KOHLS Corp
Form 10-Q
December 02, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended October 29, 2016

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

For the Transition period from ________ to _________

Commission file number 1-11084

KOHL'S CORPORATION
(Exact name of registrant as specified in its charter)

Wisconsin	39-1630919
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
N56 W17000 Ridgewood Drive, Menomonee Falls, Wisconsin	53051
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (262) 703-7000

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 ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ý	Accelerated filer ¨
Non-accelerated filer ¨¬ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by a check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: November 26, 2016 Common Stock, Par Value $0.01 per Share, 176,472,956 shares outstanding.

Table of Contents

KOHL'S CORPORATION
INDEX

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

KOHL'S CORPORATION
CONSOLIDATED BALANCE SHEETS
(Dollars in Millions)

	October 29, 2016 (Unaudited)	January 30, 2016 (Audited)	October 31, 2015 (Unaudited)
Assets			
Current assets:			
Cash and cash equivalents	$ 597	$ 707	$ 501
Merchandise inventories	4,721	4,038	5,254
Other	336	331	312
Total current assets	5,654	5,076	6,067
Property and equipment, net	8,203	8,308	8,499
Other assets	219	222	228
Total assets	$ 14,076	$ 13,606	$ 14,794
Liabilities and Shareholders' Equity			
Current liabilities:			
Accounts payable	$ 2,097	$ 1,251	$ 2,141
Accrued liabilities	1,235	1,206	1,244
Income taxes payable	66	130	28
Current portion of capital lease and financing obligations	128	127	126
Short-term debt	—	—	400
Total current liabilities	3,526	2,714	3,939
Long-term debt	2,794	2,792	2,792
Capital lease and financing obligations	1,702	1,789	1,817
Deferred income taxes	298	257	216
Other long-term liabilities	649	563	556
Shareholders' equity:			
Common stock	4	4	4
Paid-in capital	2,981	2,944	2,926
Treasury stock, at cost	(10,221)	(9,769)	(9,556)
Accumulated other comprehensive loss	(15)	(17)	(18)
Retained earnings	12,358	12,329	12,118
Total shareholders' equity	5,107	5,491	5,474
Total liabilities and shareholders' equity	$ 14,076	$ 13,606	$ 14,794

See accompanying Notes to Consolidated Financial Statements

Table of Contents

KOHL’S CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
(Dollars in Millions, Except per Share Data)

	Three Months Ended		Nine Months Ended	
	October 29, 2016	October 31, 2015	October 29, 2016	October 31, 2015
Net sales	$4,327	$ 4,427	$12,481	$ 12,817
Cost of merchandise sold	2,720	2,784	7,812	7,990
Gross margin	1,607	1,643	4,669	4,827
Operating expenses:				
Selling, general and administrative	1,080	1,099	3,074	3,120
Depreciation and amortization	232	236	700	695
Impairments, store closing and other costs	(6)	—	186	—
Operating income	301	308	709	1,012
Interest expense, net	76	81	233	248
Loss on extinguishment of debt	—	38	—	169
Income before income taxes	225	189	476	595
Provision for income taxes	79	69	173	218
Net income	$146	$ 120	$303	$ 377
Net income per share:				
Basic	$0.83	$ 0.63	$1.68	$ 1.93
Diluted	$0.83	$ 0.63	$1.68	$ 1.92
Dividends declared and paid per share	$0.50	$ 0.45	$1.50	$ 1.35

See accompanying Notes to Consolidated Financial Statements

Table of Contents

KOHL’S CORPORATION
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS’ EQUITY
(Unaudited)
(Dollars and Shares in Millions, Except per Share Data)

	Common Stock		Paid-In Capital	Treasury Stock		Accumulated Other Comprehensive Loss	Retained Earnings	Total
	Shares	Amount		Shares	Amount			
Balance at January 30, 2016	370	$ 4	$ 2,944	(184)	$ (9,769)	$ (17)	$ 12,329	$ 5,491
Comprehensive income	—	—	—	—	—	2	303	305
Stock options and awards, net of tax	1	—	37	—	(15)	—	—	22
Dividends paid ($1.50 per common share)	—	—		—	4	—	(274)	(270)
Treasury stock purchases	—	—	—	(11)	(441)	—	—	(441)
Balance at October 29, 2016	371	$ 4	$ 2,981	(195)	$ (10,221)	$ (15)	$ 12,358	$ 5,107

See accompanying Notes to Consolidated Financial Statements

Table of Contents

KOHL'S CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(Dollars in Millions)

	Nine Months Ended October 29, 2016			October 31, 2015		
Operating activities						
Net income	$	303		$	377	
Adjustments to reconcile net income to net cash provided by operating activities:						
Depreciation and amortization	700			695		
Share-based compensation	31			36		
Excess tax benefits from share-based compensation	(4		)	(10		)
Deferred income taxes	40			(84		)
Loss on extinguishment of debt	—			169		
Impairments, store closing and other costs	57			—		
Other non-cash revenues and expenses	20			23		
Changes in operating assets and liabilities:						
Merchandise inventories	(679		)	(1,433		)
Other current and long-term assets	20			74		
Accounts payable	846			630		
Accrued and other long-term liabilities	23			(6		)
Income taxes	(77		)	(64		)
Net cash provided by operating activities	1,280			407		
Investing activities						
Acquisition of property and equipment	(591		)	(551		)
Other	7			3		
Net cash used in investing activities	(584		)	(548		)
Financing activities						
Treasury stock purchases	(441		)	(789		)
Shares withheld for taxes on vested	(15		)	(26		)

restricted shares				
Dividends paid	(270	)	(264	)
Proceeds from issuance of debt, net	—		1,088	
Net borrowings under credit facilities	—		400	
Reduction of long-term borrowings	—		(1,085	)
Premium paid on redemption of debt	—		(163	)
Capital lease and financing obligation payments	(95	)	(83	)
Proceeds from stock option exercises	6		146	
Excess tax benefits from share-based compensation	4		10	
Proceeds from financing obligations	5		1	
Net cash used in financing activities	(806	)	(765	)
Net decrease in cash and cash equivalents	(110	)	(906	)
Cash and cash equivalents at beginning of period	707		1,407	
Cash and cash equivalents at end of period	$ 597		$ 501	
Supplemental information				
Interest paid, net of capitalized interest	$ 198		$ 220	
Income taxes paid	217		370	
Non-cash investing and financing activities				
Property and equipment acquired through additional liabilities	$ 39		$ 59	

See accompanying Notes to Consolidated Financial Statements

Table of Contents
KOHL’S CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation
The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for fiscal year end consolidated financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. For further information, refer to the consolidated financial statements and related footnotes included in our Annual Report on Form 10-K for the fiscal year ended January 30, 2016 (Commission File No. 1-11084) as filed with the Securities and Exchange Commission on March 18, 2016.
Due to the seasonality of our business, results for any quarter are not necessarily indicative of the results that may be achieved for a full fiscal year.
We operate as a single business unit.

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers (Topic 606)", which supersedes the revenue recognition requirements in Accounting Standards Codification ("ASC") No. 605, "Revenue Recognition". In August 2015, the FASB issued ASU 2015-14, "Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date", which defers the effective date of ASU 2014-09 for all entities by one year. The original ASU is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This ASU is effective in the first quarter of 2018. It will change the way we account for sales returns, our loyalty program and certain promotional programs. Based on current estimates, we do not expect these provisions of the ASU to have a material impact on our financial statements. We are currently evaluating the impact other provisions of the standard may have on our financial statements.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)". The core principle of the standard is that a lessee should recognize the assets and liabilities that arise from leases. A lessee should recognize in its statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. We will be required to adopt the new standard in the first quarter of 2019. We are currently evaluating the impact this new standard will have on our financial statements.

In March 2016, the FASB issued ASU 2016-09, "Compensation - Stock Compensation (Topic 718)". This ASU modifies several aspects of accounting and reporting for share-based payment transactions. Under the new rules, excess income tax benefits and tax deficiencies related to share-based payments will be recognized within income tax expense in the statement of income, rather than within additional paid-in capital on the balance sheet. We are currently evaluating the potential impact that this provision, which is to be applied prospectively, will have on our financial statements. ASU 2016-09 also permits changes to an employers’ accounting for an employee’s use of shares to satisfy the employer’s statutory income tax withholding obligation and for forfeitures. We will be required to adopt this new standard in the first quarter of 2017. We do not expect these provisions will have a material impact on our financial statements.

In 2015, we adopted ASU No. 2015-17, "Balance Sheet Classification of Deferred Taxes (Topic 740)" which requires us to present deferred tax liabilities and assets as non-current in our balance sheet and corrected the presentation of certain other tax assets and liabilities. The following table summarizes changes to our October 31, 2015 balance sheet:
(Dollars in Millions) Prior Classification Current Classification

Deferred taxes	Current deferred tax asset	Long-term deferred tax liability	$136
Deferred taxes	Long-term deferred tax liability	Other long-term assets	32
Deferred taxes	Other long-term liabilities	Long-term deferred tax liability	15

Table of Contents
KOHL'S CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

2. Debt
Long-term debt consists of the following unsecured senior debt:

Maturity	Effective Rate	Coupon Rate	Outstanding October 29, 2016	January 30, 2016	October 31, 2015
			(Dollars in Millions)		
2021	4.81 %	4.00 %	$650	$ 650	$ 650
2023	3.25 %	3.25 %	350	350	350
2023	4.78 %	4.75 %	300	300	300
2025	4.25 %	4.25 %	650	650	650
2029	7.36 %	7.25 %	99	99	99
2033	6.05 %	6.00 %	166	166	166
2037	6.89 %	6.88 %	150	150	150
2045	5.57	5.55	450	450	450
	4.88 %		2,815	2,815	2,815
Unamortized debt discount			(5)	(5)	(5)
Deferred financing costs			(16)	(18)	(18)
Long-term debt			$2,794	$ 2,792	$ 2,792

ASC No. 820, "Fair Value Measurements and Disclosures", requires fair value measurements be classified in various pricing categories. Our long-term debt is classified as Level 1, financial instruments with unadjusted, quoted prices listed on active market exchanges. The estimated fair value of our long-term debt was $3.0 billion at October 29, 2016, $2.8 billion at January 30, 2016, and $2.9 billion at October 31, 2015.

3. Stock-Based Compensation
The following table summarizes our stock-based compensation activity for the nine months ended October 29, 2016:

(Shares and Units in Thousands)	Stock Options		Nonvested Stock Awards		Performance Share Units	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Grant Date Fair Value	Units	Weighted Average Grant Date Fair Value
Balance at beginning of period	3,076	$ 52.65	2,211	$ 57.37	347	$ 67.53
Granted	—	—	1,342	46.26	12	67.48
Exercised/vested	(150)	41.80	(835)	56.19	—	—
Forfeited/expired	(298)	55.07	(235)	55.34	(32)	67.98
Balance at end of period	2,628	$ 53.00	2,483	$ 51.95	327	$ 67.49

4. Contingencies

We are subject to certain legal proceedings and claims arising out of the conduct of our business. In the opinion of management, the outcome of these proceedings and litigation will not have a material adverse impact on our consolidated financial statements.

8

Table of Contents
KOHL'S CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

5. Net Income Per Share
The following table summarizes our basic and diluted net income per share calculations:

(Dollar and Shares in Millions)	Three Months Ended October 29, 2016	Three Months Ended October 31, 2015	Nine Months Ended October 29, 2016	Nine Months Ended October 31, 2015
Numerator—Net income	$ 146	$ 120	$ 303	$ 377
Denominator—Weighted average shares:				
Basic	177	191	180	196
Impact of dilutive stock-based awards	—	1	—	1
Diluted	177	192	180	197
Antidilutive shares	3	3	4	1

6. Impairments, Store Closing and Other Costs

On February 25, 2016, we announced plans to close 18 underperforming stores in fiscal 2016. The specific locations were announced in March 2016. Seventeen of the stores closed in June 2016. We closed the final store in November. Store employees impacted by the closures were offered the opportunity to work at nearby Kohl's locations or a severance package.

We recorded the following costs related to the store closures and the organizational realignment at our corporate office:

(Dollars in Millions)	Three Months Ended October 29, 2016	Nine Months Ended October 29, 2016
Store leases:		
Record future obligations	$ (5)	$ 114
Write-off net obligations	—	(21)
Impairments:		
Software licenses	—	23
Buildings and other store assets	—	53
Severance and other	(1)	17
Total	$ (6)	$ 186

The store lease future obligation charge represents the discounted value of rents and other lease liabilities under non-cancellable lease terms and will be paid over the next 13 years. All of the severance will be paid out within two years. The remaining charge is primarily non-cash write-offs of assets and liabilities that were previously recorded on our books.

During the quarter ended October 29, 2016, we reversed $6 million of costs that were recorded earlier in the year. The reversal includes severance for corporate associates that have found re-employment elsewhere and lease liabilities for a store that will be used for corporate purposes.

The following table summarizes changes in the store closure and restructure reserve during the quarter:

(Dollars in Millions)	Store Lease Operations	Severance	Total
Balance - July 30, 2016	$ 118	$ 6	$ 124
Payments	(3)	(1)	(4)
Reversals	(5)	(1)	(6)
Balance - October 29, 2016	$ 110	$ 4	$ 114

Table of Contents

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

For purposes of the following discussion, all references to "the quarter" and "the third quarter" are for the three fiscal months (13 weeks) ended October 29, 2016 and October 31, 2015 and all references to "year to date" and "first three quarters" are for the nine fiscal months (39 weeks) ended October 29, 2016 and October 31, 2015.
The following discussion should be read in conjunction with our Consolidated Financial Statements and the related notes included elsewhere in this report, as well as the financial and other information included in our 2015 Annual Report on Form 10-K (our "2015 Form 10-K"). The following discussion may contain forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could materially differ from those discussed in these forward-looking statements. Factors that could cause or contribute to those differences include, but are not limited to, those discussed elsewhere in this report and in our 2015 Form 10-K (particularly in "Risk Factors").

Executive Summary

As of October 29, 2016, we operated 1,155 Kohl's department stores, a website (www.Kohls.com), 12 FILA outlets, and three Off-Aisle clearance centers. Our Kohl's stores and website sell moderately-priced private label, exclusive and national brand apparel, footwear, accessories, beauty and home products. Our Kohl's stores generally carry a consistent merchandise assortment with some differences attributable to local preferences. Our website includes merchandise which is available in our stores, as well as merchandise which is available only on-line.
In the first three quarters of 2016, we opened one traditional and eight small format Kohl's stores, two Off-Aisle clearance centers, and 12 FILA outlets. We closed 17 underperforming Kohl's stores in June, one store which we have chosen not to re-open after extensive flood damage in August, and one additional underperforming store in November.

Sales were $4.3 billion for the quarter, 2.3% lower than the third quarter of last year. On a comparable store basis, sales were 1.7% lower. The decreases were primarily driven by fewer transactions in our stores partially offset by higher average transaction value.

Inventory, gross margin and expenses were well-managed in a challenging sales environment.

- Inventory per store decreased 9%.
- Gross margin as a percentage of sales increased 2 basis points to 37.1% driven by fewer promotional markdowns which were offset by higher shipping costs.
- Selling, general and administrative expenses (“SG&A”) decreased $19 million, or 2%, on strong expense management against the lower sales volume; however, we still experienced expense deleveraging.

During the quarter, we reversed $6 million of previously recorded expenses associated with store closing and restructuring costs. The reversal includes severance for corporate associates that have found re-employment elsewhere and lease liabilities for a store that will be used for corporate purposes.

Net income for the quarter was $146 million, or $0.83 per diluted share. Excluding the store closure and restructuring items in 2016 and loss on extinguishment of debt in 2015, net income was $142 million, or $0.80 per diluted share, 7% higher than the third quarter of last year.

See "Results of Operations" and "Financial Condition and Liquidity" for additional details about our financial results.
Results of Operations

Net sales.

Net sales decreased $100 million, or 2.3%, to $4.3 billion for the third quarter of 2016. Year to date, net sales decreased $336 million, or 2.6%, to $12.5 billion. Comparable sales decreased 1.7% for the third quarter and 2.4%

year to date. Comparable sales include sales for stores (including relocated or remodeled stores) which were open during both the current and prior year periods. We also include e-commerce sales in our comparable sales. Orders that have been shipped, but not yet been received by the customer, are excluded from net sales, but are included in our comparable sales.

Drivers of the changes in comparable sales for the quarter and year to date were as follows:

Change in Comparable Sales	Quarter	Year to Date
Selling price per unit	1.9 %	0.3 %
Units per transaction	2.1	2.4
Average transaction value	4.0	2.7
Number of transactions	(5.7)	(5.1)
Comparable sales	(1.7)%	(2.4)%

From a regional perspective, including on-line originated sales, the West was the strongest region for both the quarter and year to date. The Mid-Atlantic and Northeast regions underperformed the company in both periods.
By line of business, Men's and Footwear were the strongest categories for both the quarter and year to date. Accessories, Children's, and Women's underperformed the company in both periods.
Gross margin.

	Quarter				Year to Date			
(Dollars in Millions)	2016	2015	Increase/(Decrease) $	%	2016	2015	(Decrease) $	%
Gross margin	$1,607	$1,643	$ (36)	(2)%	$4,669	$4,827	$ (158)	(3)%
As a percent of net sales	37.1 %	37.1 %		0.02 %	37.4 %	37.7 %		(0.26)%

Gross margin includes the total cost of products sold, including product development costs, net of vendor payments other than reimbursement of specific, incremental and identifiable costs; inventory shrink; markdowns; freight expenses associated with moving merchandise from our vendors to our distribution centers; shipping and handling expenses of on-line sales; and terms cash discount. Our gross margin may not be comparable with that of other retailers because we include distribution center and buying costs in selling, general and administrative expenses while other retailers may include these expenses in cost of merchandise sold.

Gross margin as a percent of sales increased 2 basis points for the quarter and decreased 26 basis points year to date. Merchandise margin increased in both periods due to fewer promotional markdowns. For the quarter, the increase in merchandise margin was offset by shipping costs. Year to date, the benefit of fewer promotional markdowns was more than offset by additional clearance markdowns and shipping costs.

Selling, general and administrative expenses.

	Quarter				Year to Date			
(Dollars in Millions)	2016	2015	Increase/(Decrease) $	%	2016	2015	Increase/(Decrease) $	%
Selling, general and administrative expenses	$1,080	$1,099	$ (19)	(2)%	$3,074	$3,120	$ (46)	(1)%
As a percent of net sales	25.0 %	24.8 %		0.12 %	24.6 %	24.3 %		0.29 %

SG&A expenses include compensation and benefit costs (including stores, headquarters, buying and merchandising, and distribution centers); occupancy and operating costs of our retail, distribution and corporate facilities; freight expenses associated with moving merchandise from our distribution centers to our retail stores and among distribution and retail facilities; marketing expenses, offset by vendor payments for reimbursement of specific, incremental and identifiable costs; net revenues from our Kohl’s credit card operations; and other administrative revenues and expenses. We do not include depreciation and amortization in SG&A. The classification of these expenses varies across the retail industry.

The following table summarizes the increases and (decreases) in SG&A by expense type for the quarter and year to date:

(Dollars In Millions)	Quarter	Year to Date
Increase in net revenues from credit card operations	$ (10)	$ (23)
Corporate expenses	(9)	(20)
Marketing costs, excluding credit card operations	(4)	9
Distribution costs	1	(2)
Store expenses	3	(10)
Total decrease	$ (19)	$ (46)

Many of our expenses, including store payroll and distribution costs, are variable in nature. These costs generally increase as sales increase and decrease as sales decrease. We measure both the change in these variable expenses and the expense as a percent of sales. If the expense as a percent of sales decreased from the prior year, the expense "leveraged" and indicates that the expense was well-managed or effectively generated additional sales. If the expense as a percent of sales increased over the prior year, the expense "deleveraged" and indicates that sales growth was less than expense growth. SG&A as a percent of sales increased, or "deleveraged," by 12 basis points for the quarter and 29 basis points year to date.

The increases in net revenues from credit card operations reflect growth in the portfolio which was partially offset by higher operating costs. The decreases in corporate expenses are primarily due to lower incentive compensation. Marketing costs include higher digital spending in both periods. For the quarter, increases in digital spend and in tab marketing were more than offset by lower consulting and agency fees. Year-to-date marketing includes additional spending for our Academy Awards sponsorship in the first quarter of 2016. Store expenses include higher payroll in both periods due to on-going wage pressures and in-store support of ship-from-store and buy-online, pick-up from store. Reductions in controllable store expenses partially offset the higher payroll during the quarter, but more than offset year-to-date payroll increases.

Other Expenses.

	Quarter				Year to Date			
	2016	2015	Increase/(Decrease)		2016	2015	Increase/(Decrease)	
(Dollars in Millions)			$	%			$	%
Depreciation and amortization	$232	$236	$ (4)	(2)%	$700	$695	$ 5	1 %
Interest expense, net	76	81	(5)	(6)%	233	248	(15)	(6)%
Impairments, store closing and other costs	(6)	—	6	100 %	186	—	186	100 %
Loss on extinguishment of debt	—	38	(38)	(100)%	—	169	(169)	(100)%
Provision for income taxes	79	69	10	14 %	173	218	(45)	(21)%
Effective tax rate	35.0 %	36.5 %			36.3 %	36.6 %		

Depreciation and amortization reflects the net impact of higher IT amortization due to continued investments and offset by lower store amortization due to maturing of the portfolio and the store closures in the second quarter of 2016. Interest expense decreased in both periods due to lower interest on capital leases as the portfolio matures and due to the store closures. Last summer's refinancing also lowered year-to-date interest expense.

Impairments, store closing and other costs includes the following:

(Dollars in Millions)	Three Months Ended October 29, 2016	Nine Months Ended October 29, 2016
Store leases:		
Record future obligations	$ (5)	$ 114
Write-off net obligations	—	(21)
Impairments:		
Software licenses	—	23
Buildings and other store assets	—	53
Severance and other	(1)	17
Total	$ (6)	$ 186

For the quarter, impairments, store closing and other costs includes the reversal of severance costs for corporate associates that have found re-employment elsewhere and lease liabilities for a store that will be used for corporate purposes. We do not expect future charges for the store closures and corporate restructuring related to this announcement to be material.

The provision for income taxes reflects changes in pretax income and the effective tax rate. Our income tax rate was 35.0% in the third quarter, 150 basis points lower than last year. The decrease was driven by an increase in non-taxable trust income in 2016. Year to date, our income tax rate decreased 30 basis points as a result of higher non-taxable trust income and federal tax credits that were enacted in the fourth quarter of 2015. These decreases were partially offset by favorable state audit settlements in the first quarter of 2015.

Net Income and Earnings Per Share.

	Quarter					
	2016			2015		
(Dollars in Millions, Except per Share Data)	Income before Taxes	Net Income	Earnings Per Share	Income before Taxes	Net Income	Earnings Per Share
GAAP	$225	$ 146	$ 0.83	$189	$ 120	$ 0.63
Adjustments						
Impairments, store closing and other costs	(6)	(4)	(0.03)	—	—	—
Loss on extinguishment of debt	—	—	—	38	24	0.12
Adjusted (Non-GAAP)	$219	$ 142	$ 0.80	$227	$ 144	$ 0.75

	Year to Date					
	2016			2015		
(Dollars in Millions, Except per Share Data)	Income before Taxes	Net Income	Earnings Per Share	Income before Taxes	Net Income	Earnings Per Share
GAAP	$476	$ 303	$ 1.68	$595	$ 377	$ 1.92
Adjustments						
Impairments, store closing and other costs	186	117	0.65	—	—	—
Loss on extinguishment of debt	—	—	—	169	107	0.54
Adjusted (Non-GAAP)	$662	$ 420	$ 2.33	$764	$ 484	$ 2.46

We believe adjusted results are useful because they provide enhanced visibility into our results for the periods excluding the impact of store closures and restructuring charges in 2016 and the loss on extinguishment of debt in 2015. However, these non-GAAP financial measures are not intended to replace GAAP measures.

Seasonality and Inflation

Our business, like that of most retailers, is subject to seasonal influences, with the major portion of sales and income typically realized during the second half of each fiscal year, which includes the back-to-school and holiday seasons. Approximately 15% of annual sales typically occur during the back-to-school season and 30% during the holiday season. Because of the seasonality of our business, results for any quarter are not necessarily indicative of the results that may be achieved for a full fiscal year.

Although we expect that our operations will be influenced by general economic conditions, including food, fuel and energy prices, and by costs to source our merchandise, we do not believe that inflation has had a material effect on our results of operations. However, there can be no assurance that our business will not be impacted by such factors in the future.

Table of Contents

Liquidity and Capital Resources

The following table presents our primary cash requirements and sources of funds.

Cash Requirements	Sources of Funds
• Operational needs, including salaries, rent, taxes and other costs of running our business	• Cash flow from operations
• Capital expenditures	• Short-term trade credit, in the form of extended payment terms
• Inventory (seasonal and new store)	• Line of credit under our revolving credit facility
• Share repurchases	
• Dividend payments	

Our working capital and inventory levels typically build throughout the fall, peaking during the November and December holiday selling season.

			Increase/(Decrease) in Cash	
(Dollars in Millions)	2016	2015	$	%
Net cash provided by (used in):				
Operating activities	$1,280	$407	$ 873	214 %
Investing activities	(584)	(548)	(36)	(7)%
Financing activities	(806)	(765)	(41)	(5)%

Operating Activities. Operating activities generated $1.3 billion of cash in the first three quarters of 2016, an increase of $873 million over the first three quarters of 2015. The increase is primarily due to reductions in inventory. Merchandise inventories decreased $533 million from October 31, 2015 to $4.7 billion at October 29, 2016. Inventory per store decreased 9% from the third quarter of 2015. Accounts payable as a percent of inventory was 44.4% at October 29, 2016, compared to 40.7% at October 31, 2015. The increase is due to lower ending inventory levels in 2016 compared to 2015.

Investing Activities. Investing activities used cash of $584 million in the first three quarters of 2016 and $548 million in the first three quarters of 2015. Substantially all of the increase is due to spending on our fifth e-commerce fulfillment center, which we plan to open in 2017.

Financing Activities. Financing activities used cash of $806 million in the first three quarters of 2016 and $765 million in the first three quarters of 2015.

We paid cash for treasury stock purchases of $441 million in the first three quarters of 2016 and $789 million in the first three quarters of 2015. Share repurchases are discretionary in nature. The timing and amount of repurchases is based upon available cash balances, our stock price and other factors.

We paid cash dividends of $270 million ($1.50 per share) in the first three quarters of 2016 and $264 million ($1.35 per share) in the first three quarters of 2015. On November 9, 2016, our Board of Directors declared a quarterly cash dividend of $0.50 per common share. The dividend is payable on December 21, 2016 to shareholders of record at the close of business on December 7, 2016.

In 2015, we completed a cash tender offer for $767 million of our debt and exercised our right to redeem $318 million of 2017 notes which were not initially tendered. In conjunction with the tender offer, we recognized a loss on extinguishment of debt of $169 million. We used the proceeds from a $1.1 billion debt issuance and cash on hand to pay the principal, premium, and accrued interest of the tendered and redeemed debt. During the third quarter of 2015, we drew $400 million on our revolving credit facility to temporarily fund inventory purchases.

We received proceeds from stock option exercises of $6 million in the first three quarters of 2016 and $146 million in the first three quarters of 2015. The decrease is due to high stock prices in the first quarter of 2015, which led to a large number of exercised options.

15

Table of Contents

As of October 29, 2016, our credit ratings were as follows:

	Moody's	Standard & Poor's	Fitch
Long-term debt	Baa2	BBB	BBB

Free Cash Flow. Free cash flow is a non-GAAP financial measure which we define as net cash provided by operating activities and proceeds from financing obligation payments (which generally represent landlord reimbursements of construction costs) less capital expenditures and capital lease and financing obligations. Free cash flow should be evaluated in addition to, and not considered a substitute for, other financial measures such as net income and cash flow provided by operations. We believe that free cash flow represents our ability to generate additional cash flow from our business operations.

The following table reconciles net cash provided by operating activities (a GAAP measure) to free cash flow (a non-GAAP measure).

(Dollars in Millions)	2016	2015	Increase/(Decrease) in Free Cash Flow
Net cash provided by operating activities	$1,280	$407	$ 873
Acquisition of property and equipment	(591)	(551)	(40)
Capital lease and financing obligation payments	(95)	(83)	(12)
Proceeds from financing obligations	5	1	4
Free cash flow	$599	$(226)	$ 825

Key financial ratios. Key financial ratios that provide certain measures of our liquidity are as follows:

(Dollars in Millions)	October 29, 2016	October 31, 2015
Working capital	$ 2,128	$ 2,128
Current ratio	1.60	1.54
Debt/capitalization	47.5 %	48.4 %

The increase in the current ratio is primarily due to draws on our revolver in 2015 and higher cash balances in 2016, which were partially offset by lower inventory. The decrease in the debt/capitalization ratio was primarily due to revolver draws in 2015 partially offset by lower shareholders' equity resulting from share repurchases.

Table of Contents

Debt Covenant Compliance. As of October 29, 2016, we were in compliance with all debt covenants and expect to remain in compliance during the remainder of fiscal 2016.

(Dollars in Millions)	
Included Indebtedness	
Total debt	$4,645
Permitted exclusions	(5)
Subtotal	4,640
Rent x 8	2,208
Included Indebtedness	$6,848
Debt Compliance Adjusted EBITDAR - Rolling 12-month	
Net income	$599
Rent expense	276
Depreciation and amortization	939
Net interest	312
Provision for income taxes	339
EBITDAR	2,465
Impairments, store closing and other costs	186
Adjusted EBITDAR	2,651
Stock based compensation	46
Other non-cash revenues and expenses	8
Debt Compliance Adjusted EBITDAR - Rolling 12-month	$2,705
Debt Ratio (a)	2.53
Maximum permitted Debt Ratio	3.75

(a) Included Indebtedness divided by Debt Compliance Adjusted EBITDAR

Contractual Obligations

There have been no significant changes in the contractual obligations disclosed in our 2015 Form 10-K.

Off-Balance Sheet Arrangements

We have not provided any financial guarantees as of October 29, 2016. We have not created, and are not party to, any special-purpose or off-balance sheet entities for the purpose of raising capital, incurring debt or operating our business. We do not have any arrangements or relationships with entities that are not consolidated into our financial statements that are reasonably likely to materially affect our liquidity or the availability of capital resources.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect reported amounts. Management has discussed the development, selection and disclosure of its estimates and assumptions with the Audit Committee of our Board of Directors. There have been no significant changes in the critical accounting policies and estimates discussed in our 2015 Form 10-K.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no significant changes in the market risks described in our 2015 Form 10-K.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we carried out an evaluation of the effectiveness of the design and operation of our disclosure

controls and procedures (the “Evaluation”) at a reasonable assurance level as of the last day of the period covered by this report.
Based upon the Evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective at the reasonable assurance level. Disclosure controls and procedures are defined by Rule 13a-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act") as controls and other procedures that are designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures.
It should be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving our stated goals under all potential future conditions, regardless of how remote.
(b) Changes in Internal Control Over Financial Reporting
There were no changes in our internal control over financial reporting during the quarter ended October 29, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1A. Risk Factors
There have been no significant changes in the risk factors described in our 2015 Form 10-K.
Forward-looking Statements
This Form 10-Q contains "forward-looking statements" made within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as "believes," “anticipates,” “plans,” "may," "intends," "will," "should," “expects” and similar expressions are intended to identify forward-looking statements. Forward-looking statements may include comments about our future sales or financial performance and our plans, performance, and other objectives, expectations or intentions, such as statements regarding our liquidity, debt service requirements, planned capital expenditures, future store initiatives, adequacy of capital resources and reserves. Forward-looking statements are based on our management’s then current views and assumptions and, as a result, are subject to certain risks and uncertainties that could cause actual results to differ materially from those projected. Any such forward-looking statements are qualified by the important risk factors described in Item 1A of our 2015 Form 10-K or disclosed from time to time in our filings with the SEC, that could cause actual results to differ materially from those predicted by the forward-looking statements. Forward-looking statements relate to the date initially made, and we undertake no obligation to update them.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds
We did not sell any securities during the quarter ended October 29, 2016, which were not registered under the Securities Act of 1933, as amended.
The following table contains information for shares of common stock repurchased and shares acquired from employees in lieu of amounts required to satisfy minimum tax withholding requirements upon the vesting of the employees’ restricted stock during the three fiscal months ended October 29, 2016:

(Dollars in Millions)	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
July 31 – August 27, 2016	1,237,104	$ 42.43	1,229,074	$ 325

August 28 – October 1, 2016	1,569,081	43.39	1,563,062	257	
October 2 – October 29, 2016	1,227,076	44.26	1,221,421	203	
Total	4,033,261	$ 43.36	4,013,557	$	203

In November 2016, our Board of Directors increased the remaining share repurchase authorization under our existing share repurchase program to $2.0 billion. We expect to repurchase shares in open market transactions, subject to market conditions, over the next three years.

Table of Contents

Item 6. Exhibits

Exhibit Number	Description
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the 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 the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

SIGNATURES

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

		Kohl's Corporation (Registrant)
Date:	December 2, 2016	/s/ Wesley S. McDonald Wesley S. McDonald On behalf of the Registrant and as Chief Financial Officer (Principal Financial Officer)