quarterly guidance and instead we will provide guidance on an annual basis only. We believe this approach is better aligned with the long-term view we take in managing our business and our focus on long-term stockholder value creation. Although we believe that this guidance provides investors and analysts with a better understanding of management's expectations for the future and is useful to our stockholders and potential stockholders, such guidance is comprised of forward-looking statements subject to the risks and uncertainties described in this report and in our other public filings and public statements. Our actual results may not always be in

line with or exceed the guidance we have provided or the expectations of our investors and analysts, especially in times of economic uncertainty. In the past, when we have reduced our previously provided guidance, the market price of our common stock has declined. If, in the future, our operating or financial results for a particular period do not meet our guidance or the expectations of our investors and analysts or if we reduce our guidance for future periods, the market price of our common stock may decline.

---

**Table of Contents**

*A variety of factors, including seasonality and the economic environment, may cause our quarterly operating results to fluctuate, leading to volatility in our stock price.*

Our quarterly results have fluctuated in the past and may fluctuate in the future, depending upon a variety of factors, including changes in economic conditions, shifts in the timing of holiday selling seasons, including Valentine's Day, Easter, Halloween, Thanksgiving and Christmas, as well as timing shifts due to 53-week fiscal years, which occur approximately every five years. Historically, a significant portion of our net revenues and net earnings have typically been realized during the period from October through January each year, our peak selling season. In anticipation of increased holiday sales activity, we incur certain significant incremental expenses prior to and during peak selling seasons, including fixed catalog production and mailing costs and the costs associated with hiring a substantial number of temporary employees to supplement our existing workforce.

*We may require funding from external sources, which may not be available at the levels we require, or may cost more than we expect, and, as a consequence, our expenses and operating results could be negatively affected.*

We regularly review and evaluate our liquidity and capital needs. While we have a growing balance of cash that is held offshore, we currently believe that our available cash, cash equivalents and cash flow from operations will be sufficient to finance our operations and expected capital requirements for at least the next 12 months. However, we might experience periods during which we encounter additional cash needs and we might need additional external funding to support our operations. Although we were able to amend and increase our credit facility during fiscal 2017 on acceptable terms to provide for a \$500,000,000 unsecured revolving line of credit and a \$300,000,000 unsecured term loan facility, in the event we require additional liquidity from our lenders, such funds may not be available to us on acceptable terms, or at all. For example, in the event we were to breach any of our financial covenants, our banks would not be required to provide us with additional funding, or they may require us to renegotiate our existing credit facility on less favorable terms. In addition, we may not be able to renew our letters of credit that we use to help pay our suppliers on terms that are acceptable to us, or at all, as the availability of letter of credit facilities may become limited. Further, the providers of such credit may reallocate the available credit to other borrowers. If we are unable to access credit at the levels we require, or the cost of credit is greater than expected, it could adversely affect our operating results.

*Disruptions in the financial markets may adversely affect our liquidity and capital resources and our business.*

Global financial markets can experience extreme volatility, disruption and credit contraction, which adversely affect global economic conditions. Such turmoil in financial and credit markets or other changes in economic conditions could adversely affect sources of liquidity available to us or our costs of capital. For example, each financial institution in the syndicate for our credit facility is responsible for providing a portion of the loans to be made under the facility. If any lender, or group of lenders, with a significant portion of the commitments in our credit facility fails to satisfy its obligations to extend credit under the facility and we are unable to find a replacement for such lender or group of lenders on a timely basis, if at all, our liquidity and our business may be materially adversely affected.

*If we are unable to pay quarterly dividends or repurchase our stock at intended levels, our reputation and stock price may be harmed.*

We had \$224,000,000 remaining for future repurchases under our existing stock repurchase program as of February 3, 2019. In March 2019, our Board of Directors authorized an increase in our stock repurchase program by an additional \$500,000,000, as well as an increase in our quarterly cash dividend from \$0.43 to \$0.48 per common share for an annual cash dividend of \$1.92 per share. The stock repurchase program and dividend may require the use of a significant portion of our cash earnings. As a result, we may not retain a sufficient amount of cash to fund our



operations or finance future growth opportunities, new product development initiatives and unanticipated capital expenditures, which could adversely affect our financial performance. Further, our Board of Directors may, at its discretion, decrease or entirely discontinue the payment of dividends at any time. The stock repurchase program does not have an expiration date and may be limited or eliminated at any time. Our ability to pay dividends and repurchase stock will depend on our ability to generate sufficient cash flows from operations

**Table of Contents**

in the future. This ability may be subject to certain economic, financial, competitive and other factors that are beyond our control. Any failure to pay dividends or repurchase stock after we have announced our intention to do so may negatively impact our reputation and investor confidence in us, and may negatively impact our stock price.

*If we fail to maintain proper and effective internal controls, our ability to produce accurate and timely financial statements could be impaired and our investors' views of us could be harmed.*

We have evaluated and tested our internal controls in order to allow management to report on, and our registered independent public accounting firm to attest to, the effectiveness of our internal controls, as required by Section 404 of the Sarbanes-Oxley Act of 2002. If we are not able to continue to meet the requirements of Section 404 in a timely manner, or with adequate compliance, we may be required to disclose material weaknesses if they develop or are uncovered, and we may be subject to sanctions or investigation by regulatory authorities, such as the SEC or the New York Stock Exchange. In addition, our internal controls may not prevent or detect all errors and fraud on a timely basis, if at all. A control system, no matter how well designed and operated, is based upon certain assumptions and can provide only reasonable assurance that the objectives of the control system will be met. If any of the above were to occur, our business and the perception of us in the financial markets could be negatively impacted.

*Changes to accounting rules or regulations may adversely affect our operating results.*

Changes to existing accounting rules or regulations may impact our future operating results. A change in accounting rules or regulations may even affect our reporting of transactions completed before the change is effective. The introduction of new accounting rules or regulations and varying interpretations of existing accounting rules or regulations have occurred and may occur in the future, such as the new revenue recognition standard, effective for us in fiscal 2018, and the new lease accounting standard, effective for us in fiscal 2019. Future changes to accounting rules or regulations, or the questioning of current accounting practices, may adversely affect our operating results.

*In preparing our financial statements we make certain assumptions, judgments and estimates that affect the amounts reported, which, if not accurate, may impact our financial results.*

We make assumptions, judgments and estimates that impact amounts reported in our consolidated financial statements for a number of items, including merchandise inventories, property and equipment, goodwill, self-insured liabilities, and income taxes, among others. These assumptions, judgments and estimates are derived from historical experience and various other factors that we believe are reasonable under the circumstances as of the date our consolidated financial statements are prepared. Actual results could differ materially from our estimates, and such differences may impact our financial results.

*Changes to estimates related to our cash flow projections may cause us to incur impairment charges related to our retail store locations and other property and equipment, including information technology systems, as well as goodwill.*

We make estimates and projections in connection with impairment analyses for our retail store locations and other property and equipment, including information technology systems, as well as goodwill. These analyses require us to make a number of estimates and projections of future results. If these estimates or projections change or prove incorrect, we may be, and have been, required to record impairment charges on certain store locations and other property and equipment, including information technology systems. These impairment charges have been significant in the past and may be significant in the future and, as a result of these charges, our operating results have been and may, in the future, be adversely affected.

*If we fail to attract and retain key personnel, our business and operating results may be harmed.*

Our future success depends to a significant degree on the skills, experience and efforts of key personnel in our senior management, whose vision for our company, knowledge of our business and expertise would be difficult

**Table of Contents**

to replace. If any one of our key employees leaves, is seriously injured or unable to work, or fails to perform and we are unable to find a qualified replacement, we may be unable to execute our business strategy. In addition, our main offices are located in the San Francisco Bay Area, where competition for personnel with retail and technology skills can be intense. In addition, several of our strategic initiatives, including our technology and supply chain initiatives, require that we hire and/or develop employees with appropriate experience. We may not be successful in recruiting, retaining and motivating skilled personnel domestically or globally who have the requisite experience to achieve our global business goals, and failure to do so may harm our business. Further, in the event we need to hire additional personnel, we may experience difficulties in attracting and successfully hiring such individuals due to competition for highly skilled personnel, as well as the significantly higher cost of living expenses in our markets.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

We lease store locations, distribution and manufacturing facilities, corporate facilities and customer care centers for our U.S. and foreign operations for original terms generally ranging from 5 to 22 years. Certain leases contain renewal options for periods of up to 20 years.

For our store locations, our gross leased store space as of February 3, 2019 totaled approximately 6,557,000 square feet for 625 stores compared to approximately 6,451,000 square feet for 631 stores as of January 28, 2018.

*Leased Properties*

The following table summarizes the location and size of our leased facilities occupied by us as of February 3, 2019:

| Location   | Occupied Square Footage (Approximate) |
|--|---------------------------------------|
| <i>Distribution and Manufacturing Facilities</i> |                                       |
| Mississippi                                      | 2,165,000                             |
| New Jersey                                       | 2,103,000                             |
| California                                       | 1,432,000                             |
| Georgia  | 1,075,000                             |
| Texas  | 822,000                               |
| Tennessee  | 603,000                               |
| North Carolina                                   | 412,000                               |
| Ohio   | 265,000                               |
| Massachusetts                                    | 140,000                               |
| Florida  | 135,000                               |
| Oregon   | 91,000                                |
| Colorado   | 80,000                                |
| <i>Corporate Facilities</i>                      |                                       |
| California                                       | 266,000                               |
| New York   | 238,000                               |
| Oregon   | 49,000                                |

*Customer Care Centers*

|        |        |
|--------|--------|
| Nevada | 36,000 |
| Other  | 32,000 |

In addition to the above leased properties, we enter into other agreements for offsite storage needs for our distribution facilities and our retail store locations, as necessary. As of February 3, 2019, the total leased space

**Table of Contents**

relating to these properties was not material to us and is not included in the occupied square footage reported above.

*Owned Properties*

As of February 3, 2019, we owned 471,000 square feet of space, primarily in California, for our corporate headquarters and certain data center operations.

We believe that all of our facilities are adequate for our current needs and that suitable additional or substitute space will be available in the future to replace our existing facilities, or to accommodate the expansion of our operations, if necessary.

**ITEM 3. LEGAL PROCEEDINGS**

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 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.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**Table of Contents****PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS  
AND ISSUER PURCHASES OF EQUITY SECURITIES  
MARKET INFORMATION**

Our common stock is traded on the New York Stock Exchange, or the NYSE, under the symbol WSM. The closing price of our common stock on the NYSE on March 31, 2019 was \$56.27.

**STOCKHOLDERS**

The number of stockholders of record of our common stock as of March 31, 2019 was 320. This number excludes stockholders whose stock is held in nominee or street name by brokers.

**PERFORMANCE GRAPH**

This graph compares the cumulative total stockholder return for our common stock with those of the NYSE Composite Index and S&P Retailing, our peer group index. The cumulative total return listed below assumed an initial investment of \$100 and reinvestment of dividends. The graph shows historical stock price performance, including reinvestment of dividends, and is not necessarily indicative of future performance.

**COMPARISON OF FIVE YEAR CUMULATIVE TOTAL RETURN\***

**Among Williams-Sonoma, Inc., the NYSE Composite Index,  
and S&P Retailing**

\*\$100 invested on 2/2/14 in stock or index, including reinvestment of dividends. Fiscal year ending February 3.

|                       | <b>2/2/14</b> | <b>2/1/15</b> | <b>1/31/16</b> | <b>1/29/17</b> | <b>1/28/18</b> | <b>2/03/19</b> |
|-----------------------|---------------|---------------|----------------|----------------|----------------|----------------|
| Williams-Sonoma, Inc. | 100.00        | 146.32        | 98.58          | 93.24          | 108.08         | 112.76         |
| NYSE Composite Index  | 100.00        | 108.27        | 101.44         | 122.00         | 151.10         | 140.18         |
| S&P Retailing         | 100.00        | 119.10        | 140.73         | 167.81         | 241.26         | 249.58         |

\* **Notes:**

A. The lines represent monthly index levels derived from compounded daily returns that include all dividends.

- B. The indices are re-weighted daily, using the market capitalization on the previous trading day.
- C. If the monthly interval, based on the fiscal year-end, is not a trading day, the preceding trading day is used.



Table of Contents**STOCK REPURCHASE PROGRAMS**

During fiscal 2018, we repurchased 5,373,047 shares of our common stock at an average cost of \$54.96 per share and a total cost of \$295,304,000. In March 2019, our Board of Directors authorized an increase in the amount available for repurchase under our existing stock repurchase plan by an additional \$500,000,000. During fiscal 2017, we repurchased 4,050,697 shares of our common stock at an average cost of \$48.43 per share and a total cost of \$196,179,000. During fiscal 2016, we repurchased 2,871,480 shares of our common stock at an average cost of \$52.68 per share and a total cost of \$151,272,000.

The following table summarizes our repurchases of shares of our common stock during the fourth quarter of fiscal 2018 under our stock repurchase program:

| Fiscal period     |                   | Total Number<br>of Shares<br>Purchased <sup>1</sup> | Average<br>Price Paid<br>Per Share | Total Number of<br>Shares Purchased as<br>Part of a Publicly<br>Announced Program <sup>1</sup> | Maximum<br>Dollar Value of<br>Shares That May<br>Yet Be Purchased<br>Under the Program |
|-------------------|-------------------|---|------------------------------------|--|--|
| October 29, 2018  | November 25, 2018 | 141,671   | \$ 59.12                           | 141,671  | \$ 290,522,000   |
| November 26, 2018 | December 30, 2018 | 1,074,046   | \$ 48.96                           | 1,074,046  | \$ 237,934,000   |
| December 31, 2018 | February 3, 2019  | 273,455   | \$ 51.63                           | 273,455  | \$ 223,815,000   |
| Total             |                   | 1,489,172   | \$ 50.42                           | 1,489,172  | \$ 223,815,000   |

<sup>1</sup> 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.

**Table of Contents****ITEM 6. SELECTED FINANCIAL DATA***Five-Year Selected Financial Data*

|   | <i>Fiscal 2018<sup>1</sup></i> | Fiscal 2017  | Fiscal 2016  | Fiscal 2015  | Fiscal 2014  |
|---|--------------------------------|--------------|--------------|--------------|--------------|
| <i>In thousands, except percentages, per share amounts<br/>and retail stores data</i> | (53 Weeks)                     | (52 Weeks)   | (52 Weeks)   | (52 Weeks)   | (52 Weeks)   |
| <b>Results of Operations</b>  |                                |              |              |              |              |
| Net revenues  | \$ 5,671,593                   | \$ 5,292,359 | \$ 5,083,812 | \$ 4,976,090 | \$ 4,698,719 |
| Net revenue growth  | 7.2%                           | 4.1%         | 2.2%         | 5.9%         | 7.1%         |
| Comparable brand revenue growth <sup>2</sup>  | 3.7%                           | 3.2%         | 0.7%         | 3.7%         | 7.1%         |
| Gross profit  | \$ 2,101,013                   | \$ 1,931,711 | \$ 1,883,310 | \$ 1,844,214 | \$ 1,800,504 |
| Gross margin  | 37.0%                          | 36.5%        | 37.0%        | 37.1%        | 38.3%        |
| Operating income  | \$ 435,953                     | \$ 453,811   | \$ 472,599   | \$ 488,634   | \$ 502,265   |
| Operating margin <sup>3</sup>   | 7.7%                           | 8.6%         | 9.3%         | 9.8%         | 10.7%        |
| Net earnings  | \$ 333,684                     | \$ 259,545   | \$ 305,387   | \$ 310,068   | \$ 308,854   |
| Basic earnings per share  | \$ 4.10                        | \$ 3.03      | \$ 3.45      | \$ 3.42      | \$ 3.30      |
| Diluted earnings per share  | \$ 4.05                        | \$ 3.02      | \$ 3.41      | \$ 3.37      | \$ 3.24      |
| Shares used in calculation of earnings per share:                                     |                                |              |              |              |              |
| Basic   | 81,420                         | 85,592       | 88,594       | 90,787       | 93,634       |
| Diluted   | 82,340                         | 86,080       | 89,462       | 92,102       | 95,200       |
| <b>Financial Position</b>   |                                |              |              |              |              |
| Working capital <sup>4</sup>  | \$ 619,531                     | \$ 628,622   | \$ 405,924   | \$ 339,673   | \$ 515,975   |
| Total assets  | \$ 2,812,844                   | \$ 2,785,749 | \$ 2,476,879 | \$ 2,417,427 | \$ 2,330,277 |
| Return on assets  | 11.9%                          | 9.9%         | 12.5%        | 13.1%        | 13.2%        |
| Net cash provided by operating activities   | \$ 585,986                     | \$ 499,704   | \$ 524,709   | \$ 544,026   | \$ 461,697   |
| Capital expenditures  | \$ 190,102                     | \$ 189,712   | \$ 197,414   | \$ 202,935   | \$ 204,800   |
| Long-term debt and other long-term liabilities  | \$ 380,944                     | \$ 372,226   | \$ 71,215    | \$ 49,713    | \$ 62,698    |
| Stockholders' equity  | \$ 1,155,714                   | \$ 1,203,566 | \$ 1,248,220 | \$ 1,198,226 | \$ 1,224,706 |
| Stockholders' equity per share (book value)   | \$ 14.66                       | \$ 14.37     | \$ 14.29     | \$ 13.38     | \$ 13.33     |
| Return on equity  | 28.3%                          | 21.2%        | 25.0%        | 25.6%        | 24.9%        |
| Annual dividends declared per share   | \$ 1.72                        | \$ 1.56      | \$ 1.48      | \$ 1.40      | \$ 1.32      |
| <b>E-commerce Net Revenues</b>  |                                |              |              |              |              |
| E-commerce net revenue growth   | 10.9%                          | 5.5%         | 4.4%         | 6.4%         | 12.1%        |
| E-commerce net revenues as a percent of net revenues                                  | 54.3%                          | 52.5%        | 51.8%        | 50.7%        | 50.5%        |
| <b>Retail Net Revenues</b>  |                                |              |              |              |              |
| Retail net revenue growth (decline)   | 3.0%                           | 2.6%         | (0.1%)       | 5.4%         | 2.4%         |
| Retail net revenues as a percent of net revenues                                      | 45.7%                          | 47.5%        | 48.2%        | 49.3%        | 49.5%        |
| Number of stores at year-end  | 625                            | 631          | 629          | 618          | 601          |
| Store selling square footage at year-end  | 4,105,000                      | 4,019,000    | 3,951,000    | 3,827,000    | 3,684,000    |
| Store leased square footage at year-end   | 6,557,000                      | 6,451,000    | 6,359,000    | 6,163,000    | 5,965,000    |

<sup>1</sup> In fiscal 2018, we adopted Accounting Standards Update 2014-09, Revenue from Contracts with Customers, using the modified retrospective method. Amounts reported for fiscal 2017 and prior years have not been adjusted, and continue to be reported in accordance with previous revenue recognition guidance. See Note A to the Consolidated Financial Statements.

<sup>2</sup> *Comparable brand revenue is calculated on a 52-week to 52-week basis, with the exception of fiscal 2018 which is calculated on a 53-week to 53-week basis. See definition of comparable brand revenue within Management's Discussion and Analysis of Financial Condition and Results of Operations.*

<sup>3</sup> *Operating margin is defined as operating income as a percent of net revenues.*

<sup>4</sup> *In fiscal 2015, we prospectively adopted Accounting Standards Update 2015-17, Balance Sheet Classification of Deferred Taxes, and now present both deferred tax assets and deferred tax liabilities as noncurrent in our Consolidated Balance Sheets. Prior balance sheets were not retrospectively adjusted and, as a result, working capital for fiscal 2014 may not be comparable to other years.*

The information set forth above is not necessarily indicative of future operations and should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and notes thereto in this Annual Report on Form 10-K.

---

**Table of Contents****ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion and analysis of our financial condition, results of operations, and liquidity and capital resources for the 53 weeks ended February 3, 2019 (fiscal 2018), the 52 weeks ended January 28, 2018 (fiscal 2017), and the 52 weeks ended January 29, 2017 (fiscal 2016) should be read in conjunction with our Consolidated Financial Statements and notes thereto. As fiscal 2018 is a 53-week year as compared to a 52-week year in fiscal 2017, our discussion of fiscal 2018 results below includes approximately \$85,000,000 of net revenues and \$0.10 of diluted earnings per share associated with the additional week. All explanations of changes in operational results are discussed in order of magnitude.

**OVERVIEW**

Net revenues in fiscal 2018, including the impact of the additional week, increased by \$379,234,000, or 7.2%, compared to fiscal 2017, with comparable brand revenue growth of 3.7%. This increase in net revenues was driven by a 10.9% increase in e-commerce net revenues and a 3.0% increase in retail net revenues, with particular strength in furniture. Total fiscal 2018 net revenue growth was partially attributable to a 1.6% increase in store leased square footage and a 5.7% increase in international revenues, primarily related to our company-owned international operations, as well as the favorable impact of the adoption of ASU 2014-09 primarily associated with the reclassification of other income from selling, general and administrative expenses into net revenues (see Note A to our Consolidated Financial Statements). Revenue growth was also supported by our double digit new customer growth, which reflects the success of our strategies to increase customer acquisition and drive our future growth.

All brands delivered positive comparable brand revenue growth in fiscal 2018. Growth in Pottery Barn accelerated from last year, driven by strength in e-commerce and growth in new businesses: Marketplace and Pottery Barn Apartment, as well as strong upholstery growth. The Pottery Barn Kids and Teen business improved from last year, delivering combined comparable brand revenue growth of 2.8%. Our Baby business continued to gain momentum attracting new customers as the entry point to our brand and through registry creations. West Elm had another year of double digit net revenue growth driven by strong e-commerce performance and continued strength in the core furniture business. The Williams Sonoma brand delivered comparable brand revenue growth of 1.7%. And, our emerging brands, Rejuvenation and Mark and Graham, continued to scale with double digit net revenue growth and increased profitability.

Across the business, fiscal 2018 was a year of delivering more compelling experiences for our customers. As part of our strategic priority of digital leadership, we enhanced the e-commerce experience through two differentiators: content and convenience. In fiscal 2018, we updated our shop path with more accurate and engaging content that is inspirational and drives conversion. We also enhanced our product information pages with a focus on product quality and reasons to buy. To provide our customers with omni-channel convenience, we launched Buy Online Pickup In Store in our brands and are in the process of scaling other fulfillment capabilities such as Buy Online Ship To Store and Buy Online Ship From Store. As a result, our e-commerce revenue growth almost doubled in fiscal 2018. With over 54% of our business conducted online, we are among the top 25 e-commerce retailers in North America.

We are using cross-brand initiatives to strengthen our position as the resource for all home furnishing, cooking and entertaining needs. In fiscal 2018, we continued to scale our loyalty program, The Key, where we have seen strong membership growth over the past year, as well as our complimentary design service, Design Crew. We also launched two new initiatives during the year: Design Crew Room Planner and The One Registry collective, both of which are enabling a more personalized and convenient shopping experience for our customers.

In our supply chain, we continued to drive operational improvements in fiscal 2018. In our non-furniture business, our order consolidation efforts and continued improvement in distribution center productivity enabled us to lower our cartons-per-order and order-to-delivery time so that our customers received their orders faster this holiday season and with less waste. Additionally, we were proud to be recognized once again by Barron's for all of our sustainability efforts across the business. At a ranking of number 24, we were the only company in our industry to be among the financial publication's annual list of 100 Most Sustainable U.S. companies.

**Table of Contents**

In summary, 2018 was another year of solid financial and operational accomplishments resulting in earnings and cash flow generation that allowed us to return approximately \$435,629,000 to our stockholders through stock repurchases and dividends.

Over the next few years, we plan target whitespace in the market; we plan to drive cross-brand initiatives that leverage our platform; and we plan to bring technology innovation and continued improvement in customer experience. We have a strong foundation to support the execution of our initiatives in fiscal 2019 and beyond, as well as to deliver long-term shareholder value.

Table of Contents*Results of Operations***NET REVENUES**

Net revenues consist of e-commerce net revenues and retail net revenues. E-commerce net revenues include sales of merchandise to customers through our e-commerce websites and our catalogs, as well as shipping fees. Retail net revenues include sales of merchandise to customers at our retail stores 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. Due to the adoption of ASU 2014-09 in fiscal 2018, certain incentives received from credit card issuers as well as breakage income related to our unredeemed stored-value cards are now presented within net revenues (see Note A to our Consolidated Financial Statements).

|                         | Fiscal 2018  |         | Fiscal 2017  |         | Fiscal 2016  |         |
|-------------------------|--------------|---------|--------------|---------|--------------|---------|
| <i>In thousands</i>     | (53 Weeks)   | % Total | (52 Weeks)   | % Total | (52 Weeks)   | % Total |
| E-commerce net revenues | \$ 3,082,064 | 54.3%   | \$ 2,778,457 | 52.5%   | \$ 2,633,602 | 51.8%   |
| Retail net revenues     | 2,589,529    | 45.7%   | 2,513,902    | 47.5%   | 2,450,210    | 48.2%   |
| Net revenues            | \$ 5,671,593 | 100.0%  | \$ 5,292,359 | 100.0%  | \$ 5,083,812 | 100.0%  |

Net revenues in fiscal 2018, including the impact of the additional week of net revenues, increased by \$379,234,000 or 7.2%, compared to fiscal 2017, with comparable brand revenue growth of 3.7%. This increase in net revenues was driven by a 10.9% increase in e-commerce net revenues (primarily driven by West Elm, Pottery Barn and Pottery Barn Kids and Teen) and a 3.0% increase in retail net revenues (primarily driven by West Elm and Pottery Barn), with particular strength in furniture. Total fiscal 2018 net revenue growth was partially attributable to a 1.6% increase in store leased square footage and a 5.7% increase in international revenues primarily related to our company-owned international operations, as well as the favorable impact of the adoption of ASU 2014-09 primarily associated with the reclassification of other income from selling, general and administrative expenses into net revenues (see Note A to our Consolidated Financial Statements).

Net revenues in fiscal 2017 increased by \$208,547,000 or 4.1%, compared to fiscal 2016, with comparable brand revenue growth of 3.2%. This increase in net revenues was driven by a 5.5% increase in e-commerce net revenues (primarily driven by West Elm, Williams Sonoma and Rejuvenation) and a 2.6% increase in retail net revenues (primarily driven by Pottery Barn and West Elm), with particular strength in furniture. Total fiscal 2017 net revenue growth was partially attributable to a 1.4% increase in store leased square footage primarily due to 2 net new stores, and a 2.2% increase in international revenues primarily related to our company-owned international operations.

The following table summarizes our net revenues by brand for fiscal 2018, fiscal 2017 and fiscal 2016:

|                     | Fiscal 2018  | Fiscal 2017  | Fiscal 2016  |
|---------------------|--------------|--------------|--------------|
| <i>In thousands</i> | (53 Weeks)   | (52 Weeks)   | (52 Weeks)   |
| Pottery Barn        | \$ 2,177,344 | \$ 2,066,302 | \$ 2,024,218 |
| West Elm            | 1,292,928    | 1,114,339    | 971,568      |
| Williams Sonoma     | 1,056,125    | 1,022,434    | 1,002,194    |

|   |              |              |              |
|---|--------------|--------------|--------------|
| Pottery Barn Kids and Teen <sup>1</sup> | 895,762      | 860,468      | 873,199      |
| Other <sup>2</sup>                      | 249,434      | 228,816      | 212,633      |
| Total                                   | \$ 5,671,593 | \$ 5,292,359 | \$ 5,083,812 |

<sup>1</sup>Net revenues of the Pottery Barn Kids and PBteen brands are being reported on a combined basis as Pottery Barn Kids and Teen.

<sup>2</sup>Primarily consists of net revenues from our international franchise operations, Rejuvenation and Mark and Graham. 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



**Table of Contents**

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 are meaningful to evaluating their performance. Additionally, comparable brand revenue growth for newer concepts is not separately disclosed until such time that we believe those sales are meaningful to evaluating the performance of the brand.

|  | Fiscal 2018 | Fiscal 2017 | Fiscal 2016 |
|--|-------------|-------------|-------------|
| <i>Comparable brand revenue growth (decline)<sup>1</sup></i> | (53 Weeks)  | (52 Weeks)  | (52 Weeks)  |
| Pottery Barn   | 1.2%        | 1.0%        | (3.5%)      |
| West Elm   | 9.5%        | 10.2%       | 12.8%       |
| Williams Sonoma  | 1.7%        | 3.2%        | 1.3%        |
| Pottery Barn Kids and Teen                                   | 2.8%        | (1.7%)      | (2.8%)      |
| Total <sup>2</sup>   | 3.7%        | 3.2%        | 0.7%        |

<sup>1</sup> Comparable brand revenue is calculated on a 53-week to 53-week basis for fiscal 2018 and on a 52-week to 52-week basis for fiscal 2017 and fiscal 2016.

<sup>2</sup>Total comparable brand revenue growth includes the results of Rejuvenation and Mark and Graham.

**RETAIL STORE DATA**

|   | Fiscal 2018  | Fiscal 2017  | Fiscal 2016  |
|---|--------------|--------------|--------------|
| <i>In thousands</i>                             | (53 Weeks)   | (52 Weeks)   | (52 Weeks)   |
| Retail net revenues                             | \$ 2,589,529 | \$ 2,513,902 | \$ 2,450,210 |
| Retail net revenue growth (decline)             | 3.0%         | 2.6%         | (0.1%)       |
| Store count beginning of year                   | 631          | 629          | 618          |
| Store openings <sup>1</sup>                     | 23           | 28           | 29           |
| Store closings <sup>1</sup>                     | (29)         | (26)         | (18)         |
| Store count end of year                         | 625          | 631          | 629          |
| Store selling square footage at year-end        | 4,105,000    | 4,019,000    | 3,951,000    |
| Store leased square footage ( LSF ) at year-end | 6,557,000    | 6,451,000    | 6,359,000    |

<sup>1</sup> Store openings and closings in fiscal 2017 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 reopened during the fourth quarter of fiscal 2017.

| Fiscal 2018 | Fiscal 2017 | Fiscal 2016 |
|-------------|-------------|-------------|
|-------------|-------------|-------------|

Edgar Filing: WILLIAMS SONOMA INC - Form 10-K

|                   | Store |                       | Store |                       | Store |                       |
|-------------------|-------|-----------------------|-------|-----------------------|-------|-----------------------|
|                   | Count | Avg. LSF<br>Per Store | Count | Avg. LSF<br>Per Store | Count | Avg. LSF<br>Per Store |
| Williams Sonoma   | 220   | 6,900                 | 228   | 6,700                 | 234   | 6,600                 |
| Pottery Barn      | 205   | 14,200                | 203   | 13,900                | 201   | 13,900                |
| West Elm          | 112   | 13,100                | 106   | 13,100                | 98    | 13,300                |
| Pottery Barn Kids | 78    | 7,500                 | 86    | 7,400                 | 89    | 7,400                 |
| Rejuvenation      | 10    | 8,500                 | 8     | 8,800                 | 7     | 9,100                 |
| Total             | 625   | 10,500                | 631   | 10,200                | 629   | 10,100                |

**Table of Contents****COST OF GOODS SOLD**

| <i>In thousands</i>             | Fiscal 2018  |                | Fiscal 2017  |                | Fiscal 2016  |                |
|---------------------------------|--------------|----------------|--------------|----------------|--------------|----------------|
|                                 | (53 Weeks)   | % Net Revenues | (52 Weeks)   | % Net Revenues | (52 Weeks)   | % Net Revenues |
| Cost of goods sold <sup>1</sup> | \$ 3,570,580 | 63.0%          | \$ 3,360,648 | 63.5%          | \$ 3,200,502 | 63.0%          |

<sup>1</sup>Includes occupancy expenses of \$702,537, \$683,958 and \$664,177 in fiscal 2018, fiscal 2017 and 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.

*Fiscal 2018 vs. Fiscal 2017*

Cost of goods sold increased by \$209,932,000, or 6.2%, in fiscal 2018 compared to fiscal 2017. Cost of goods sold as a percentage of net revenues decreased to 63.0% in fiscal 2018 from 63.5% in fiscal 2017. This decrease was primarily driven by the leverage of occupancy costs and includes the favorable impact from the adoption of ASU 2014-09, primarily associated with the reclassification of other income from selling, general and administrative expenses into net revenues.

In the e-commerce channel, cost of goods sold as a percentage of net revenues decreased in fiscal 2018 compared to fiscal 2017, primarily driven by higher selling margins.

In the retail channel, cost of goods sold as a percentage of net revenues increased in fiscal 2018 compared to fiscal 2017, primarily driven by lower selling margins, partially offset by the leverage of occupancy costs.

*Fiscal 2017 vs. Fiscal 2016*

Cost of goods sold increased by \$160,146,000, or 5.0%, in fiscal 2017 compared to fiscal 2016. Cost of goods sold as a percentage of net revenues increased to 63.5% in fiscal 2017 from 63.0% in fiscal 2016. This increase was 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 fiscal 2017 compared to fiscal 2016 primarily driven by lower merchandise margins, reduced shipping income and higher shipping costs, 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 fiscal 2017 compared to fiscal 2016 primarily driven by lower selling margins, as well as higher occupancy costs to support our growth initiatives.

**Table of Contents****SELLING, GENERAL AND ADMINISTRATIVE EXPENSES**

|  | Fiscal 2018             | % Net                 | Fiscal 2017  | % Net    | Fiscal 2016  | % Net    |
|--|-------------------------|-----------------------|--------------|----------|--------------|----------|
| <i>In thousands</i>                          | (53 weeks) <sup>1</sup> | Revenues <sup>1</sup> | (52 weeks)   | Revenues | (52 weeks)   | Revenues |
| Selling, general and administrative expenses | \$ 1,665,060            | 29.4%                 | \$ 1,477,900 | 27.9%    | \$ 1,410,711 | 27.7%    |

<sup>1</sup> Includes the impact of the adoption of ASU 2014-09 primarily from the reclassification of other income from selling, general and administrative expenses into net revenues.

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.

*Fiscal 2018 vs. Fiscal 2017*

Selling, general and administrative expenses increased by \$187,160,000, or 12.7%, in fiscal 2018 compared to fiscal 2017. Selling, general and administrative expenses as a percentage of net revenues increased to 29.4% in fiscal 2018 from 27.9% in fiscal 2017. This increase as a percentage of net revenues was driven by an increase in general expenses primarily from the reclassification of other income from selling, general and administrative expenses into net revenues due to the adoption of ASU 2014-09, an increase in incentive compensation, as well as increased hourly wages and digital advertising from the reinvestment of tax savings, the impact from our acquisition of Outward, and impairment and early lease termination charges related to underperforming retail stores. This was partially offset by the optimization of catalog advertising costs.

In the e-commerce channel, selling, general and administrative expenses as a percentage of net revenues increased in fiscal 2018 compared to fiscal 2017, driven by an increase in general expenses primarily associated with the reclassification of other income from selling, general and administrative expenses into net revenues, the impact from our acquisition of Outward, as well as increased hourly wages and digital advertising from the reinvestment of tax savings, partially offset by the optimization of catalog advertising costs.

In the retail channel, selling, general and administrative expenses as a percentage of net revenues increased in fiscal 2018 compared to fiscal 2017, driven by an increase in general expenses primarily associated with the reclassification of other income from selling, general and administrative expenses into net revenues as well as impairment and early lease termination charges related to underperforming retail stores.

*Fiscal 2017 vs. Fiscal 2016*

Selling, general and administrative expenses increased by \$67,189,000, or 4.8%, in fiscal 2017 compared to fiscal 2016. Selling, general and administrative expenses as a percentage of net revenues increased to 27.9% in fiscal 2017 from 27.7% in fiscal 2016. This increase as a percentage of net revenues was primarily driven by higher digital advertising expenses resulting from our focus on new customer acquisition. This increase was partially offset by lower employment expenses within the unallocated segment.

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

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

---

**Table of Contents**

**INCOME TAXES**

The 2017 Tax Cuts and Jobs Act ( the Tax Act ) was enacted on December 22, 2017. Among other things, the Tax Act reduced the corporate income tax rate to 21% as of January 1, 2018, introduced a new tax on global intangible low-taxed income ( GILTI ), and implemented a modified territorial tax system that includes a transition tax on deemed repatriated earnings of foreign subsidiaries.

Staff Accounting Bulletin No. 118 ( SAB 118 ) issued by the SEC in December 2017 provided us with up to one year to finalize our measurement of the income tax effects of the Tax Act on our fiscal year ended January 28, 2018. As of January 28, 2018, we had made reasonable estimates of the income tax effects of the Tax Act, including the transition tax under Internal Revenue Code section 965.

As of February 3, 2019, we have completed the accounting for the income tax effects of the Tax Act based on our current interpretation of available notices and regulations issued and proposed by the U.S. Department of the Treasury and the Internal Revenue Service. As a result, during fiscal 2018 we recorded an immaterial adjustment to the fiscal 2017 provisional transition tax amount. In addition, during fiscal 2018, we booked a net tax benefit of approximately \$10,576,000 from the re-measurement of our deferred tax assets.

We have historically elected not to provide for U.S. income taxes with respect to the undistributed earnings of our foreign subsidiaries as we intended to utilize those earnings in our foreign operations for an indefinite period of time. Under Internal Revenue Code section 965 of the Tax Act, we are deemed to have distributed all the post-1986 earnings of our foreign subsidiaries to the U.S. as of December 31, 2017. In light of the Tax Act, we re-evaluated our permanent reinvestment assertion with respect to unremitted foreign earnings, and we are now only permanently reinvested with respect to our foreign earnings in Canada beginning in fiscal 2018. As a result, we recorded approximately \$1,493,000 of foreign withholding tax and additional state income tax in fiscal 2018. As of February 3, 2019, the post-fiscal 2017 earnings of our Canadian subsidiary are permanently reinvested. If we did not consider these earnings to be permanently reinvested, the deferred tax liability would have been immaterial as of February 3, 2019.

In fiscal 2018, we are subject to several provisions of the Tax Act, including GILTI, the base erosion anti-abuse tax and a deduction for foreign-derived intangible income. We have elected to account for GILTI as a periodic expense when the tax arises. The net impact due to these provisions was immaterial in fiscal 2018.

Our effective tax rate was 22.3% for fiscal 2018, 42.6% for fiscal 2017 and 35.3% for fiscal 2016. The decrease in the effective tax rate from fiscal 2017 was primarily due to the reduction of the U.S. corporate income tax rate from 35% to 21% as of January 1, 2018 as a result of the Tax Act, as well as the tax benefit from the true up of the remeasurement of our deferred tax assets under SAB 118.

**LIQUIDITY AND CAPITAL RESOURCES**

As of February 3, 2019, we held \$338,954,000 in cash and cash equivalents, the majority of which was held in interest-bearing demand deposit accounts and money market funds, and of which \$185,810,000 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.

Throughout the fiscal year, we utilize our cash balances to build our inventory levels in preparation for our fourth quarter holiday sales. In fiscal 2019, we plan to use our cash resources to fund our inventory and inventory-related purchases, advertising and marketing initiatives, stock repurchases and dividend payments, and property and

equipment purchases. In addition to our cash balances on hand, we have a credit facility which provides for a \$500,000,000 unsecured revolving line of credit ( revolver ), and a \$300,000,000 unsecured term loan facility ( term loan ). The revolver 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 revolver by up to \$250,000,000, at such lenders option, to provide for a total of \$750,000,000 of unsecured revolving credit. During fiscal 2018, we had borrowings under the revolver of \$60,000,000, all of which were repaid in the fourth quarter of fiscal 2018. During fiscal 2017, we had borrowings under the revolver of \$170,000,000, all of which



---

**Table of Contents**

were repaid in the fourth quarter of fiscal 2017. As of February 3, 2019, we had \$300,000,000 outstanding under our term loan. The term loan matures on January 8, 2021, at which point all outstanding principal and any accrued interest must be repaid. Additionally, as of February 3, 2019, a total of \$11,732,000 in issued but undrawn standby letters of credit were outstanding under the credit facility. The standby letters of credit were issued to secure the liabilities associated with workers' compensation and other insurance programs.

Additionally, we have three unsecured letter of credit reimbursement facilities, which were amended during the year, for a total of \$70,000,000, of which an aggregate of \$6,820,000 was outstanding as of February 3, 2019. These letter of credit facilities represent only a future commitment to fund inventory purchases to which we had not taken legal title.

We are currently in compliance with all of our financial covenants under the credit facility and, based on our current projections, we expect to remain in compliance throughout fiscal 2019. 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 fiscal 2018, net cash provided by operating activities was \$585,986,000 compared to \$499,704,000 in fiscal 2017. For fiscal 2018, net cash provided by operating activities was primarily attributable to net earnings adjusted for non-cash items, an increase in accounts payable and accrued expenses and other liabilities, as well as an increase in gift card and other deferred revenue, partially offset by an increase in merchandise inventories and prepaid expenses and other assets and a decrease in income taxes payable. This represents an increase in net cash provided by operating activities compared to fiscal 2017 primarily due to an increase in accounts payable and accrued expenses and other liabilities offset by a change in income taxes payable.

For fiscal 2017, net cash provided by operating activities was \$499,704,000 compared to \$524,709,000 in fiscal 2016. For fiscal 2017, net cash provided by operating activities was primarily attributable to net earnings adjusted for non-cash items, an increase in income taxes payable, as well as deferred rent and lease incentives, partially offset by an increase in merchandise inventories. This represents a decrease in net cash provided by operating activities compared to fiscal 2016 primarily due to an increase in merchandise inventories and a decrease in net earnings, partially offset by a decrease in income taxes paid in fiscal 2017 compared to fiscal 2016.

*Cash Flows from Investing Activities*

For fiscal 2018, net cash used in investing activities was \$187,899,000 compared to \$269,760,000 in fiscal 2017, and was primarily attributable to purchases of property and equipment. Net cash used in investing activities compared to fiscal 2017 is lower due to the acquisition of Outward in fiscal 2017 (see Note O to our Consolidated Financial Statements).

For fiscal 2017, net cash used in investing activities was \$269,760,000 compared to \$196,975,000 in fiscal 2016, and was primarily attributable to purchases of property and equipment and the acquisition of Outward. Net cash used in investing activities compared to fiscal 2016 increased due to the acquisition of Outward.

*Cash Flows from Financing Activities*

For fiscal 2018, net cash used in financing activities was \$450,066,000 compared to \$51,707,000 in fiscal 2017. For fiscal 2018, net cash used in financing activities was primarily attributable to repurchases of common stock of \$295,304,000 and the payment of dividends of \$140,325,000. Net cash used in financing activities compared to fiscal

2017 decreased primarily due to term loan borrowings in fiscal 2017 and an increase in repurchases of common stock in fiscal 2018.

For fiscal 2017, net cash used in financing activities was \$51,707,000 compared to \$305,806,000 in fiscal 2016. For fiscal 2017, net cash used in financing activities was primarily attributable to repurchases of common stock of \$196,179,000 and the payment of dividends of \$135,010,000, partially offset by proceeds from issuance of long-term debt of \$300,000,000. Net cash used in financing activities compared to fiscal 2016 decreased primarily due to proceeds from the issuance of long-term debt, partially offset by an increase in repurchases of common stock.

**Table of Contents****Dividends**

In fiscal 2018, fiscal 2017 and fiscal 2016, total cash dividends declared were approximately \$144,609,000, or \$1.72 per common share, \$135,779,000, or \$1.56 per common share, and \$133,588,000, or \$1.48 per common share, respectively. In March 2019, our Board of Directors authorized a \$0.05, or 11.6%, increase in our quarterly cash dividend, from \$0.43 to \$0.48 per common share, for an annual cash dividend of \$1.92 per share, subject to capital availability. Our quarterly cash dividend may be limited or terminated at any time.

**Stock Repurchase Programs**

See section titled Stock Repurchase Programs within Part II, Item 5 of this Annual Report on Form 10-K for further information.

**Contractual Obligations**

The following table provides summary information concerning our future contractual obligations as of February 3, 2019:

| <i>In thousands</i>               | Payments Due by Period <sup>1</sup> |                     |                   |                   | Total               |
|-----------------------------------|-------------------------------------|---------------------|-------------------|-------------------|---------------------|
|                                   | Fiscal 2019                         | Fiscal 2020         | Fiscal 2023       | Fiscal 2024       |                     |
| Long-term debt <sup>2</sup>       | \$                                  | \$ 300,000          | \$                | \$                | \$ 300,000          |
| Interest                          | 10,898                              | 10,232              |                   |                   | 21,130              |
| Operating leases <sup>3</sup>     | 292,387                             | 678,447             | 298,086           | 422,024           | 1,690,944           |
| Purchase obligations <sup>4</sup> | 960,132                             | 29,271              | 186               |                   | 989,589             |
| <b>Total</b>                      | <b>\$ 1,263,417</b>                 | <b>\$ 1,017,950</b> | <b>\$ 298,272</b> | <b>\$ 422,024</b> | <b>\$ 3,001,663</b> |

<sup>1</sup> This table excludes \$40.6 million of liabilities for unrecognized tax benefits associated with uncertain tax positions as we are not able to reasonably estimate when and if cash payments for these liabilities will occur. This amount, however, has been recorded as a liability in our accompanying Consolidated Balance Sheet as of February 3, 2019.

<sup>2</sup> Long-term debt consists of term loan borrowings under our credit facility. See Note C to our Consolidated Financial Statements for discussion of our borrowing arrangements.

<sup>3</sup> Projected undiscounted payments include only those amounts that are fixed and determinable as of the reporting date. See Note E to our Consolidated Financial Statements for discussion of our operating leases.

<sup>4</sup> Represents estimated commitments at year-end to purchase inventory and other goods and services in the normal course of business to meet operational requirements.

**Other Contractual Obligations**

We have other liabilities reflected in our Consolidated Balance Sheet. The payment obligations associated with these liabilities are not reflected in the table above due to the absence of scheduled maturities. The timing of these payments cannot be determined, except for amounts estimated to be payable in fiscal 2019, which are included in our current liabilities as of February 3, 2019.

We are party to a variety of contractual agreements under which we may be obligated to indemnify the other party for certain matters. These contracts primarily relate to commercial matters, operating leases, trademarks, intellectual property and financial matters. Under these contracts, we may provide certain routine indemnification relating to representations and warranties or personal injury matters. The terms of these indemnifications range in duration and may not be explicitly defined. Historically, we have not made significant payments for these indemnifications. We believe that if we were to incur a loss in any of these matters, the loss would not have a material effect on our financial condition or results of operations.

**Table of Contents*****Commercial Commitments***

The following table provides summary information concerning our outstanding commercial commitments as of February 3, 2019:

| <i>In thousands</i>         | Amount of Outstanding Commitment Expiration by Period <sup>1</sup> |             |             |                | Total            |
|-----------------------------|--|-------------|-------------|----------------|------------------|
|                             | Fiscal 2019 to Fiscal 2022   | Fiscal 2020 | Fiscal 2023 | to Fiscal 2024 |                  |
| Standby letters of credit   | \$ 11,732  | \$          | \$          | \$             | \$ 11,732        |
| Letter of credit facilities | 6,820  |             |             |                | 6,820            |
| <b>Total</b>                | <b>\$ 18,552</b>   | <b>\$</b>   | <b>\$</b>   | <b>\$</b>      | <b>\$ 18,552</b> |

<sup>1</sup> See Note C to our Consolidated Financial Statements for discussion of our borrowing arrangements.

**IMPACT OF INFLATION**

The impact of inflation (or deflation) on our results of operations for the past three fiscal years has not been significant. However, we cannot be certain of the effect inflation (or deflation) may have on our results of operations in the future.

**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

Management's Discussion and Analysis of Financial Condition and Results of Operations is based on our Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these 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 from these estimates.

We believe the following critical accounting policies used in the preparation of our Consolidated Financial Statements include the significant estimates and assumptions that we consider to be the most critical to an understanding of our financial statements because they involve significant judgments and uncertainties. See Note A to our Consolidated Financial Statements for further discussion of each policy.

***Merchandise Inventories***

Merchandise inventories, net of an allowance for shrinkage and obsolescence, are stated at the lower of cost (weighted average method) or market. To determine if the value of our inventory should be reduced below cost, we consider current and anticipated demand, customer preferences and age of the merchandise. The significant estimates used in inventory valuation are obsolescence (including excess and slow-moving inventory and lower of cost or market reserves) and estimates of inventory shrinkage. We reserve for obsolescence based on historical trends of inventory sold below cost and specific identification.

Reserves for shrinkage are estimated and recorded throughout the year as a percentage of net sales based on historical shrinkage results, cycle count results within our distribution centers, expectations of future shrinkage and current inventory levels. Actual shrinkage is recorded at year-end based on the results of our cycle count and year end physical inventory counts and can vary from our estimates due to such factors as changes in operations, the mix of our inventory (which ranges from large furniture to small tabletop items) and execution against loss prevention initiatives in our stores, distribution facilities, off-site storage locations, and with our third-party warehouse and transportation providers. Accordingly, there is no shrinkage reserve at year-end, with the exception of a cycle count reserve based on the historical cycle count results in our distribution centers. This reserve was not material to our Consolidated Financial Statements as of February 3, 2019. Historically, actual shrinkage has not differed materially from our estimates.

Our obsolescence and shrinkage reserve calculations contain estimates that require management to make assumptions and to apply judgment regarding a number of factors, including market conditions, the selling

---

**Table of Contents**

environment, historical results and current inventory trends. If actual obsolescence or shrinkage estimates change from our original estimate, we will adjust our reserves accordingly throughout the year. We have made no material changes to our assumptions included in the calculations of the obsolescence and shrinkage reserves throughout the year. In addition, we do not believe a 10% change in our inventory reserves would have a material effect on our net earnings. As of February 3, 2019 and January 28, 2018, our inventory obsolescence reserves were \$13,580,000 and \$12,649,000, respectively.

*Property and Equipment*

Property and equipment is stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets.

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. Our impairment analyses determine whether projected cash flows from operations are sufficient to recover the carrying value of these assets. Impairment may result when the carrying value of the asset exceeds the estimated undiscounted future cash flows over its remaining useful life. For store impairment, our estimate of undiscounted future cash flows over the store lease term is based upon our experience, the historical operations of the stores and estimates of future store profitability and economic conditions. The estimates of future store profitability and economic conditions require estimating such factors as sales growth, gross margin, employment costs, lease escalations, inflation and the overall economics of the retail industry, and are therefore subject to variability and difficult to predict. Actual future results may differ from those estimates. If a long-lived asset is found to be impaired, the amount recognized for impairment is equal to the excess of the asset's net carrying value over its fair value. Long-lived assets are measured at fair value on a nonrecurring basis using Level 3 inputs as defined in the fair value hierarchy (see Note M to our Consolidated Financial Statements). 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.

During fiscal 2018, we recorded asset impairment charges of approximately \$9,639,000, related to our retail stores, which is recorded within selling, general and administrative expenses. During fiscal 2017, we did not record any asset impairment charges. During fiscal 2016, we recorded asset impairment charges of approximately \$1,765,000 related to our retail stores.

*Business Combinations*

We account for acquired businesses when we obtain control of the business using the acquisition method of accounting. Assets acquired and liabilities assumed are recorded based upon the estimated fair value as of the acquisition date. Estimated fair values represent the estimated price that would be paid by a third-party market participant based upon the highest and best use of the assets acquired or liabilities assumed. The determination of the fair value of assets acquired and liabilities assumed requires significant judgment and estimates. In making such judgments and estimates, we utilize inputs from independent third-party valuation specialists and other internal sources. Any excess of the purchase price over the estimated fair value of the identifiable net assets acquired is recorded as goodwill. Acquisition-related expenses are expensed as incurred. During fiscal 2017, we acquired Outward (see Note O to our Consolidated Financial Statements). During the second quarter of fiscal 2018, we finalized the valuation of intangible assets acquired, which primarily represent 3-D imaging data and core intellectual property which are being amortized over a useful life of four years.

*Goodwill*

Goodwill is initially recorded as of the acquisition date, and is measured as any excess of the purchase price over the estimated fair value of the identifiable net assets acquired. Goodwill is not amortized, but rather is subject to impairment testing annually (on the first day of the fourth quarter), or between annual tests whenever events or changes in circumstances indicate that the fair value of a reporting unit may be below its carrying amount. We first perform a qualitative assessment to evaluate goodwill for potential impairment. If based on that assessment it is more likely than not that the fair value of the reporting unit is below its carrying value, a quantitative impairment test is necessary. The quantitative impairment test requires determining the fair value of the reporting



## **Table of Contents**

unit. We use the income approach, whereby we calculate the fair value based on the present value of estimated future cash flows using a discount rate that approximates our weighted average cost of capital. The process of evaluating the potential impairment of goodwill is subjective and requires significant estimates and assumptions about the future such as sales growth, gross margins, employment costs, capital expenditures, inflation and future economic and market conditions. Actual future results may differ from those estimates. If the carrying value of the reporting unit's assets and liabilities, including goodwill, exceeds its fair value, impairment is recorded for the excess, not to exceed the total amount of goodwill allocated to the reporting unit.

As of February 3, 2019 and January 28, 2018, we had goodwill of \$85,382,000 and \$18,838,000, respectively, primarily related to our fiscal 2017 acquisition of Outward and our fiscal 2011 acquisition of Rejuvenation, Inc. In fiscal 2018, fiscal 2017, and fiscal 2016, we performed a qualitative assessment of potential goodwill impairment and determined it was more likely than not that the fair value of each of our reporting units exceeded its carrying value. Accordingly, no further impairment testing of goodwill was performed. We did not recognize any goodwill impairment in fiscal 2018, fiscal 2017, or fiscal 2016.

### *Self-Insured Liabilities*

We are primarily self-insured for workers' compensation, employee health benefits, product and other general liability claims. We record self-insurance liability reserves based on claims filed, including the development of those claims, and an estimate of claims incurred but not yet reported, based on an actuarial analysis of historical claims data. Factors affecting these estimates include future inflation rates, changes in severity, benefit level changes, medical costs and claim settlement patterns. Should a different number of claims occur compared to what was estimated, or costs of the claims increase or decrease beyond what was anticipated, reserves may need to be adjusted accordingly. Self-insurance reserves for workers' compensation, employee health benefits, product and other general liability claims were \$28,542,000 and \$26,370,000 as of February 3, 2019 and January 28, 2018, respectively.

### *Income Taxes*

Income taxes are accounted for using the asset and liability method. Under this method, deferred income taxes arise from temporary differences between the tax basis of assets and liabilities and their reported amounts in our Consolidated Financial Statements. We record reserves for our estimates of the additional income tax liability that is more likely than not to result from the ultimate resolution of foreign and domestic tax examinations. At any one time, many tax years are subject to examination by various taxing jurisdictions. The results of these audits and negotiations with taxing authorities may affect the ultimate settlement of these issues. We review and update the estimates used in the accrual for uncertain tax positions as more definitive information becomes available from taxing authorities, upon completion of tax examination, upon expiration of statutes of limitation, or upon occurrence of other events.

In order to compute income tax on an interim basis, we estimate what our effective tax rate will be for the full fiscal year and adjust these estimates throughout the year as necessary. Adjustments to our income tax provision due to changes in our estimated effective tax rate are recorded in the interim period in which the change occurs. The tax expense (or benefit) related to items other than ordinary income is individually computed and recognized when the items occur. Our effective tax rate in a given financial statement period may be materially impacted by changes in the mix and level of our earnings in various taxing jurisdictions or changes in tax law.

**Table of Contents**

**ITEM 7A. 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 revolver and our term loan each have a variable interest rate which, when drawn upon, subjects us to risks associated with changes in that interest rate. As of February 3, 2019, we had \$300,000,000 outstanding under the term loan, and during fiscal 2018 we had borrowings of \$60,000,000 under the revolver, all of which were repaid in the fourth quarter of fiscal 2018. A hypothetical increase or decrease of one percentage point on our existing variable rate debt instruments 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 February 3, 2019, our investments, made primarily in interest bearing 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 and, as such, any foreign currency impact related to these international purchase transactions was not significant to us during fiscal 2018 or fiscal 2017. 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 fiscal 2018, 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 L to our Consolidated Financial Statements).

**Table of Contents****ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA***Williams-Sonoma, Inc.**Consolidated Statements of Earnings*

|   | Fiscal 2018  | Fiscal 2017  | Fiscal 2016  |
|---|--------------|--------------|--------------|
| <i>In thousands, except per share amounts</i>     | (53 weeks)   | (52 weeks)   | (52 weeks)   |
| E-commerce net revenues                           | \$ 3,082,064 | \$ 2,778,457 | \$ 2,633,602 |
| Retail net revenues                               | 2,589,529    | 2,513,902    | 2,450,210    |
| Net revenues                                      | 5,671,593    | 5,292,359    | 5,083,812    |
| Cost of goods sold                                | 3,570,580    | 3,360,648    | 3,200,502    |
| Gross profit                                      | 2,101,013    | 1,931,711    | 1,883,310    |
| Selling, general and administrative expenses      | 1,665,060    | 1,477,900    | 1,410,711    |
| Operating income                                  | 435,953      | 453,811      | 472,599      |
| Interest (income) expense, net                    | 6,706        | 1,372        | 688          |
| Earnings before income taxes                      | 429,247      | 452,439      | 471,911      |
| Income taxes                                      | 95,563       | 192,894      | 166,524      |
| Net earnings                                      | \$ 333,684   | \$ 259,545   | \$ 305,387   |
| Basic earnings per share                          | \$ 4.10      | \$ 3.03      | \$ 3.45      |
| Diluted earnings per share                        | \$ 4.05      | \$ 3.02      | \$ 3.41      |
| Shares used in calculation of earnings per share: |              |              |              |
| Basic   | 81,420       | 85,592       | 88,594       |
| Diluted   | 82,340       | 86,080       | 89,462       |

*See Notes to Consolidated Financial Statements.*

*Williams-Sonoma, Inc.**Consolidated Statements of Comprehensive Income*

|  | Fiscal 2018 | Fiscal 2017 | Fiscal 2016 |
|--|-------------|-------------|-------------|
| <i>In thousands</i>  | (53 weeks)  | (52 weeks)  | (52 weeks)  |
| Net earnings   | \$ 333,684  | \$ 259,545  | \$ 305,387  |
| Other comprehensive income (loss):   |             |             |             |
| Foreign currency translation adjustments   | (5,032)     | 3,730       | 1,523       |
| Change in fair value of derivative financial instruments, net of tax (tax benefit) of \$390, \$(259) and \$(327)                               | 1,098       | (715)       | (916)       |
| Reclassification adjustment for realized (gain) loss on derivative financial instruments, net of tax (tax benefit) of \$122, \$(38) and \$(41) | (357)       | 106         | 106         |
| Comprehensive income   | \$ 329,393  | \$ 262,666  | \$ 306,100  |

*See Notes to Consolidated Financial Statements.*



**Table of Contents****Williams-Sonoma, Inc.****Consolidated Balance Sheets**

| <i>In thousands, except per share amounts</i>  | Feb. 3, 2019 | Jan. 28, 2018 |
|--|--------------|---------------|
| <b>ASSETS</b>  |              |               |
| Current assets   |              |               |
| Cash and cash equivalents  | \$ 338,954   | \$ 390,136    |
| Accounts receivable, net   | 107,102      | 90,119        |
| Merchandise inventories, net   | 1,124,992    | 1,061,593     |
| Prepaid catalog expenses   |              | 20,517        |
| Prepaid expenses   | 101,356      | 62,204        |
| Other current assets   | 21,939       | 11,876        |
| Total current assets   | 1,694,343    | 1,636,445     |
| Property and equipment, net  | 929,635      | 932,283       |
| Deferred income taxes, net   | 44,055       | 67,306        |
| Goodwill   | 85,382       | 18,838        |
| Other long-term assets, net  | 59,429       | 130,877       |
| Total assets   | \$ 2,812,844 | \$ 2,785,749  |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |              |               |
| Current liabilities  |              |               |
| Accounts payable   | \$ 526,702   | \$ 457,144    |
| Accrued expenses   | 163,559      | 134,207       |
| Gift card and other deferred revenue   | 290,445      | 300,607       |
| Income taxes payable   | 21,461       | 56,783        |
| Other current liabilities  | 72,645       | 59,082        |
| Total current liabilities  | 1,074,812    | 1,007,823     |
| Deferred rent and lease incentives   | 201,374      | 202,134       |
| Long-term debt   | 299,620      | 299,422       |
| Other long-term liabilities  | 81,324       | 72,804        |
| Total liabilities  | 1,657,130    | 1,582,183     |
| Commitments and contingencies  | See Note I   |               |
| Stockholders' equity   |              |               |
| Preferred stock: \$.01 par value; 7,500 shares authorized; none issued   |              |               |
| Common stock: \$.01 par value; 253,125 shares authorized; 78,813 and 83,726 shares issued and outstanding at February 3, 2019 and January 28, 2018, respectively | 789          | 837           |
| Additional paid-in capital   | 581,900      | 562,814       |
| Retained earnings  | 584,333      | 647,422       |
| Accumulated other comprehensive loss   | (11,073)     | (6,782)       |
| Treasury stock at cost: 2 and 11 shares as of February 3, 2019 and January 28, 2018, respectively  | (235)        | (725)         |
| Total stockholders' equity   | 1,155,714    | 1,203,566     |
| Total liabilities and stockholders' equity   | \$ 2,812,844 | \$ 2,785,749  |

*See Notes to Consolidated Financial Statements.*



Table of Contents*Williams-Sonoma, Inc.**Consolidated Statements of Stockholders Equity*

| <i>In thousands</i>  | Common Stock |        | Additional | Retained   | Accumulated   | Treasury   | Total        |
|--|--------------|--------|------------|------------|---------------|------------|--------------|
|  | Shares       | Amount | Paid-in    | Earnings   | Other         |            | Stock        |
|  |              |        | Capital    |            | Comprehensive |            | Equity       |
|  |              |        |            |            | Income (Loss) |            |              |
| Balance at January 31, 2016  | 89,563       | \$ 896 | \$ 541,307 | \$ 668,545 | \$ (10,616)   | \$ (1,906) | \$ 1,198,226 |
| Net earnings   |              |        |            | 305,387    |               |            | 305,387      |
| Foreign currency translation adjustments   |              |        |            |            | 1,523         |            | 1,523        |
| Change in fair value of derivative financial instruments, net of tax                                 |              |        |            |            | (916)         |            | (916)        |
| Reclassification adjustment for realized (gain) loss on derivative financial instruments, net of tax |              |        |            |            | 106           |            | 106          |
| Exercise of stock-based awards and related tax effect  | 39           |        | 4,762      |            |               |            | 4,762        |
| Conversion/release of stock-based awards <sup>1</sup>  | 594          | 6      | (26,805)   |            |               | (263)      | (27,062)     |
| Repurchases of common stock  | (2,871)      | (29)   | (12,684)   | (138,559)  |               |            | (151,272)    |
| Reissuance of treasury stock under stock-based compensation plans <sup>1</sup>                       |              |        | (706)      | (83)       |               | 789        |              |
| Stock-based compensation expense   |              |        | 51,054     |            |               |            | 51,054       |
| Dividends declared   |              |        |            | (133,588)  |               |            | (133,588)    |
| Balance at January 29, 2017  | 87,325       | 873    | 556,928    | 701,702    | (9,903)       | (1,380)    | 1,248,220    |
| Net earnings   |              |        |            | 259,545    |               |            | 259,545      |
| Foreign currency translation adjustments   |              |        |            |            | 3,730         |            | 3,730        |
| Change in fair value of derivative financial instruments, net of tax                                 |              |        |            |            | (715)         |            | (715)        |
| Reclassification adjustment for realized (gain) loss on derivative financial instruments, net of tax |              |        |            |            | 106           |            | 106          |
|  | 452          | 5      | (17,810)   |            |               | (325)      | (18,130)     |

|  |         |        |            |            |             |          |              |
|--|---------|--------|------------|------------|-------------|----------|--------------|
| Conversion/release of stock-based awards <sup>1</sup>  |         |        |            |            |             |          |              |
| Repurchases of common stock  | (4,051) | (41)   | (18,518)   | (177,620)  |             |          | (196,179)    |
| Reissuance of treasury stock under stock-based compensation plans <sup>1</sup>                       |         |        | (554)      | (426)      |             | 980      |              |
| Stock-based compensation expense   |         |        | 42,768     |            |             |          | 42,768       |
| Dividends declared   |         |        |            | (135,779)  |             |          | (135,779)    |
| Balance at January 28, 2018  | 83,726  | 837    | 562,814    | 647,422    | (6,782)     | (725)    | 1,203,566    |
| Net earnings   |         |        |            | 333,684    |             |          | 333,684      |
| Foreign currency translation adjustments   |         |        |            |            | (5,032)     |          | (5,032)      |
| Change in fair value of derivative financial instruments, net of tax                                 |         |        |            |            | 1,098       |          | 1,098        |
| Reclassification adjustment for realized (gain) loss on derivative financial instruments, net of tax |         |        |            |            | (357)       |          | (357)        |
| Conversion/release of stock-based awards <sup>1</sup>  | 460     | 5      | (14,149)   |            |             | (291)    | (14,435)     |
| Repurchases of common stock  | (5,373) | (53)   | (25,775)   | (269,476)  |             |          | (295,304)    |
| Reissuance of treasury stock under stock-based compensation plans <sup>1</sup>                       |         |        | (418)      | (363)      |             | 781      |              |
| Stock-based compensation expense   |         |        | 59,428     |            |             |          | 59,428       |
| Dividends declared   |         |        |            | (144,609)  |             |          | (144,609)    |
| Adoption of accounting pronouncements <sup>2</sup>   |         |        |            | 17,675     |             |          | 17,675       |
| Balance at February 3, 2019  | 78,813  | \$ 789 | \$ 581,900 | \$ 584,333 | \$ (11,073) | \$ (235) | \$ 1,155,714 |

<sup>1</sup> Amounts are shown net of shares withheld for employee taxes.

<sup>2</sup> Primarily relates to our adoption of ASU 2014-09 in fiscal 2018. See Note A. See Notes to Consolidated Financial Statements.



**Table of Contents***Williams-Sonoma, Inc.**Consolidated Statements of Cash Flows*

|   | Fiscal 2018   | Fiscal 2017   | Fiscal 2016   |
|---|---------------|---------------|---------------|
| <i>In thousands</i>   | (53<br>Weeks) | (52<br>Weeks) | (52<br>Weeks) |
| Cash flows from operating activities:   |               |               |               |
| Net earnings  | \$ 333,684    | \$ 259,545    | \$ 305,387    |
| Adjustments to reconcile net earnings to net cash provided by (used in) operating activities: |               |               |               |
| Depreciation and amortization   | 188,808       | 183,077       | 173,195       |
| Loss on disposal/impairment of assets   | 10,209        | 1,889         | 3,806         |
| Amortization of deferred lease incentives   | (26,199)      | (25,372)      | (25,212)      |
| Deferred income taxes   | 23,639        | 63,381        | 7,114         |
| Tax benefit related to stock-based awards   |               |               | 3,230         |
| Excess tax benefit related to stock-based awards  |               |               | (4,894)       |
| Stock-based compensation expense  | 59,802        | 42,988        | 51,116        |
| Other   | (579)         | (135)         | (423)         |
| Changes in:   |               |               |               |
| Accounts receivable   | (15,329)      | 149           | (9,794)       |
| Merchandise inventories   | (70,331)      | (80,235)      | 4,493         |
| Prepaid catalog expenses  |               | (1,019)       | 6,448         |
| Prepaid expenses and other assets   | (54,691)      | (15,475)      | (7,521)       |
| Accounts payable  | 62,377        | 2,549         | 4,276         |
| Accrued expenses and other liabilities  | 45,976        | 9,597         | 19,712        |
| Gift card and other deferred revenue  | 38,899        | (3,002)       | 2,020         |
| Deferred rent and lease incentives  | 24,929        | 28,226        | 35,559        |
| Income taxes payable  | (35,208)      | 33,541        | (43,803)      |
| Net cash provided by operating activities   | 585,986       | 499,704       | 524,709       |
| Cash flows from investing activities:   |               |               |               |
| Purchases of property and equipment   | (190,102)     | (189,712)     | (197,414)     |
| Acquisition of Outward, Inc., net of cash received  |               | (80,528)      |               |
| Other   | 2,203         | 480           | 439           |
| Net cash used in investing activities   | (187,899)     | (269,760)     | (196,975)     |
| Cash flows from financing activities:   |               |               |               |
| Repurchases of common stock   | (295,304)     | (196,179)     | (151,272)     |
| Payment of dividends  | (140,325)     | (135,010)     | (133,539)     |
| Borrowings under revolving line of credit   | 60,000        | 170,000       | 125,000       |
| Repayments of borrowings under revolving line of credit                                       | (60,000)      | (170,000)     | (125,000)     |
| Tax withholdings related to stock-based awards  | (14,437)      | (18,130)      | (27,062)      |
| Proceeds from issuance of long-term debt  |               | 300,000       |               |
| Excess tax benefit related to stock-based awards  |               |               | 4,894         |
| Proceeds related to stock-based awards  |               |               | 1,532         |

Edgar Filing: WILLIAMS SONOMA INC - Form 10-K

|   |            |            |            |
|---|------------|------------|------------|
| Debt issuance costs   |            | (1,191)    | (359)      |
| Other   |            | (1,197)    |            |
| Net cash used in financing activities                               | (450,066)  | (51,707)   | (305,806)  |
| Effect of exchange rates on cash and cash equivalents               | 797        | (1,814)    | (1,862)    |
| Net increase (decrease) in cash and cash equivalents                | (51,182)   | 176,423    | 20,066     |
| Cash and cash equivalents at beginning of year                      | 390,136    | 213,713    | 193,647    |
| Cash and cash equivalents at end of year                            | \$ 338,954 | \$ 390,136 | \$ 213,713 |
| Supplemental disclosure of cash flow information:                   |            |            |            |
| Cash paid during the year for interest                              | \$ 11,424  | \$ 2,915   | \$ 2,202   |
| Cash paid during the year for income taxes, net of refunds          | \$ 107,951 | \$ 99,062  | \$ 203,426 |
| Non-cash investing activities:                                      |            |            |            |
| Purchases of property and equipment not yet paid for at end of year | \$ 2,773   | \$ 1,257   | \$ 625     |
| <i>See Notes to Consolidated Financial Statements.</i>              |            |            |            |

**Table of Contents**

*Williams-Sonoma, Inc.*

*Notes to Consolidated Financial Statements*

**Note A: Summary of Significant Accounting Policies**

We are 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 625 stores. These brands are also part of The Key Rewards, our free-to-join loyalty program that offers members exclusive benefits across the Williams-Sonoma family of brands. 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, Mexico and South Korea, as well as e-commerce websites in certain locations. In 2017, we acquired Outward, Inc., a 3-D imaging and augmented reality platform for the home furnishings and décor industry.

*Reclassifications*

Certain amounts reported in our Consolidated Balance Sheet as of January 28, 2018 and our Consolidated Statements of Cash Flows for the fifty-two weeks ended January 28, 2018 and January 29, 2017 have been reclassified in order to conform to the current period presentation. These reclassifications impacted prepaid catalog expenses, prepaid expenses, goodwill, other long-term assets, accounts payable, accrued expenses, gift card and other deferred revenue and other current liabilities. There was no change to total current assets, total assets, total current liabilities, or cash flows as a result of these reclassifications.

*Consolidation*

The Consolidated Financial Statements include the accounts of Williams-Sonoma, Inc. and its subsidiaries. All intercompany transactions and balances have been eliminated.

*Fiscal Year*

Our fiscal year ends on the Sunday closest to January 31, based on a 52 or 53-week year. Fiscal 2018, a 53-week year, ended on February 3, 2019; Fiscal 2017, a 52-week year, ended on January 28, 2018; and Fiscal 2016, a 52-week year, ended on January 29, 2017.

*Use of Estimates*

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America 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 from these estimates.

*Cash Equivalents*

Cash equivalents include highly liquid investments with an original maturity of three months or less. As of February 3, 2019, we were invested primarily in interest-bearing demand deposit accounts and money market funds.

Book cash overdrafts issued, but not yet presented to the bank for payment, are reclassified to accounts payable.

*Accounts Receivable and Allowance for Doubtful Accounts*

Accounts receivable are stated at their carrying values, net of an allowance for doubtful accounts. Accounts receivable consist primarily of credit card, franchisee and landlord receivables for which collectability is reasonably assured. Receivables are evaluated for collectability on a regular basis and an allowance for doubtful accounts is recorded, if necessary. Our allowance for doubtful accounts was not material to our financial statements as of February 3, 2019 and January 28, 2018.

*Merchandise Inventories*

Merchandise inventories, net of an allowance for shrinkage and obsolescence, are stated at the lower of cost (weighted average method) or market. To determine if the value of our inventory should be reduced below cost,

**Table of Contents**

we consider current and anticipated demand, customer preferences and age of the merchandise. The significant estimates used in inventory valuation are obsolescence (including excess and slow-moving inventory and lower of cost or market reserves) and estimates of inventory shrinkage. We reserve for obsolescence based on historical trends, aging reports, specific identification and our estimates of future sales and selling prices.

Reserves for shrinkage are estimated and recorded throughout the year as a percentage of net sales based on historical shrinkage results, cycle count results within our distribution centers, expectations of future shrinkage and current inventory levels. Actual shrinkage is recorded at year-end based on the results of our physical inventory counts and can vary from our estimates due to such factors as changes in operations, the mix of our inventory (which ranges from large furniture to small tabletop items) and execution against loss prevention initiatives in our stores, distribution facilities, off-site storage locations, and with our third-party warehouse and transportation providers. Accordingly, there is no shrinkage reserve at year-end, with the exception of a cycle count reserve based on the historical cycle count results in our distribution centers. This reserve was not material to our Consolidated Financial Statements as of February 3, 2019. Historically, actual shrinkage has not differed materially from our estimates.

Our obsolescence and shrinkage reserve calculations contain estimates that require management to make assumptions and to apply judgment regarding a number of factors, including market conditions, the selling environment, historical results and current inventory trends. If actual obsolescence or shrinkage estimates change from our original estimate, we will adjust our reserves accordingly throughout the year. We have made no material changes to our assumptions included in the calculations of the obsolescence and shrinkage reserves throughout the year. As of February 3, 2019, and January 28, 2018, our inventory obsolescence reserves were \$13,580,000 and \$12,649,000, respectively.

*Property and Equipment*

Property and equipment is stated at cost. Depreciation is computed using the straight-line method over the following estimated useful lives of the assets:

|                                     |   |
|-------------------------------------|---|
| Leasehold improvements              | Shorter of estimated useful life or lease term (generally 5 – 22 years) |
| Fixtures and equipment              | 2 – 20 years  |
| Buildings and building improvements | 10 – 40 years   |
| Capitalized software                | 2 – 10 years  |

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. Our impairment analyses determine whether projected cash flows from operations are sufficient to recover the carrying value of these assets. Impairment may result when the carrying value of the asset exceeds the estimated undiscounted future cash flows over its remaining useful life. For store impairment, our estimate of undiscounted future cash flows over the store lease term is based upon our experience, the historical operations of the stores and estimates of future store profitability and economic conditions. The estimates of future store profitability and economic conditions require estimating such factors as sales growth, gross margin, employment costs, lease escalations, inflation and the overall economics of the retail industry, and are therefore subject to variability and difficult to predict. Actual future results may differ from those estimates. If a long-lived asset is found to be impaired, the amount recognized for impairment is equal to the excess of the asset's net carrying value over its fair value. Long-lived assets are measured at fair value on a nonrecurring basis using Level 3 inputs as defined in the fair value hierarchy (see Note M). 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.

During fiscal 2018, we recorded asset impairment charges of approximately \$9,639,000, related to our retail stores, which is recorded within selling, general and administrative expenses. During fiscal 2017, we did not record any asset impairment charges. During fiscal 2016, we recorded asset impairment charges of approximately \$1,765,000, related to our retail stores.

*Goodwill*

Goodwill is initially recorded as of the acquisition date, and is measured as any excess of the purchase price over the estimated fair value of the identifiable net assets acquired. Goodwill is not amortized, but rather is subject to

---

**Table of Contents**

impairment testing annually (on the first day of the fourth quarter), or between annual tests whenever events or changes in circumstances indicate that the fair value of a reporting unit may be below its carrying amount. We first perform a qualitative assessment to evaluate goodwill for potential impairment. If based on that assessment it is more likely than not that the fair value of the reporting unit is below its carrying value, a quantitative impairment test is necessary. The quantitative impairment test requires determining the fair value of the reporting unit. We use the income approach, whereby we calculate the fair value based on the present value of estimated future cash flows using a discount rate that approximates our weighted average cost of capital. The process of evaluating the potential impairment of goodwill is subjective and requires significant estimates and assumptions about the future such as sales growth, gross margins, employment costs, capital expenditures, inflation and future economic and market conditions. Actual future results may differ from those estimates. If the carrying value of the reporting unit's assets and liabilities, including goodwill, exceeds its fair value, impairment is recorded for the excess, not to exceed the total amount of goodwill allocated to the reporting unit.

As of February 3, 2019 and January 28, 2018, we had goodwill of \$85,382,000 and \$18,838,000, respectively, primarily related to our fiscal 2017 acquisition of Outward (see Note O) and to our fiscal 2011 acquisition of Rejuvenation, Inc. In fiscal 2018, fiscal 2017 and fiscal 2016, we performed a qualitative assessment of potential goodwill impairment and determined it was more likely than not that the fair value of each of our reporting units exceeded its carrying value. Accordingly, no further impairment testing of goodwill was performed. We did not recognize any goodwill impairment in fiscal 2018, fiscal 2017 or fiscal 2016.

*Self-Insured Liabilities*

We are primarily self-insured for workers' compensation, employee health benefits, product and other general liability claims. We record self-insurance liability reserves based on claims filed, including the development of those claims, and an estimate of claims incurred but not yet reported, based on an actuarial analysis of historical claims data. Factors affecting these estimates include future inflation rates, changes in severity, benefit level changes, medical costs and claim settlement patterns. Should a different number of claims occur compared to what was estimated, or costs of the claims increase or decrease beyond what was anticipated, reserves may need to be adjusted accordingly. Self-insurance reserves for workers' compensation, employee health benefits, product and other general liability claims were \$28,542,000 and \$26,370,000 as of February 3, 2019 and January 28, 2018, respectively.

*Deferred Rent and Lease Incentives*

For leases that contain fixed escalations of the minimum annual lease payment during the original term of the lease, we recognize rent expense on a straight-line basis over the lease term, including the construction period, and record the difference between rent expense and the amount currently payable as deferred rent. Deferred lease incentives include construction allowances received from landlords, which are amortized on a straight-line basis over the lease term, including the construction period.

For any store or facility closure where a lease obligation still exists, we record the estimated future liability associated with the rental obligation on the cease use date.

*Fair Value of Financial Instruments*

The carrying values of cash and cash equivalents, accounts receivable, accounts payable and debt approximate their estimated fair values. We use derivative financial instruments to hedge against foreign currency exchange rate fluctuations. The assets or liabilities associated with our derivative financial instruments are recorded at fair value in either other current or long-term assets or other current or long-term liabilities. The fair value of our foreign currency

derivative instruments is measured using the income approach whereby we use observable market data at the measurement date and standard valuation techniques to convert future amounts to a single present value amount. These observable inputs include spot rates, forward rates, interest rates and credit derivative market rates (see Notes L and M for additional information).

*Merchandise Sales*

Revenues from the sale of our merchandise through our e-commerce channel, at our retail stores, as well as to our franchisees and wholesale customers are, in each case, recognized at a point in time when control of



---

**Table of Contents**

merchandise is transferred to the customer. Merchandise can either be picked up in our stores, or delivered to the customer. For merchandise picked up in the store, control is transferred at the time of the sale to the customer. For merchandise delivered to the customer, control is transferred either when delivery has been completed, or when we have a present right to payment which, for certain merchandise, occurs upon conveyance of the merchandise to the carrier for delivery. We exclude from revenue any taxes assessed by governmental authorities, including value-added and other sales-related taxes, that are imposed on and are concurrent with revenue-generating activities. Our payment terms are primarily at the point of sale for merchandise sales and for most services. We have elected to account for shipping and handling as fulfillment activities, and not as a separate performance obligation.

Revenue from the sale of merchandise is reported net of sales returns. We estimate future returns based on historical return trends together with current product sales performance. As of February 3, 2019, we recorded a liability for expected sales returns of approximately \$26,276,000 within other current liabilities and a corresponding asset for the expected net realizable value of the merchandise inventory to be returned of approximately \$10,030,000 within other current assets in our Consolidated Balance Sheet.

Prior to the adoption of Auditing Standards Update ( ASU ) 2014-09, *Revenue from Contracts with Customers* in the first quarter of fiscal 2018, we recorded a reserve for estimated product returns, net of cost of merchandise inventory to be returned, within other current liabilities. For fiscal 2017 and fiscal 2016, the opening balance of our sales returns reserve was \$16,058,000 and \$19,113,000, respectively. For fiscal 2017 and fiscal 2016, provision for sales returns was \$302,320,000 and \$303,694,000, respectively, and actual sales returns were \$306,536,000 and \$306,749,000, respectively. The closing balance of our sales returns reserve was \$11,842,000 and \$16,058,000 for fiscal 2017 and fiscal 2016, respectively.

#### *Gift Card and Other Deferred Revenue*

We defer revenue when cash payments are received in advance of satisfying performance obligations, primarily associated with our stored-value cards, merchandise sales, customer loyalty programs, and incentives received from credit card issuers.

We issue stored-value cards that may be redeemed on future merchandise purchases at our stores or through our e-commerce channel. Our stored-value cards have no expiration dates. Revenue from stored-value cards is recognized at a point in time upon redemption of the card and as control of the merchandise is transferred to the customer. Revenue from estimated unredeemed stored-value cards (breakage) is recognized in a manner consistent with our historical redemption patterns over the estimated period of redemption of our cards of approximately four years, the majority of which is recognized within one year of the card issuance. Breakage revenue is not material to our Consolidated Financial Statements.

For merchandise sales, we record a liability at each period end where we have not fulfilled our obligation to transfer goods or services to the customer, but for which we have already received consideration or have a right to consideration.

We have customer loyalty programs which allow members to earn points for each qualifying purchase. Points earned enable members to receive certificates that may be redeemed on future merchandise purchases at our stores or through our e-commerce channel. This customer option is a material right and, accordingly, represents a separate performance obligation to the customer. The allocated consideration for the points earned by our loyalty program members is deferred based on the standalone selling price of the points and recorded within gift card and other deferred revenue within our Consolidated Balance Sheet. The measurement of standalone selling prices takes into consideration the discount the customer would receive in a separate transaction for the delivered item, as well as our estimate of

certificates expected to be redeemed, based on historical redemption patterns. This measurement is applied to our portfolio of performance obligations for points earned, as all obligations have similar economic characteristics. We believe the impact to our Consolidated Financial Statements would not be materially different if this measurement was applied to each individual performance obligation. Revenue is recognized for these performance obligations at a point in time when certificates are redeemed by the customer. These obligations relate to contracts with terms less than one year, as our certificates generally expire within 6 months from issuance.

## **Table of Contents**

We enter into agreements with credit card issuers in connection with our private label and co-branded credit cards whereby we receive cash incentives in exchange for promised services, such as licensing our brand names and marketing the credit card program to customers. Services promised under these agreements are interrelated and are thus considered a single performance obligation. Revenue is recognized over time as we transfer promised services throughout the contract term.

As of February 3, 2019, we had recorded \$298,435,000 for gift card and other deferred revenue in our Consolidated Balance Sheet, substantially all of which will be recognized into revenue within the next 12 months.

### *Vendor Allowances*

We receive allowances or credits from certain vendors for volume rebates. We treat such volume rebates as an offset to the cost of the product or services provided at the time the expense is recorded. These allowances and credits received are recorded in both cost of goods sold and in selling, general and administrative expenses.

### *Cost of Goods Sold*

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.

### *Selling, General and Administrative Expenses*

Selling, general and administrative expenses consist of non-occupancy-related costs associated with our retail stores, distribution 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.

### *Stock-Based Compensation*

We account for stock-based compensation arrangements by measuring and recognizing compensation expense for all stock-based awards using a fair value based method. Restricted stock units are valued using the closing price of our stock on the date prior to the date of grant. The fair value of each stock-based award is amortized over the requisite service period.

### *Advertising Expenses*

Advertising expenses consist of media and production costs related to digital advertising, catalog mailings and other direct marketing activities. All advertising costs are expensed as incurred, or upon the release of the initial advertisement. Prior to the adoption of ASU 2014-09 in fiscal 2018, prepaid advertising costs were capitalized and amortized over their expected period of future benefit of approximately three months.

Total advertising expenses (including digital advertising, catalog advertising and other advertising costs) were approximately \$390,115,000, \$382,206,000 and \$347,474,000 in fiscal 2018, fiscal 2017 and fiscal 2016, respectively.

### *Foreign Currency Translation*

Some of our foreign operations have a functional currency other than the U.S. dollar. Assets and liabilities are translated into U.S. dollars using the current exchange rates in effect at the balance sheet date, while revenues and expenses are translated at the average exchange rates during the period. The resulting translation adjustments are recorded as other comprehensive income within stockholders' equity. Foreign currency exchange gains and losses are recorded in selling, general and administrative expenses, except for those discussed in Note L.

*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

## **Table of Contents**

average number of common shares outstanding plus 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.

### *Income Taxes*

Income taxes are accounted for using the asset and liability method. Under this method, deferred income taxes arise from temporary differences between the tax basis of assets and liabilities and their reported amounts in our Consolidated Financial Statements. We record reserves for our estimates of the additional income tax liability that is more likely than not to result from the ultimate resolution of foreign and domestic tax examinations. At any one time, many tax years are subject to examination by various taxing jurisdictions. The results of these audits and negotiations with taxing authorities may affect the ultimate settlement of these issues. We review and update the estimates used in the accrual for uncertain tax positions as more definitive information becomes available from taxing authorities, upon completion of tax examination, upon expiration of statutes of limitation, or upon occurrence of other events.

In order to compute income tax on an interim basis, we estimate what our effective tax rate will be for the full fiscal year and adjust these estimates throughout the year as necessary. Adjustments to our income tax provision, due to changes in our estimated effective tax rate, are recorded in the interim period in which the change occurs. The tax expense (or benefit) related to items other than ordinary income is individually computed and recognized when the items occur. Our effective tax rate in a given financial statement period may be materially impacted by changes in the mix and level of our earnings in various taxing jurisdictions or changes in tax law.

### *New Accounting Pronouncements*

In May 2014, the Financial Accounting Standards Board ( FASB ) issued ASU 2014-09, *Revenue from Contracts with Customers*, to clarify the principles of recognizing revenue and create common revenue recognition guidance between U.S. GAAP and International Financial Reporting Standards. We adopted the ASU on a modified retrospective basis in the first quarter of fiscal 2018 and applied the guidance therein to all applicable contracts that were not complete as of the date of application. As a result, we recorded an increase to opening retained earnings as of January 29, 2018 of approximately \$17,862,000, net of tax, for the cumulative effect adjustments of adopting the ASU. The adoption of this standard most significantly impacted our Consolidated Financial Statements due to:

the reclassification from selling, general and administrative expenses into net revenues for certain incentives received from credit card issuers,

the reclassification of breakage income related to our unredeemed stored-value cards from selling, general and administrative expenses into net revenues, as well as the acceleration in the timing of recognizing breakage income,

the acceleration in the timing of revenue recognition for certain merchandise shipped to our customers, and

the recording of a right of return asset for merchandise we expect to receive back from customers.

In addition, prepaid catalog advertising costs, which were capitalized and amortized over their expected period of future benefit prior to adoption, and are now expensed as incurred. Prior period balances were not retrospectively adjusted as a result of adopting the ASU.

The following summarizes the impact of adopting ASU 2014-09 on our Consolidated Statement of Earnings for the fiscal year ended February 3, 2019:

|  | As           | ASU 2014-09 | As           |
|--|--------------|-------------|--------------|
| <i>In thousands</i>                          | Reported     | Adjustment  | Adjusted     |
| Net revenue                                  | \$ 5,671,593 | \$ (61,106) | \$ 5,610,487 |
| Cost of goods sold                           | 3,570,580    | (6,059)     | 3,564,521    |
| Gross profit                                 | 2,101,013    | (55,047)    | 2,045,966    |
| Selling, general and administrative expenses | 1,665,060    | (48,766)    | 1,616,294    |
| Operating income                             | \$ 435,953   | \$ (6,281)  | \$ 429,672   |

---

**Table of Contents**

Other than the presentation of our sales returns liability and a right of return asset, which resulted in a reclassification of liabilities into other current assets, all other impacts to our Consolidated Balance Sheet from the adoption of this ASU were not material either individually or in the aggregate as of February 3, 2019. The adoption of this ASU had no net impact to our Consolidated Statement of Cash Flows for the fiscal year ended February 3, 2019.

In February 2016, the FASB issued ASU 2016-02, *Leases*, which requires lessees to recognize a right-of-use asset and a lease liability for virtually all leases. This ASU, as amended, is effective for us beginning in the first quarter of fiscal 2019. We estimate that the adoption of the ASU will result in an increase in total long-term assets and total liabilities of approximately \$1.2 billion, which includes an increase in liabilities for lease obligations of approximately \$1.4 billion, a decrease in deferred rent and deferred lease incentives of approximately \$0.2 billion, and an increase in right-of-use assets of approximately \$1.2 billion. We have elected to apply the provisions of this ASU at the adoption date, instead of to the earliest comparative period presented in the financial statements. We will elect the package of practical expedients upon adoption, which permits us not to reassess whether existing contracts are or contain leases, the lease classification of existing leases, or initial direct costs for existing leases. We will also elect not to separate lease and non-lease components for all of our leases and not to recognize a right-of-use asset and a lease liability for short-term leases. We do not expect the adoption of the ASU to materially impact our Consolidated Statement of Earnings or our Consolidated Statement of Cash Flows.

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. We adopted this ASU in the first quarter of fiscal 2018. The adoption did not have a material impact on our financial condition, results of operations or cash flows.

In January 2017, the FASB issued ASU 2017-04, *Simplifying the Test for Goodwill Impairment*, which simplifies the subsequent measurement of goodwill by eliminating step two from the goodwill impairment test. We adopted this ASU in the first quarter of fiscal 2018. The adoption of this ASU had no impact on our Consolidated Financial Statements.

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 us in the first quarter of fiscal 2019. 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. We do not expect the adoption of this ASU to have a material impact on our financial condition, results of operations or cash flows.

In August 2018, the FASB issued ASU 2018-15, *Intangibles Goodwill and Other Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*. The ASU aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. Accordingly, the amendments require an entity in a hosting arrangement that is a service contract to follow the guidance in Subtopic 350-40 to determine which implementation costs to capitalize as an asset related to the service contract and which costs to expense. We do not expect the adoption of this ASU to have

a material impact on our financial condition, results of operations or cash flows.



**Table of Contents****Note B: Property and Equipment**

Property and equipment consists of the following:

| <i>In thousands</i>                    | Feb. 3, 2019 | Jan. 28, 2018 |
|--|--------------|---------------|
| Leasehold improvements                 | \$ 950,259   | \$ 950,024    |
| Fixtures and equipment                 | 836,400      | 800,003       |
| Capitalized software                   | 733,941      | 621,730       |
| Land and buildings                     | 175,181      | 173,457       |
| Corporate systems projects in progress | 39,416       | 65,283        |
| Construction in progress <sup>1</sup>  | 7,205        | 8,615         |
| Total                                  | 2,742,402    | 2,619,112     |
| Accumulated depreciation               | (1,812,767)  | (1,686,829)   |
| Property and equipment, net            | \$ 929,635   | \$ 932,283    |

<sup>1</sup> Construction in progress primarily consists of leasehold improvements and furniture and fixtures related to new, expanded or remodeled retail stores where construction had not been completed as of year-end.

**Note C: Borrowing Arrangements***Credit Facility*

We have a credit facility which provides for a \$500,000,000 unsecured revolving line of credit ( revolver ) and a \$300,000,000 unsecured term loan facility ( term loan ). The revolver 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 revolver by up to \$250,000,000, at such lenders' option, to provide for a total of \$750,000,000 of unsecured revolving credit. The revolver matures on January 8, 2023, at which time all outstanding borrowings must be repaid and all outstanding letters of credit must be cash collateralized. We may, prior to the first and second anniversaries of the closing date of the amendment of the credit facility, elect to extend the maturity date for an additional year, subject to lender approval.

During fiscal 2018, we had borrowings of \$60,000,000 under the revolver (at a weighted average interest rate of 3.20%), all of which were repaid in the fourth quarter of fiscal 2018, and no amounts were outstanding as of February 3, 2019. During fiscal 2017, we had borrowings of \$170,000,000 under the revolver (at a weighted average interest rate of 2.21%), all of which were repaid in the fourth quarter of fiscal 2017, and no amounts were outstanding as of January 28, 2018. Additionally, as of February 3, 2019, \$11,732,000 in issued but undrawn standby letters of credit were outstanding under the revolver. The standby letters of credit were issued to secure the liabilities associated with workers' compensation and other insurance programs.

As of February 3, 2019, we had \$300,000,000 outstanding under our term loan (at a weighted average interest rate of 3.21%). The term loan matures on January 8, 2021, at which time all outstanding principal and any accrued interest must be repaid. Costs incurred in connection with the issuance of the term loan are presented as a reduction to the carrying value of the debt in our Consolidated Balance Sheet.

The interest rate under the credit facility is variable, and may be elected by us as: (i) the London Interbank Offer Rate

( LIBOR ) plus an applicable margin based on our leverage ratio ranging from 0.91% to 1.775% for a revolver borrowing, and 1.0% to 2.0% for the term loan; or (ii) a base rate as defined in the credit facility, plus an applicable margin ranging from 0% to 0.775% for a revolver borrowing, and 0% to 1.0% for the term loan.

As of February 3, 2019, we were in compliance with our covenants under the credit facility and, based on current projections, we expect to remain in compliance throughout fiscal 2019.

*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 24, 2019. The letter of credit facilities contain covenants that are consistent with our credit facility. Interest on unreimbursed amounts under the letter of credit facilities accrues at a base rate as defined in

**Table of Contents**

the credit facility, plus an applicable margin based on our leverage ratio. As of February 3, 2019, an aggregate of \$6,820,000 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 21, 2020.

**Note D: Income Taxes**

The 2017 Tax Cuts and Jobs Act (the Tax Act) was enacted on December 22, 2017. Among other things, the Tax Act reduced the corporate income tax rate to 21.0% as of January 1, 2018, introduced a new tax on global intangible low-taxed income (GILTI), and implemented a modified territorial tax system that includes a one-time transition tax on deemed repatriated earnings of foreign subsidiaries.

Staff Accounting Bulletin No. 118 (SAB 118) issued by the SEC in December 2017 provided us up to one year to finalize our measurement of the income tax effects of the 2017 Tax Cuts and Jobs Act (the Tax Act) on our fiscal year ended January 28, 2018. As of January 28, 2018, we had made reasonable estimates of the income tax effects of the Tax Act, including the transition tax under Internal Revenue Code section 965.

As of February 3, 2019, we have completed the accounting for the income tax effects of the Tax Act based on our current interpretation of available notices and regulations issued and proposed by the U.S. Department of the Treasury and the Internal Revenue Service. As a result, during fiscal 2018, we recorded an immaterial adjustment to the fiscal 2017 provisional transition tax amount. In addition, during fiscal 2018, we booked a net tax benefit of approximately \$10,576,000 from the re-measurement of our deferred tax assets.

The components of earnings before income taxes, by tax jurisdiction, are as follows:

|                                    | Fiscal 2018 | Fiscal 2017 | Fiscal 2016 |
|------------------------------------|-------------|-------------|-------------|
| <i>In thousands</i>                | (53 Weeks)  | (52 Weeks)  | (52 Weeks)  |
| United States                      | \$ 333,594  | \$ 379,000  | \$ 425,517  |
| Foreign                            | 95,653      | 73,439      | 46,394      |
| Total earnings before income taxes | \$ 429,247  | \$ 452,439  | \$ 471,911  |

The provision for income taxes consists of the following:

|                     | Fiscal 2018 | Fiscal 2017 | Fiscal 2016 |
|---------------------|-------------|-------------|-------------|
| <i>In thousands</i> | (53 Weeks)  | (52 Weeks)  | (52 Weeks)  |
| Current             |             |             |             |
| Federal             | \$ 43,745   | \$ 97,202   | \$ 125,760  |
| State               | 15,357      | 19,552      | 26,197      |
| Foreign             | 12,822      | 12,759      | 7,453       |
| Total current       | 71,924      | 129,513     | 159,410     |
| Deferred            |             |             |             |
| Federal             | 23,507      | 62,893      | 8,307       |

|                 |           |            |            |
|-----------------|-----------|------------|------------|
| State           | 1,562     | 460        | (807)      |
| Foreign         | (1,430)   | 28         | (386)      |
| Total deferred  | 23,639    | 63,381     | 7,114      |
| Total provision | \$ 95,563 | \$ 192,894 | \$ 166,524 |

We have historically elected not to provide for U.S. income taxes with respect to the undistributed earnings of our foreign subsidiaries as we intended to utilize those earnings in our foreign operations for an indefinite period of time. Under Internal Revenue Code section 965 of the Tax Act, we are deemed to have distributed all the post-1986 earnings of our foreign subsidiaries to the U.S. as of December 31, 2017. In light of the Tax Act, we re-evaluated our permanent reinvestment assertion with respect to unremitted foreign earnings, and we are now

**Table of Contents**

only permanently reinvested with respect to our foreign earnings in Canada beginning in fiscal 2018. As a result, we recorded approximately \$1,493,000 of foreign withholding tax and additional state income tax in fiscal 2018. As of February 3, 2019, the post-fiscal 2017 earnings of our Canadian subsidiary are permanently reinvested. If we did not consider these earnings to be permanently reinvested, the deferred tax liability would have been immaterial as of February 3, 2019.

In fiscal 2018, we are subject to several provisions of the Tax Act, including GILTI, the base erosion anti-abuse tax and a deduction for foreign-derived intangible income. The company has elected to account for GILTI as a periodic expense when the tax arises. The net impact due to these provisions was immaterial in fiscal 2018.

A reconciliation of income taxes at the federal statutory corporate rate to the effective rate is as follows:

|   | Fiscal 2018   | Fiscal 2017   | Fiscal 2016   |
|---|---------------|---------------|---------------|
|   | (53<br>Weeks) | (52<br>Weeks) | (52<br>Weeks) |
| Federal income taxes at the statutory rate            | 21.0%         | 33.9%         | 35.0%         |
| Re-measurement of deferred tax assets and liabilities | (2.2%)        | 6.7%          |               |
| Transition tax  | (0.6%)        | 2.9%          |               |
| State income tax rate                                 | 3.8%          | 2.5%          | 3.5%          |
| Change in uncertain tax positions                     | 4.1%          | (1.6%)        | 2.8%          |
| Rate differential                                     | (2.3%)        | (2.9%)        | (5.7%)        |
| Research and development credits                      | (2.1%)        |               |               |
| Other   | 0.6%          | 1.1%          | (0.3%)        |
| Effective tax rate                                    | 22.3%         | 42.6%         | 35.3%         |

Significant components of our deferred income tax accounts are as follows:

| <i>Deferred tax assets (liabilities), in thousands</i> | Feb. 3, 2019 | Jan. 28, 2018 |
|--|--------------|---------------|
| Deferred rent  | \$ 18,942    | \$ 18,387     |
| Merchandise inventories                                | 18,703       | 23,314        |
| Customer deposits                                      | 14,345       | 23,601        |
| Stock-based compensation                               | 14,281       | 9,024         |
| Accrued liabilities                                    | 13,470       | 13,626        |
| Compensation   | 11,251       | 14,127        |
| State taxes  | 7,435        | 5,099         |
| Executive deferred compensation                        | 5,739        | 5,886         |
| Federal and state net operating loss                   | 4,223        | 6,026         |
| Depreciation   | (31,557)     | (17,361)      |
| Deferred lease incentives                              | (26,032)     | (24,854)      |
| Other  | (4,797)      | (3,116)       |
| Valuation allowance                                    | (3,542)      | (1,067)       |
| Prepaid catalog expenses                               | (936)        | (5,386)       |
| Total deferred income tax assets, net                  | \$ 41,525    | \$ 67,306     |

As a result of the acquisition of Outward, Inc. (see Note O), we had net operating loss carry-forwards of \$4,979,000 and \$7,102,000 for U.S. federal and state, respectively, as of February 3, 2019. A valuation allowance has been provided to the state net operating loss carry-forwards, as we don't expect to fully utilize the losses in future years.

**Table of Contents**

The following table summarizes the activity related to our gross unrecognized tax benefits:

| <i>In thousands</i>                               | Fiscal 2018 | Fiscal 2017 | Fiscal 2016 |
|---|-------------|-------------|-------------|
| Balance at beginning of year                      | \$ 18,051   | \$ 25,864   | \$ 13,290   |
| Increases related to current year's tax positions | 4,694       | 3,345       | 11,772      |
| Increases related to prior years' tax positions   | 14,905      | 808         | 3,456       |
| Decreases related to prior years' tax positions   | (1,279)     | (10,610)    | (818)       |
| Lapses in statute of limitations                  | (786)       | (1,356)     | (1,122)     |
| Settlements                                       | (376)       |             | (714)       |
| Balance at end of year                            | \$ 35,209   | \$ 18,051   | \$ 25,864   |

As of February 3, 2019, we had \$35,209,000 of gross unrecognized tax benefits of which \$31,209,000 would, if recognized, affect the effective tax rate.

We accrue interest and penalties related to unrecognized tax benefits in the provision for income taxes. As of February 3, 2019 and January 28, 2018, our accruals for the payment of interest and penalties totaled \$5,437,000 and \$3,719,000, respectively.

Due to the potential resolution of tax issues, it is reasonably possible that the balance of our gross unrecognized tax benefits could decrease within the next twelve months by a range of \$0 to \$10,800,000.

We file income tax returns in the U.S. and foreign jurisdictions. We are subject to examination by the tax authorities in these jurisdictions. Our U.S. federal taxable years for which the statute of limitations has not expired are fiscal years 2014 to 2017. Substantially all material states, local and foreign jurisdictions' statutes of limitations are closed for taxable years prior to 2014.

**Note E: Accounting for Leases***Operating Leases*

We lease store locations, distribution and manufacturing facilities, corporate facilities, customer care centers and certain equipment for our U.S. and foreign operations for original terms generally ranging from 5 to 22 years. Certain leases contain renewal options for periods up to 20 years. The rental payments for our store leases are typically structured as either: minimum rent; rent based on a percentage of store sales; minimum rent plus additional rent based on a percentage of store sales; or rent based on a percentage of store sales if a specified store sales threshold or contractual obligation of the landlord has not been met. Contingent rental payments, including rental payments that are based on a percentage of sales, cannot be predicted with certainty at the onset of the lease term. Accordingly, such contingent rental payments are recorded as incurred each period and are excluded from our calculation of deferred rent liability.

Total rent expense for all operating leases was as follows:

| <i>In thousands</i> | Fiscal 2018 | Fiscal 2017 | Fiscal 2016 |
|---------------------|-------------|-------------|-------------|
|---------------------|-------------|-------------|-------------|

Edgar Filing: WILLIAMS SONOMA INC - Form 10-K

|   | (53 Weeks) | (52 Weeks) | (52 Weeks) |
|---|------------|------------|------------|
| Rent expense  | \$ 271,522 | \$ 263,409 | \$ 251,066 |
| Contingent rent expense                             | 26,414     | 24,918     | 26,980     |
| Rent expense before deferred lease incentive income | 297,936    | 288,327    | 278,046    |
| Deferred lease incentive income                     | (26,189)   | (25,293)   | (25,298)   |
| Less: sublease rental income                        | (522)      | (578)      | (558)      |
| Total rent expense <sup>1</sup>                     | \$ 271,225 | \$ 262,456 | \$ 252,190 |

<sup>1</sup> Excludes all other occupancy-related costs including depreciation, common area maintenance, property taxes and utilities.



**Table of Contents**

The aggregate contractual future minimum annual cash rental payments under non-cancellable operating leases in effect at February 3, 2019 were as follows:

| <i>In thousands</i> | Lease Commitments <sup>1</sup> |
|---------------------|--------------------------------|
| Fiscal 2019         | \$ 292,387                     |
| Fiscal 2020         | 262,429                        |
| Fiscal 2021         | 225,755                        |
| Fiscal 2022         | 190,263                        |
| Fiscal 2023         | 160,308                        |
| Thereafter          | 559,802                        |
| Total               | \$ 1,690,944                   |

<sup>1</sup> *Projected cash payments include only those amounts that are fixed and determinable as of the reporting date and are not necessarily representative of future expected rent expense. We currently pay rent for certain store locations based on a percentage of store sales. As future store sales cannot be predicted with certainty, projected payments for these locations are based on minimum rent, which is generally higher than rent based on a percentage of store sales. We incur other lease obligation expenses, such as common area maintenance and other executory costs, which are not fixed in nature and are thus not included in the future projected cash payments reflected above. In addition, projected cash payments do not include any benefit from deferred lease incentive income, which is reflected within Total rent expense above.*

**Memphis-Based Distribution Facility**

In fiscal 2015, we entered into an agreement with a partnership comprised of the estate of W. Howard Lester, our former Chairman of the Board and Chief Executive Officer, and the estate of James A. McMahan, a former Director Emeritus and significant stockholder and two unrelated parties to lease a distribution facility in Memphis, Tennessee through July 2017. In fiscal 2017, we exercised the first of two one-year extensions available under the lease to extend the term through July 2018. Subsequently, in fiscal 2017, we amended the lease to further extend the term through July 2020. The amended lease provides for two additional one-year renewal options. We made annual rental payments of approximately \$1,689,000, \$1,629,000, and \$1,599,000 plus applicable taxes, insurance and maintenance expenses in fiscal 2018, fiscal 2017 and fiscal 2016, respectively.

**Note F: Earnings Per Share**

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

| <i>In thousands, except per share amounts</i> | Net Earnings | Weighted<br>Average Shares | Earnings<br>Per Share |
|---|--------------|----------------------------|-----------------------|
| Fiscal 2018 (53 Weeks)                        |              |                            |                       |
| Basic   | \$ 333,684   | 81,420                     | \$ 4.10               |
| Effect of dilutive stock-based awards         |              | 920                        |                       |
| Diluted                                       | \$ 333,684   | 82,340                     | \$ 4.05               |
| Fiscal 2017 (52 Weeks)                        |              |                            |                       |

Edgar Filing: WILLIAMS SONOMA INC - Form 10-K

|                                       |    |         |        |    |      |
|---------------------------------------|----|---------|--------|----|------|
| Basic                                 | \$ | 259,545 | 85,592 | \$ | 3.03 |
| Effect of dilutive stock-based awards |    |         | 488    |    |      |
| Diluted                               | \$ | 259,545 | 86,080 | \$ | 3.02 |
| Fiscal 2016 (52 Weeks)                |    |         |        |    |      |
| Basic                                 | \$ | 305,387 | 88,594 | \$ | 3.45 |
| Effect of dilutive stock-based awards |    |         | 868    |    |      |
| Diluted                               | \$ | 305,387 | 89,462 | \$ | 3.41 |

Stock-based awards of 31,000, 577,000, and 261,000 were excluded from the computation of diluted earnings per share in fiscal 2018, fiscal 2017 and fiscal 2016, respectively, as their inclusion would be anti-dilutive.

## **Table of Contents**

### **Note G: 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 approximately 36,570,000 shares. As of February 3, 2019, there were approximately 7,436,000 shares available for future grant. Awards may be granted under the Plan to officers, employees and non-employee members of the Board of Directors of the company (the *Board*) or any parent or subsidiary. Shares issued as a result of award exercises or releases are primarily funded with the issuance of new shares.

#### *Option Awards*

Annual grants of option awards are limited to 1,000,000 shares on a per person basis and have a maximum term of seven years. The exercise price of these option awards is not less than 100% of the closing price of our stock on the day prior to the grant date. Option awards granted to employees generally vest 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.

#### *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 fiscal 2018, fiscal 2017 and fiscal 2016, we recognized total stock-based compensation expense, as a component of selling, general and administrative expenses, of \$59,802,000, \$42,988,000, and \$51,116,000, respectively. As of February 3, 2019, there was \$78,694,000 of unrecognized stock-based compensation expense (net of estimated forfeitures), which we expect to recognize on a straight-line basis over a weighted average remaining service period of approximately two years. At each reporting period, all compensation expense attributable to vested awards has been fully recognized.

#### *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.



**Table of Contents**

The following table summarizes our stock-settled stock appreciation right activity during fiscal 2018:

|   | Shares    | Weighted<br>Average<br>Conversion<br>Price <sup>1</sup> |
|---|-----------|---|
| Balance at January 28, 2018 (100% vested) | 167,737   | \$ 30.91  |
| Granted                                   |           |   |
| Converted into common stock               | (166,447) | 30.83   |
| Cancelled                                 | (1,290)   | 40.87   |
| Balance at February 3, 2019               |           | \$  |

<sup>1</sup> Conversion price is equal to the market value on the date of grant.

No stock-settled stock appreciation rights were granted in fiscal 2018, fiscal 2017 or fiscal 2016. The total intrinsic value of awards converted to common stock was \$4,394,000 for fiscal 2018, \$7,287,000 for fiscal 2017 and \$5,237,000 for fiscal 2016. Intrinsic value for conversions is based on the excess of the market value on the date of conversion over the conversion price.

**Restricted Stock Units**

The following table summarizes our restricted stock unit activity during fiscal 2018:

|   | Shares    | Weighted<br>Average<br>Grant Date<br>Fair Value | Weighted Average<br>Contractual<br>Term<br>Remaining (Years) | Intrinsic<br>Value <sup>1</sup> |
|---|-----------|---|--|---------------------------------|
| Balance at January 28, 2018                             | 2,358,137 | \$ 58.18  |  |                                 |
| Granted   | 1,432,954 | 49.72   |  |                                 |
| Granted, with vesting subject to performance conditions | 256,350   | 48.76   |  |                                 |
| Released  | (677,251) | 59.47   |  |                                 |
| Cancelled   | (357,267) | 60.48   |  |                                 |
| Balance at February 3, 2019                             | 3,012,923 | \$ 52.88  | 3.03   | \$ 162,698,000                  |
| Vested plus expected to vest at February 3, 2019        | 2,389,343 | \$ 52.74  | 3.10   | \$ 129,025,000                  |

<sup>1</sup> Intrinsic value for outstanding and unvested restricted stock units is based on the market value of our common stock on the last business day of the fiscal year (or \$54.00).

The following table summarizes additional information about restricted stock units:

|  | Fiscal 2018   | Fiscal 2017   | Fiscal 2016   |
|--|---------------|---------------|---------------|
| Weighted average grant date fair value per share of awards granted | \$ 49.57      | \$ 52.76      | \$ 59.17      |
| Intrinsic value of awards released <sup>1</sup>                    | \$ 34,213,000 | \$ 35,508,000 | \$ 56,405,000 |

<sup>1</sup> *Intrinsic value for releases is based on the market value on the date of release.*

*Tax Effect*

In accordance with ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting*, we record excess tax benefits and deficiencies resulting from the settlement of stock-based awards as a benefit or expense within income taxes in the period in which they occur. Further, in accordance with the ASU, we no longer classify such tax benefits as a financing cash inflow and an operating cash outflow. We adopted the classification requirements of this ASU prospectively as of the first quarter of fiscal 2017 and, as such, our Consolidated Statement of Cash Flows for fiscal 2016 has not been retrospectively adjusted. During fiscal 2018, fiscal 2017

---

**Table of Contents**

and fiscal 2016, proceeds related to stock-based awards were \$0, \$0 and \$1,532,000, respectively, and the current tax benefit related to stock-based awards totaled \$9,927,000, \$16,066,000 and \$24,129,000, respectively.

**Note H: Williams-Sonoma, Inc. 401(k) Plan and Other Employee Benefits**

We have a defined contribution retirement plan, the Williams-Sonoma, Inc. 401(k) Plan (the 401(k) Plan ), which is intended to be qualified under Internal Revenue Code sections 401(a), 401(k), 401(m) and 4975(e)(7). The 401(k) Plan permits eligible employees to make salary deferral contributions up to 75% of their eligible compensation each pay period (7% for highly-compensated employees). Employees designate the funds in which their contributions are invested. Each participant may choose to have his or her salary deferral contributions and earnings thereon invested in one or more investment funds, including our company stock fund.

Our matching contribution is equal to 50% of each participant's salary deferral contribution, taking into account only those contributions that do not exceed 6% of the participant's eligible pay for the pay period. Each participant's matching contribution is earned on a semi-annual basis with respect to eligible salary deferrals for those participants that are employed with the company on June 30th or December 31st of the year in which the deferrals are made. Each associate must complete one year of service prior to receiving company matching contributions. For the first five years of the participant's employment, all matching contributions vest at the rate of 20% per year of service, measuring service from the participant's hire date. Thereafter, all matching contributions vest immediately. Our contributions to the plan were \$9,036,000, \$8,224,000 and \$7,725,000 in fiscal 2018, fiscal 2017 and fiscal 2016, respectively.

The 401(k) Plan consists of two parts: a profit sharing plan portion and a stock bonus plan/employee stock ownership plan (the ESOP ). The ESOP portion is the portion that is invested in the Williams-Sonoma, Inc. Stock Fund. The profit sharing and ESOP components of the 401(k) Plan are considered a single plan under Internal Revenue Code section 414(l).

We also have a nonqualified executive deferred compensation plan that provides supplemental retirement income benefits for a select group of management. This plan permits eligible employees to make salary and bonus deferrals that are 100% vested. We have an unsecured obligation to pay in the future the value of the deferred compensation adjusted to reflect the performance, whether positive or negative, of selected investment measurement options chosen by each participant during the deferral period. As of February 3, 2019 and January 28, 2018, \$23,319,000 and \$24,151,000, respectively, is included in other long-term liabilities related to these deferred compensation obligations. Additionally, we have purchased life insurance policies on certain participants to potentially offset these unsecured obligations. The cash surrender value of these policies was \$25,390,000 and \$25,550,000 as of February 3, 2019 and January 28, 2018, respectively, and is included in other long-term assets, net.

**Note I: 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 J: Stock Repurchase Program and Dividends**

During fiscal 2018, we repurchased 5,373,047 shares of our common stock at an average cost of \$54.96 per share and a total cost of approximately \$295,304,000 under our stock repurchase program. As of February 3, 2019,



---

**Table of Contents**

there was approximately \$223,815,000 remaining under our current stock repurchase program. In March 2019, our Board of Directors authorized an increase in our current stock repurchase program by an additional \$500,000,000. As of February 3, 2019, we held treasury stock of \$235,000 that represents the cost of shares available for issuance intended to satisfy future stock-based award settlements in certain foreign jurisdictions.

During fiscal 2017, we repurchased 4,050,697 shares of our common stock at an average cost of \$48.43 per share and a total cost of approximately \$196,179,000. During fiscal 2016, we repurchased 2,871,480 shares of our common stock at an average cost of \$52.68 per share and a total cost of approximately \$151,272,000.

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.

Total cash dividends declared in fiscal 2018, fiscal 2017 and fiscal 2016, were approximately \$144,609,000, or \$1.72 per common share, \$135,779,000, or \$1.56 per common share and \$133,588,000, or \$1.48 per common share, respectively. In March 2019, our Board of Directors authorized a \$0.05, or 11.6%, increase in our quarterly cash dividend, from \$0.43 to \$0.48 per common share, subject to capital availability.

**Note K: Segment Reporting**

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. Beginning in fiscal 2019, due to the convergence of our e-commerce and retail businesses, we will only report one reportable segment.

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.

**Table of Contents****Segment Information**

| <i>In thousands</i>                   | E-commerce   | Retail       | Unallocated | Total        |
|---------------------------------------|--------------|--------------|-------------|--------------|
| <b>Fiscal 2018 (53 Weeks)</b>         |              |              |             |              |
| Net revenues <sup>1</sup>             | \$ 3,082,064 | \$ 2,589,529 | \$          | \$ 5,671,593 |
| Depreciation and amortization expense | 36,294       | 89,419       | 63,095      | 188,808      |
| Operating income (loss) <sup>2</sup>  | 643,592      | 217,070      | (424,709)   | 435,953      |
| Assets <sup>3</sup>                   | 914,452      | 1,183,604    | 714,788     | 2,812,844    |
| Capital expenditures                  | 45,151       | 82,840       | 62,111      | 190,102      |
| <b>Fiscal 2017 (52 Weeks)</b>         |              |              |             |              |
| Net revenues <sup>1</sup>             | \$ 2,778,457 | \$ 2,513,902 | \$          | \$ 5,292,359 |
| Depreciation and amortization expense | 28,977       | 90,625       | 63,475      | 183,077      |
| Operating income (loss) <sup>4</sup>  | 599,491      | 224,608      | (370,288)   | 453,811      |
| Assets <sup>3</sup>                   | 776,569      | 1,114,726    | 894,454     | 2,785,749    |
| Capital expenditures                  | 39,273       | 83,750       | 66,689      | 189,712      |
| <b>Fiscal 2016 (52 Weeks)</b>         |              |              |             |              |
| Net revenues <sup>1</sup>             | \$ 2,633,602 | \$ 2,450,210 | \$          | \$ 5,083,812 |
| Depreciation and amortization expense | 31,135       | 86,228       | 55,832      | 173,195      |
| Operating income (loss) <sup>4</sup>  | 606,286      | 231,929      | (365,616)   | 472,599      |
| Assets <sup>3</sup>                   | 614,213      | 1,077,593    | 785,073     | 2,476,879    |
| Capital expenditures                  | 21,479       | 102,859      | 73,076      | 197,414      |

<sup>1</sup> Includes net revenues related to our international operations (including our operations in Canada, Australia, the United Kingdom and our franchise businesses) of approximately \$346.8 million, \$328.2 million and \$321.2 million in fiscal 2018, fiscal 2017 and fiscal 2016, respectively.

<sup>2</sup> The 53 weeks ended February 3, 2019 includes approximately \$25.2 million of expense related to our acquisition of Outward (primarily acquisition-related compensation costs, the amortization of intangible assets acquired, and the operations of the Outward business), of which \$19.6 million is recorded in the e-commerce segment and \$5.5 million is recorded in the unallocated segment; \$13.2 million of expense related to impairment and early lease termination charges which is primarily recorded in the retail segment; and \$8.0 million of employment-related expense primarily associated with an equity grant, which is recorded within the unallocated segment.

<sup>3</sup> Includes long-term assets related to our international operations of approximately \$50.3 million, \$63.4 million and \$59.2 million in fiscal 2018, fiscal 2017 and fiscal 2016.

<sup>4</sup> The 52 weeks ended January 28, 2018 includes approximately \$8.6 million for severance-related charges, primarily in our corporate functions, which is recorded within the unallocated segment and approximately \$6.2 million for costs related to the acquisition of Outward and its ongoing operations, of which \$3.3 million is recorded in the e-commerce segment and \$2.9 million is recorded in the unallocated segment. The 52 weeks ended January 29, 2017 includes \$14.4 million for severance-related reorganization charges, primarily in our corporate functions, which is recorded within the unallocated segment.

**Note L: Derivative Financial Instruments**

We have retail and 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 financial 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 financial instrument is designated as a hedge and qualifies for hedge accounting in accordance with the 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 Canadian subsidiary. These

**Table of Contents**

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 February 3, 2019, we expect to reclassify a net pre-tax gain of approximately \$253,000 from OCI to cost of goods sold over the next 12 months.

We also enter into non-designated foreign currency forward contracts (to sell Australian dollars and British pounds 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 February 3, 2019, and January 28, 2018, we had foreign currency forward contracts outstanding (in U.S. dollars) with notional values as follows:

| <i>In thousands</i>                          | Feb. 3, 2019 | Jan. 28, 2018 |
|--|--------------|---------------|
| Contracts designated as cash flow hedges     | \$ 16,600    | \$ 28,200     |
| Contracts not designated as cash flow hedges | \$ 5,300     | \$ 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 fiscal 2018, fiscal 2017 and fiscal 2016.

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

| <i>In thousands</i>  | Fiscal 2018 | Fiscal 2017 | Fiscal 2016 |
|--|-------------|-------------|-------------|
| Net gain (loss) recognized in OCI  | \$ 1,488    | \$ (974)    | \$ (1,243)  |
| Net gain (loss) reclassified from OCI to cost of goods sold                                  | \$ 478      | \$ (144)    | \$ (147)    |
| Net foreign exchange gain (loss) recognized in selling, general and administrative expenses: |             |             |             |
| Instruments designated as cash flow hedges <sup>1</sup>                                      | \$ 57       | \$ 88       | \$ (4)      |
| Instruments not designated or de-designated  | \$ 3,967    | \$ (3,286)  | \$ (3,569)  |

<sup>1</sup> *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 Consolidated Balance Sheets. All fair values were measured using Level 2 inputs as defined by the fair value hierarchy described in Note M.

Edgar Filing: WILLIAMS SONOMA INC - Form 10-K

| <i>In thousands</i>                                | Feb. 3, 2019 | Jan. 28, 2018 |
|--|--------------|---------------|
| Derivatives designated as cash flow hedges:        |              |               |
| Other current assets                               | \$ 358       | \$            |
| Other current liabilities                          | \$           | \$ (635)      |
| Other long-term liabilities                        | \$           | \$ (54)       |
| Derivatives not designated as hedging instruments: |              |               |
| Other current assets                               | \$ 4         | \$            |
| Other current liabilities                          | \$           | \$ (299)      |

## **Table of Contents**

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.

### **Note M: 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.

### *Long-term Debt*

As of February 3, 2019, the fair value of our long-term debt, which consists of outstanding borrowings under our term loan, approximates its carrying value, as the instrument is relatively short-term in nature and the interest rate under the term loan is based on observable Level 2 inputs, primarily quoted market interest rates for instruments with similar maturities.

### *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 foreign 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 fiscal 2018 or fiscal 2017.



**Table of Contents****Note N: Accumulated Other Comprehensive Income (loss)**

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

| <i>In thousands</i>   | Foreign Currency<br>Translation | Cash Flow<br>Hedges | Accumulated Other<br>Comprehensive<br>Income (Loss) |
|---|---------------------------------|---------------------|---|
| Balance at January 31, 2016   | \$ (11,480)                     | \$ 864              | \$ (10,616)   |
| Foreign currency translation adjustments  | 1,523                           |                     | 1,523   |
| Change in fair value of derivative financial instruments  |                                 | (916)               | (916)   |
| Reclassification adjustment for realized (gain) loss on derivative financial instruments <sup>1</sup> |                                 | 106                 | 106   |
| Other comprehensive income (loss)   | 1,523                           | (810)               | 713   |
| Balance at January 29, 2017   | (9,957)                         | 54                  | (9,903)   |
| Foreign currency translation adjustments  | 3,730                           |                     | 3,730   |
| Change in fair value of derivative financial instruments  |                                 | (715)               | (715)   |
| Reclassification adjustment for realized (gain) loss on derivative financial instruments <sup>1</sup> |                                 | 106                 | 106   |
| Other comprehensive income (loss)   | 3,730                           | (609)               | 3,121   |
| Balance at January 28, 2018   | (6,227)                         | (555)               | (6,782)   |
| Foreign currency translation adjustments  | (5,032)                         |                     | (5,032)   |
| Change in fair value of derivative financial instruments  |                                 | 1,098               | 1,098   |
| Reclassification adjustment for realized (gain) loss on derivative financial instruments <sup>1</sup> |                                 | (357)               | (357)   |
| Other comprehensive income (loss)   | (5,032)                         | 741                 | (4,291)   |
| Balance at February 3, 2019   | \$ (11,259)                     | \$ 186              | \$ (11,073)   |

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

**Note O: Acquisition of Outward, Inc.**

On December 1, 2017, we acquired Outward, Inc., a 3-D imaging and augmented reality platform for the home furnishings and décor industry. Outward's technology enables applications in product visualization, digital room design and augmented and virtual reality. Of the \$112,000,000 contractual purchase price, approximately \$80,812,000 was deemed to be purchase consideration, \$26,690,000 is payable to former stockholders of Outward over a period of four years from the acquisition date, contingent upon their continued service during that time, and \$4,498,000 primarily represents settlement of pre-existing obligations of Outward with third parties on the acquisition date. Certain key employees of Outward may also collectively earn up to an additional \$20,000,000, contingent upon achievement of certain financial performance targets, and subject to their continued service over the performance period. Both of these contingent amounts will be recognized as post-combination compensation expense as they are earned.

**Table of Contents**

The purchase consideration has been allocated based on estimates of the fair value of identifiable assets acquired and liabilities assumed, as set forth in the table below.

*In thousands*

|  |               |
|--|---------------|
| Working capital and other assets       | \$ 718,000    |
| Property and equipment, net            | 2,049,000     |
| Intangible assets                      | 18,300,000    |
| Liabilities                            | (6,886,000)   |
| Total identifiable net assets acquired | \$ 14,181,000 |
| Goodwill                               | 66,631,000    |
| Total purchase consideration           | \$ 80,812,000 |

During the second quarter of fiscal 2018, we finalized the valuation of intangible assets acquired, which primarily represent 3-D imaging data and core intellectual property which are being amortized over a useful life of four years. Goodwill is primarily attributable to expected synergies as a result of the acquisition, which include the leverage of acquired technology and talent to drive improved conversion, cost savings and operating efficiencies. Goodwill of \$55,215,000 and \$11,416,000 was assigned to the e-commerce and retail reportable segments, respectively. None of the goodwill will be deductible for income tax purposes.

Outward is a wholly-owned subsidiary of Williams-Sonoma, Inc. Results of operations for Outward have been included in our Consolidated Financial Statements from the acquisition date. Pro forma results of Outward have not been presented as the results are insignificant to our Consolidated Financial Statements for all periods presented and would not have been significant had the acquisition occurred at the beginning of fiscal 2017.

**Table of Contents**

***REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM***

To the shareholders and the Board of Directors of Williams-Sonoma, Inc.:

**Opinions on the Financial Statements and Internal Control over Financial Reporting**

We have audited the accompanying consolidated balance sheets of Williams-Sonoma, Inc. and subsidiaries (the Company ) as of February 3, 2019 and January 28, 2018, the related consolidated statements of earnings, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended February 3, 2019, and the related notes (collectively referred to as the financial statements ). We also have audited the Company's internal control over financial reporting as of February 3, 2019, based on criteria established in *Internal Control Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of February 3, 2019 and January 28, 2018, and the results of its operations and its cash flows for each of the three years in the period ended February 3, 2019, in conformity with the accounting principles generally accepted in the United States of America. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of February 3, 2019, based on criteria established in *Internal Control Integrated Framework (2013)* issued by COSO.

**Basis for Opinions**

The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on these financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the financial statements included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures to respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

**Definition and Limitations of Internal Control over Financial Reporting**

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable

**Table of Contents**

assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ DELOITTE & TOUCHE LLP

San Francisco, California

April 4, 2019

We have served as the Company's auditor since 1980.

**Table of Contents****Quarterly Financial Information****(Unaudited)***In thousands, except per share amounts*

|   | First       | Second      | Third       | Fourth               | Full        |
|---|-------------|-------------|-------------|----------------------|-------------|
| Fiscal 2018 (53 Weeks)                  | Quarter     | Quarter     | Quarter     | Quarter <sup>1</sup> | Year        |
| Net revenues                            | \$1,203,000 | \$1,275,174 | \$1,356,983 | \$1,836,436          | \$5,671,593 |
| Gross profit                            | 432,164     | 463,942     | 494,984     | 709,923              | 2,101,013   |
| Operating income <sup>2,3,4</sup>       | 66,550      | 74,166      | 94,384      | 200,853              | 435,953     |
| Net earnings <sup>5,6</sup>             | 45,168      | 51,713      | 81,465      | 155,338              | 333,684     |
| Basic earnings per share <sup>7</sup>   | \$ 0.54     | \$ 0.63     | \$ 1.01     | \$ 1.95              | \$ 4.10     |
| Diluted earnings per share <sup>7</sup> | \$ 0.54     | \$ 0.62     | \$ 1.00     | \$ 1.93              | \$ 4.05     |
|   | First       | Second      | Third       | Fourth               | Full        |
| Fiscal 2017 (52 Weeks)                  | Quarter     | Quarter     | Quarter     | Quarter <sup>1</sup> | Year        |
| Net revenues                            | \$1,111,507 | \$1,201,606 | \$1,299,336 | \$1,679,910          | \$5,292,359 |
| Gross profit                            | 395,760     | 422,711     | 467,067     | 646,173              | 1,931,711   |
| Operating income <sup>2,3</sup>         | 62,474      | 81,584      | 110,813     | 198,940              | 453,811     |
| Net earnings <sup>5,6</sup>             | 39,555      | 52,917      | 71,313      | 95,760               | 259,545     |
| Basic earnings per share <sup>7</sup>   | \$ 0.45     | \$ 0.61     | \$ 0.84     | \$ 1.14              | \$ 3.03     |
| Diluted earnings per share <sup>7</sup> | \$ 0.45     | \$ 0.61     | \$ 0.84     | \$ 1.13              | \$ 3.02     |

<sup>1</sup> Our fourth quarter of fiscal 2018 included 14 weeks as compared to 13 weeks in fiscal 2017.

<sup>2</sup> Fiscal 2018 includes approximately \$6.9 million in the first quarter, \$5.0 million in the second quarter, \$6.0 million in the third quarter and \$7.2 million in the fourth quarter of expenses related to the acquisition of Outward and its ongoing operations, primarily recorded in selling, general and administrative expenses. Fiscal 2017 includes approximately \$6.2 million in the fourth quarter of expenses related to the acquisition of Outward and its ongoing operations, primarily recorded in selling, general and administrative expenses.

<sup>3</sup> Fiscal 2018 includes approximately \$1.7 million in the first quarter, \$1.9 million in the second quarter, \$1.9 million in the third quarter and \$2.5 million in the fourth quarter for employment-related expense primarily associated with an equity grant which is recorded in selling, general and administrative expenses. Fiscal 2017 includes approximately \$5.7 million in the first quarter and \$2.9 million in the fourth quarter for employment-related charges primarily related to severance in our corporate functions, which is recorded in selling, general and administrative expenses.

<sup>4</sup> Includes \$5.3 million in the second quarter, \$1.1 million in the third quarter and \$6.8 million in the fourth quarter of fiscal 2018 associated with impairment and early lease termination charges.

<sup>5</sup> Includes tax expense of approximately \$1.1 million in the first quarter of fiscal 2018, tax expense of approximately \$1.4 million in the first quarter of fiscal 2017 and a tax benefit of approximately \$1.7 million in the fourth quarter of fiscal 2017 associated with the adoption of new accounting rules related to stock-based compensation.

<sup>6</sup> Fiscal 2018 includes tax expense of \$3.3 million in the first quarter, tax expense of \$2.9 million in the second quarter, a tax benefit of \$10.6 million in the third quarter and tax expense of \$0.3 million in the fourth quarter, while fiscal 2017 includes provisional tax expense of approximately \$41.5 million in the fourth quarter, resulting

*from the enactment of the Tax Cuts and Jobs Act.*

<sup>7</sup> *Due to differences between quarterly and full year weighted average share count calculations, and the effect of quarterly rounding to the nearest cent per share, full year earnings per share may not equal the sum of the quarters.*

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**ITEM 9A. CONTROLS AND PROCEDURES**

*Evaluation of Disclosure Controls and Procedures*

As of February 3, 2019, 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

## **Table of Contents**

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 SEC.

### ***Management's Report on Internal Control Over Financial Reporting***

Our management is responsible for establishing and maintaining adequate internal control over the company's financial reporting. These internal controls are designed to provide reasonable assurance that the reported information is fairly presented, that disclosures are adequate and that the judgments inherent in the preparation of financial statements are reasonable. There are inherent limitations in the effectiveness of any internal control, including the possibility of human error and the circumvention or overriding of controls. Further, because of changes in conditions, the effectiveness of any internal control may vary over time.

Our management assessed the effectiveness of the company's internal control over financial reporting as of February 3, 2019. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework (2013)*. Based on our assessment using those criteria, our management concluded that, as of February 3, 2019, our internal control over financial reporting is effective.

Our independent registered public accounting firm audited the Consolidated Financial Statements included in this Annual Report on Form 10-K and the company's internal control over financial reporting. Their audit report appears on pages 65 and 66 of this Annual Report on Form 10-K.

### ***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.

## **ITEM 9B. OTHER INFORMATION**

On April 3, 2019, the Company's Compensation Committee adopted the Amended and Restated 2012 EVP Level Management Retention Plan (the "MRP"). The terms of the MRP are substantially identical to the terms of the Company's 2012 EVP Level Management Retention Plan adopted on November 1, 2012 by the Company's Compensation Committee, which terms were described in the Company's Current Report on Form 8-K as filed with the Commission on November 7, 2012.



**Table of Contents**

**PART III**

**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

Information required by this Item is incorporated by reference herein to information under the headings Election of Directors, Information Concerning Executive Officers, Audit and Finance Committee Report, Corporate Governance Corporate Governance Guidelines and Code of Business Conduct and Ethics, Corporate Governance Audit and Finance Committee and Section 16(a) Beneficial Ownership Reporting Compliance in our Proxy Statement for the 2019 Annual Meeting of Stockholders (the Proxy Statement ).

**ITEM 11. EXECUTIVE COMPENSATION**

Information required by this Item is incorporated by reference herein to information under the headings Corporate Governance Compensation Committee, Corporate Governance Director Compensation, and Executive Compensation in our Proxy Statement.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

Information required by this Item is incorporated by reference herein to information under the heading Security Ownership of Principal Stockholders and Management in our Proxy Statement.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

Information required by this Item is incorporated by reference herein to information under the heading Certain Relationships and Related Transactions in our Proxy Statement.

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

Information required by this Item is incorporated by reference herein to information under the headings Audit and Finance Committee Report and Proposal 3 Ratification of Selection of Independent Registered Public Accounting Firm Deloitte Fees and Services in our Proxy Statement.

**Table of Contents**

**PART IV**

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

(a)(1) Financial Statements:

The following Consolidated Financial Statements of Williams-Sonoma, Inc. and subsidiaries and the related notes are filed as part of this report pursuant to Item 8:

|  | <b>PAGE</b> |
|--|-------------|
| <u>Consolidated Statements of Earnings</u>                     | 40          |
| <u>Consolidated Statements of Comprehensive Income</u>         | 40          |
| <u>Consolidated Balance Sheets</u>                             | 41          |
| <u>Consolidated Statements of Stockholders' Equity</u>         | 42          |
| <u>Consolidated Statements of Cash Flows</u>                   | 43          |
| <u>Notes to Consolidated Financial Statements</u>              | 44          |
| <u>Report of Independent Registered Public Accounting Firm</u> | 65          |
| <u>Quarterly Financial Information</u>                         | 67          |

(a)(2) Financial Statement Schedules: Schedules have been omitted because they are not required, are not applicable, or because the required information, where material, is included in the financial statements, notes, or supplementary financial information.

(a)(3) Exhibits: The exhibits listed in the below Exhibit Index are filed or incorporated by reference as part of this Form 10-K

(b) Exhibits: The exhibits listed in the below Exhibit Index are filed or incorporated by reference as part of this Form 10-K

(c) Financial Statement Schedules: Schedules have been omitted because they are not required or are not applicable.

**Exhibit Index**

**CERTIFICATE OF INCORPORATION AND BYLAWS**

3.1 Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K as filed with the Commission on May 25, 2011, File No. 001-14077)

3.2 Amended and Restated Bylaws (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K as filed with the Commission on June 2, 2017, File No. 001-14077)

**INSTRUMENTS DEFINING THE RIGHTS OF SECURITY HOLDERS, INCLUDING INDENTURES**

- 4.1 Form of Common Stock Certificate (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K as filed with the Commission on May 25, 2011, File No. 001-14077)

---

**Table of Contents****FINANCING AGREEMENTS**

- 10.1 Seventh Amended and Restated Credit Agreement, dated January 8, 2018, between the Company and Bank of America, N.A., as administrative agent, letter of credit issuer and swingline lender, Wells Fargo Bank, National Association, as syndication agent and the lenders party thereto (incorporated by reference to Exhibit 10.1 to the Company's Annual Report on Form 10-K for the fiscal year ended January 28, 2018 as filed with the Commission on March 29, 2018, File No. 001-14077)
- 10.2 Reimbursement Agreement between the Company, Williams-Sonoma Singapore Pte. Ltd. and Bank of America, N.A., dated as of August 30, 2013 (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the period ended November 3, 2013 as filed with the Commission on December 12, 2013, File No. 001-14077)
- 10.3 First Amendment to Reimbursement Agreement between the Company, Williams-Sonoma Singapore Pte. Ltd., and Bank of America, N.A., dated as of August 29, 2014 (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the period ended November 2, 2014 as filed with the Commission on December 5, 2014, File No. 001-14077)
- 10.4 Second Amendment to Reimbursement Agreement between the Company, Williams-Sonoma Singapore Pte. Ltd., and Bank of America, N.A., dated as of August 28, 2015 (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the period ended November 1, 2015 as filed with the Commission on December 11, 2015, File No. 001-14077)
- 10.5 Third Amendment to Reimbursement Agreement between the Company, Williams-Sonoma Singapore Pte. Ltd., and Bank of America, N.A., dated as of August 26, 2016 (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the period ended October 30, 2016 as filed with the Commission on December 7, 2016, File No. 001-14077)
- 10.6 Fourth Amendment to Reimbursement Agreement between the Company, Williams-Sonoma Singapore Pte. Ltd., and Bank of America, N.A., dated as of August 25, 2017 (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the period ended October 29, 2017 as filed with the Commission on December 6, 2017, File No. 001-14077)
- 10.7 Fifth Amendment to Reimbursement Agreement between the Company, Williams-Sonoma Singapore Pte. Ltd., and Bank of America, N.A., dated as of August 24, 2018 (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the period ended October 28, 2018 as filed with the Commission on December 7, 2018, File No. 001-12077)
- 10.8 Reimbursement Agreement between the Company, Williams-Sonoma Singapore Pte. Ltd., and Wells Fargo Bank, N.A., dated as of August 30, 2013 (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the period ended November 3, 2013 as filed with the Commission on December 12, 2013, File No. 001-14077)
- 10.9 First Amendment to Reimbursement Agreement between the Company, Williams-Sonoma Singapore Pte. Ltd., and Wells Fargo Bank, N.A., dated as of August 29, 2014 (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the period ended November 2, 2014 as filed with the Commission on December 5, 2014, File No. 001-14077)
- 10.10 Second Amendment to Reimbursement Agreement between the Company, Williams-Sonoma Singapore Pte. Ltd., and Wells Fargo Bank, N.A., dated as of August 28, 2015 (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the period ended November 1, 2015 as filed with the Commission on December 11, 2015, File No. 001-14077)

- 10.11 Third Amendment to Reimbursement Agreement between the Company, Williams-Sonoma Singapore Pte. Ltd., and Wells Fargo Bank, N.A., dated as of August 26, 2016 (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the period ended October 30, 2016 as filed with the Commission on December 7, 2016, File No. 001-14077)

**Table of Contents**

- 10.12 Fourth Amendment to Reimbursement Agreement between the Company, Williams-Sonoma Singapore Pte. Ltd., and Wells Fargo Bank, N.A., dated as of August 25, 2017 (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the period ended October 29, 2017 as filed with the Commission on December 6, 2017, File No. 001-14077)
- 10.13 Fifth Amendment to Reimbursement Agreement between the Company, Williams-Sonoma Singapore Pte. Ltd., and Wells Fargo Bank, N.A., dated as of August 24, 2018 (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the period ended October 28, 2018 as filed with the Commission on December 7, 2018, File No.001-14077)
- 10.14 Reimbursement Agreement between the Company, Williams-Sonoma Singapore Pte. Ltd., and U.S. Bank National Association, dated as of August 30, 2013 (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended November 3, 2013 as filed with the Commission on December 12, 2013, File No. 001-14077)
- 10.15 First Amendment to Reimbursement Agreement between the Company, Williams-Sonoma Singapore Pte. Ltd., and U.S. Bank National Association, dated as of August 29, 2014 (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended November 2, 2014 as filed with the Commission on December 5, 2014, File No. 001-14077)
- 10.16 Second Amendment to Reimbursement Agreement between the Company, Williams-Sonoma Singapore Pte. Ltd., and U.S. Bank National Association, dated as of August 28, 2015 (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the period ended November 1, 2015 as filed with the Commission on December 11, 2015, File No. 001-14077)
- 10.17 Third Amendment to Reimbursement Agreement between the Company, Williams-Sonoma Singapore Pte. Ltd., and U.S. Bank National Association, dated as of August 26, 2016 (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the period ended October 30, 2016 as filed with the Commission on December 7, 2016, File No. 001-14077)
- 10.18 Fourth Amendment to Reimbursement Agreement between the Company, Williams-Sonoma Singapore Pte. Ltd., and U.S. Bank National Association, dated as of August 25, 2017 (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the period ended October 29, 2017 as filed with the Commission on December 6, 2017, File No. 001-14077)
- 10.19 Fifth Amendment to Reimbursement Agreement between the Company, Williams-Sonoma Singapore Pte. Ltd., and U.S. Bank National Association, dated as of August 24, 2018 (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on the Form 10-Q for the period ended October 28, 2018 as filed with the Commission on December 7, 2018, File No. 001-14077)

**STOCK PLANS**

- 10.20+ Williams-Sonoma, Inc. 2001 Long-Term Incentive Plan, as amended (incorporated by reference to Exhibit A to the Company's definitive proxy statement as filed on April 13, 2018, File No. 001-14077)

**Table of Contents**

- 10.21+ Form of Williams-Sonoma, Inc. 2001 Long-Term Incentive Plan Restricted Stock Unit Award Agreement for Grants to Non-Employee Directors (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the period ended May 4, 2014 as filed with the Commission on June 12, 2014, File No. 001-14077)
- 10.22+ Form of Williams-Sonoma, Inc. 2001 Long-Term Incentive Plan Restricted Stock Unit Award Agreement for Grants to Employees (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the period ended May 4, 2014 as filed with the Commission on June 12, 2014, File No. 001-14077)
- 10.23+ Form of Williams-Sonoma, Inc. 2001 Long-Term Incentive Plan Performance Stock Unit Award Agreement for Grants to Employees (incorporated by reference to Exhibit 10.15 to the Company's Annual Report on Form 10-K for the fiscal year ended February 2, 2014 as filed with the Commission on April 3, 2014, File No. 001-14077)
- 10.24+ Form of Williams-Sonoma, Inc. 2001 Long-Term Incentive Plan Retention Restricted Stock Unit Award Agreement for Grants to Employees (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the period ended July 30, 2017 as filed with the Commission on September 8, 2017, File No. 001-14077)

**OTHER INCENTIVE PLANS**

- 10.25+ Williams-Sonoma, Inc. 2001 Incentive Bonus Plan, as amended (incorporated by reference to Exhibit A to the Company's Definitive Proxy Statement on Schedule 14A as filed with the Commission on April 6, 2012, File No. 001-14077)
- 10.26+ Williams-Sonoma, Inc. Pre-2005 Executive Deferral Plan (incorporated by reference to Exhibit 10.40 to the Company's Annual Report on Form 10-K for the fiscal year ended February 1, 2009 as filed with the Commission on April 2, 2009, File No. 001-14077)
- 10.27+ Williams-Sonoma, Inc. Amended and Restated Executive Deferred Compensation Plan (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the period ended April 29, 2018 as filed with the Commission on June 8, 2018, File No. 001-14077)

**PROPERTIES**

- 10.28 Memorandum of Understanding between the Company and the State of Mississippi, Mississippi Business Finance Corporation, Desoto County, Mississippi, the City of Olive Branch, Mississippi and Hewson Properties, Inc., dated August 24, 1998 (incorporated by reference to Exhibit 10.6 to the Company's Quarterly Report on Form 10-Q for the period ended August 2, 1998 as filed with the Commission on September 14, 1998, File No. 001-14077)
- 10.29 Olive Branch Distribution Facility Lease, dated December 1, 1998, between the Company as lessee and WSDC, LLC (the successor-in-interest to Hewson/Desoto Phase I, L.L.C.) as lessor (incorporated by reference to Exhibit 10.3D to the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 1999 as filed with the Commission on April 30, 1999, File No. 001-14077)

**Table of Contents**

- 10.30 First Amendment, dated September 1, 1999, to the Olive Branch Distribution Facility Lease between the Company as lessee and WSDC, LLC (the successor-in-interest to Hewson/Desoto Phase I, L.L.C.) as lessor, dated December 1, 1998 (incorporated by reference to Exhibit 10.3B to the Company's Annual Report on Form 10-K for the fiscal year ended January 30, 2000 as filed with the Commission on May 1, 2000, File No. 001-14077)
- 10.31 Second Amendment, dated March 1, 2018, to the Olive Branch Distribution Facility Lease between the Company as lessee and WSDC, LLC (the successor-in-interest to Hewson/Desoto Phase I, L.L.C.) as lessor, dated December 1, 1998 (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the period ended April 29, 2018 as filed with the Commission on June 8, 2018, File No. 001-14077)
- 10.32 Lease for an additional Company distribution facility located in Olive Branch, Mississippi between Williams-Sonoma Retail Services, Inc. as lessee and SPI WS II, LLC (the successor-in-interest to Hewson/Desoto Partners, L.L.C.) as lessor, dated November 15, 1999 (incorporated by reference to Exhibit 10.14 to the Company's Annual Report on Form 10-K for the fiscal year ended January 30, 2000 as filed with the Commission on May 1, 2000, File No. 001-14077)

**EMPLOYMENT AGREEMENTS**

- 10.33+ Amended and Restated Employment Agreement with Laura Alber, dated September 6, 2012 (incorporated by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q for the period ended October 28, 2012 as filed with the Commission December 7, 2012, File No. 001-14077)
- 10.34+ Amended and Restated Management Retention Agreement with Laura Alber, dated September 6, 2012 (incorporated by reference to Exhibit 10.5 to the Company's Quarterly Report on Form 10-Q for the period ended October 28, 2012 as filed with the Commission December 7, 2012, File No. 001-14077)
- 10.35+\* Amended and Restated 2012 EVP Level Management Retention Plan

**OTHER AGREEMENTS**

- 10.36+ Form of Williams-Sonoma, Inc. Indemnification Agreement (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended July 31, 2011 as filed with the Commission on September 9, 2011, File No. 001-14077)

**OTHER EXHIBITS**

- 21.1\* Subsidiaries
- 23.1\* Consent of Independent Registered Public Accounting Firm

**CERTIFICATIONS**

- 31.1\* Certification of Chief Executive Officer, pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended
- 31.2\* Certification of Chief Financial Officer, pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended
- 32.1\* 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
- 32.2\* 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





**Table of Contents**

**XBRL**

|          |  |
|----------|--|
| 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.

+ Indicates a management contract or compensatory plan or arrangement.

**ITEM 16. FORM 10-K SUMMARY**

None.

Table of Contents

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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.

Date: April 4, 2019

By /s/ LAURA ALBER  
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Date: April 4, 2019 /s/ ADRIAN BELLAMY  
Adrian Bellamy  
Chairman of the Board of Directors

Date: April 4, 2019 /s/ LAURA ALBER  
Laura Alber  
Chief Executive Officer  
(principal executive officer)

Date: April 4, 2019 /s/ JULIE WHALEN  
Julie Whalen  
Chief Financial Officer  
(principal financial officer and principal accounting officer)

Date: April 4, 2019 /s/ ANTHONY GREENER  
Anthony Greener  
Director

Date: April 4, 2019 /s/ ROBERT LORD  
Robert Lord  
Director

Date: April 4, 2019 /s/ ANNE MULCAHY  
Anne Mulcahy  
Director

Date: April 4, 2019 /s/ GRACE PUMA  
Grace Puma  
Director

Date: April 4, 2019 /s/ CHRISTIANA SMITH SHI  
Christiana Smith Shi

Director

Date: April 4, 2019 /s/ SABRINA SIMMONS  
Sabrina Simmons  
Director

Date: April 4, 2019 /s/ FRITS VAN PAASSCHEN  
Frits van Paasschen  
Director