WILLIAMS SONOMA INC
Form 10-Q
September 08, 2016
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended July 31, 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: 001-14077

WILLIAMS-SONOMA, INC.

(Exact name of registrant as specified in its charter)

Delaware	**94-2203880**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
3250 Van Ness Avenue, San Francisco, CA	**94109**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (415) 421-7900

(Former name, former address and former fiscal year, if changed since last report)

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

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

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

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

As of August 28, 2016, 88,528,172 shares of the registrant s Common Stock were outstanding.

WILLIAMS-SONOMA, INC.

REPORT ON FORM 10-Q

FOR THE QUARTER ENDED JULY 31, 2016

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

Table of Contents

ITEM 1. FINANCIAL STATEMENTS

WILLIAMS-SONOMA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited)

In thousands, except per share amounts	Thirteen Weeks Ended July 31, 2016	August 2, 2015	Twenty-six Weeks Ended July 31, 2016	August 2, 2015
E-commerce net revenues	$ 599,683	$ 569,913	$ 1,175,917	$ 1,102,486
Retail net revenues	559,346	557,115	1,080,929	1,055,218
Net revenues	1,159,029	1,127,028	2,256,846	2,157,704
Cost of goods sold	748,490	720,403	1,453,790	1,372,238
Gross profit	410,539	406,625	803,056	785,466
Selling, general and administrative expenses	327,263	323,282	656,255	630,195
Operating income	83,276	83,343	146,801	155,271
Interest (income) expense, net	167	275	99	283
Earnings before income taxes	83,109	83,068	146,702	154,988
Income taxes	31,324	29,400	55,320	56,530
Net earnings	$ 51,785	$ 53,668	$ 91,382	$ 98,458
Basic earnings per share	$ 0.58	$ 0.59	$ 1.02	$ 1.08
Diluted earnings per share	$ 0.58	$ 0.58	$ 1.01	$ 1.06
Shares used in calculation of earnings per share:				
Basic	89,039	91,243	89,169	91,475
Diluted	89,736	92,564	90,098	92,969

See Notes to Condensed Consolidated Financial Statements.

WILLIAMS-SONOMA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

In thousands	Thirteen Weeks Ended July 31, 2016	August 2, 2015	Twenty-six Weeks Ended July 31, 2016	August 2, 2015
Net earnings	$ 51,785	$ 53,668	$ 91,382	$ 98,458
Other comprehensive income (loss):				
Foreign currency translation adjustments	(3,005)	(3,694)	2,203	(2,827)
	1,058	800	(1,107)	421

Change in fair value of derivative financial instruments, net of tax				
Reclassification adjustment for realized gains on derivative financial instruments, net of tax	(38)	(474)	(340)	(672)
Comprehensive income	$ 49,800	$ 50,300	$ 92,138	$ 95,380

See Notes to Condensed Consolidated Financial Statements.

WILLIAMS-SONOMA, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

In thousands, except per share amounts	July 31, 2016	January 31, 2016	August 2, 2015
ASSETS			
Current assets			
Cash and cash equivalents	$ 111,122	$ 193,647	$ 119,776
Accounts receivable, net	98,053	79,304	81,753
Merchandise inventories, net	962,943	978,138	1,031,472
Prepaid catalog expenses	27,097	28,919	38,088
Prepaid expenses	68,300	44,654	56,119
Deferred income taxes, net			130,687
Other assets	11,589	11,438	12,808
Total current assets	1,279,104	1,336,100	1,470,703
Property and equipment, net	908,562	886,813	875,002
Non-current deferred income taxes, net	134,721	141,784	
Other assets, net	51,177	52,730	50,266
Total assets	$ 2,373,564	$ 2,417,427	$ 2,395,971
LIABILITIES AND STOCKHOLDERS EQUITY			
Current liabilities			
Accounts payable	$ 391,597	$ 447,412	$ 416,276
Accrued salaries, benefits and other	103,040	127,122	103,695
Customer deposits	283,779	296,827	288,654
Borrowings under revolving line of credit	125,000		150,000
Income taxes payable	1,670	67,052	14,678
Other liabilities	53,331	58,014	50,237
Total current liabilities	958,417	996,427	1,023,540
Deferred rent and lease incentives	193,819	173,061	179,103
Non-current deferred income taxes, net			1,213
Other long-term obligations	66,516	49,713	50,739
Total liabilities	1,218,752	1,219,201	1,254,595
Commitments and contingencies			
Stockholders equity			
Preferred stock: $.01 par value; 7,500 shares authorized; none issued			
Common stock: $.01 par value; 253,125 shares authorized; 88,738, 89,563 and 90,860 shares issued and outstanding at July 31, 2016, January 31, 2016 and August 2, 2015, respectively	888	896	909
Additional paid-in capital	542,711	541,307	532,835
Retained earnings	622,608	668,545	615,193
Accumulated other comprehensive loss	(9,860)	(10,616)	(5,625)
	(1,535)	(1,906)	(1,936)

Treasury stock, at cost: 23, 29 and 30 shares as of July 31, 2016, January 31, 2016 and August 2, 2015, respectively			
Total stockholders equity	1,154,812	1,198,226	1,141,376
Total liabilities and stockholders equity	$ 2,373,564	$ 2,417,427	$ 2,395,971

See Notes to Condensed Consolidated Financial Statements.

2

Table of Contents

WILLIAMS-SONOMA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Twenty-six Weeks Ended	
	July 31,	August 2,
In thousands	2016	2015
Cash flows from operating activities:		
Net earnings	$ 91,382	$ 98,458
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Depreciation and amortization	83,369	83,233
Loss on disposal/impairment of assets	1,520	2,074
Amortization of deferred lease incentives	(12,550)	(12,075)
Deferred income taxes	(10,472)	(8,533)
Tax benefit related to stock-based awards	21,864	25,917
Excess tax benefit related to stock-based awards	(4,727)	(11,807)
Stock-based compensation expense	27,476	24,913
Other	(866)	69
Changes in:		
Accounts receivable	(19,021)	(14,854)
Merchandise inventories	18,221	(144,934)
Prepaid catalog expenses	1,822	(4,146)
Prepaid expenses and other assets	(22,724)	(19,708)
Accounts payable	(71,614)	15,625
Accrued salaries, benefits and other current and long-term liabilities	(12,867)	(30,835)
Customer deposits	(13,500)	27,243
Deferred rent and lease incentives	21,534	24,034
Income taxes payable	(65,399)	(17,869)
Net cash provided by operating activities	33,448	36,805
Cash flows from investing activities:		
Purchases of property and equipment	(77,877)	(86,849)
Other	363	278
Net cash used in investing activities	(77,514)	(86,571)
Cash flows from financing activities:		
Borrowings under revolving line of credit	125,000	150,000
Repurchase of common stock	(76,166)	(125,000)
Payment of dividends	(67,571)	(64,044)
Tax withholdings related to stock-based awards	(24,635)	(27,175)
Excess tax benefit related to stock-based awards	4,727	11,807
Proceeds related to stock-based awards	1,532	2,647
Repayment of long-term obligations		(1,968)
Other	(47)	

Net cash used in financing activities	(37,160)	(53,733)
Effect of exchange rates on cash and cash equivalents	(1,299)	348
Net decrease in cash and cash equivalents	(82,525)	(103,151)
Cash and cash equivalents at beginning of period	193,647	222,927
Cash and cash equivalents at end of period	$ 111,122	$ 119,776

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

WILLIAMS-SONOMA, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE A. FINANCIAL STATEMENTS - BASIS OF PRESENTATION

These financial statements include Williams-Sonoma, Inc. and its wholly owned subsidiaries (we, us or our). The Condensed Consolidated Balance Sheets as of July 31, 2016 and August 2, 2015, the Condensed Consolidated Statements of Earnings, the Condensed Consolidated Statements of Comprehensive Income for the thirteen and twenty-six weeks then ended, and the Condensed Consolidated Statements of Cash Flows for the twenty-six weeks then ended, have been prepared by us, without audit. In our opinion, the financial statements include all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position at the balance sheet dates and the results of operations for the thirteen and twenty-six weeks then ended. Intercompany transactions and accounts have been eliminated. The balance sheet as of January 31, 2016, presented herein, has been derived from our audited Consolidated Balance Sheet included in our Annual Report on Form 10-K for the fiscal year ended January 31, 2016.

The results of operations for the thirteen and twenty-six weeks ended July 31, 2016 are not necessarily indicative of the operating results of the full year.

Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) have been omitted. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended January 31, 2016.

In November 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2015-17, *Balance Sheet Classification of Deferred Taxes*, which requires entities to present both deferred tax assets and deferred tax liabilities as noncurrent in a classified balance sheet. We early adopted this ASU prospectively as of January 31, 2016, and have presented both deferred tax assets and deferred tax liabilities as noncurrent in our Condensed Consolidated Balance Sheets as of January 31, 2016 and July 31, 2016. The balance sheet as of August 2, 2015, presented herein, has not been retrospectively adjusted.

New Accounting Pronouncements

In May 2014, the 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. In addition, in March 2016, the FASB issued ASU 2016-08, *Revenue from Contracts with Customers: Principal versus Agent Considerations*. The amendments are intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations. The FASB also issued ASU 2016-10, *Identifying Performance Obligations and Licensing* in April 2016, which amends certain aspects of ASU 2014-09 for identifying performance obligations and the implementation guidance on licensing. These ASUs are effective retrospectively for fiscal years and interim periods within those years beginning after December 15, 2017. We are currently assessing the potential impact of these ASUs on our Condensed Consolidated Financial Statements.

In January 2016, the FASB issued ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*, which revises an entity s accounting related to the classification and measurement of investments in equity securities and the presentation of certain fair value changes for financial liabilities measured at fair value. This ASU is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2017. We are currently assessing the potential impact of this ASU on our Condensed Consolidated Financial Statements.

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

In March 2016, the FASB issued ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting*, which simplifies the accounting for share-based payment transactions (including the accounting for income taxes and forfeitures, among other areas). The ASU requires entities to, among other things, recognize all excess tax benefits and deficiencies in the income statement in the period in which they occur. This ASU is effective for fiscal years and interim periods within those years beginning after December 15, 2016. We are currently assessing the potential impact of this ASU on our Condensed Consolidated Financial Statements.

NOTE B. BORROWING ARRANGEMENTS

Credit Facility

We have a $500,000,000 unsecured revolving line of credit (credit facility) that may be used to borrow revolving loans or request the issuance of letters of credit. We may, upon notice to the administrative agent, request existing or new lenders to increase the credit facility by up to $250,000,000, at such lenders option, to provide for a total of $750,000,000 of unsecured revolving credit. As of July 31, 2016, we were in compliance with our financial covenants under the credit facility and based on current projections, we expect to remain in compliance throughout the next twelve months. The credit facility matures on November 19, 2019, at which time all outstanding borrowings must be repaid and all outstanding letters of credit must be cash collateralized.

We may elect interest rates calculated at (i) Bank of America s prime rate (or, if greater, the average rate on overnight federal funds plus one-half of one percent, or a rate based on LIBOR plus one percent) plus a margin based on our leverage ratio or (ii) LIBOR plus a margin based on our leverage ratio. During the second quarter of fiscal 2016, we borrowed $25,000,000 under the credit facility. For year-to-date 2016, we borrowed $125,000,000 (at a weighted average interest rate of 1.47%), all of which was outstanding as of July 31, 2016. During the second quarter of fiscal 2015, we borrowed $90,000,000 under the credit facility. For year-to-date 2015, we borrowed $150,000,000 (at a weighted average interest rate of 1.10%), all of which was outstanding as of August 2, 2015. Additionally, as of July 31, 2016, $12,276,000 in issued but undrawn standby letters of credit was outstanding under the credit facility. The standby letters of credit were issued to secure the liabilities associated with workers compensation and other insurance programs.

Letter of Credit Facilities

We have three unsecured letter of credit reimbursement facilities for a total of $70,000,000. On August 26, 2016 we renewed all three of our letter of credit facilities for an aggregate of $70,000,000, and extended each of these facilities maturity dates until August 26, 2017. The letter of credit facilities contain covenants that are consistent with our unsecured revolving line of credit. Interest on unreimbursed amounts under the letter of credit facilities accrues at the lender s prime rate (or, if greater, the average rate on overnight federal funds plus one-half of one percent) plus 2.0%. As of July 31, 2016, an aggregate of $5,621,000 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 23, 2018.

NOTE C. STOCK-BASED COMPENSATION

Equity Award Programs

Our Amended and Restated 2001 Long-Term Incentive Plan (the Plan) provides for grants of incentive stock options, nonqualified stock options, stock-settled stock appreciation rights (collectively, option awards), restricted stock awards, restricted stock units (including those that are performance-based), deferred stock awards (collectively, stock awards) and dividend equivalents up to an aggregate of 32,310,000 shares. As of July 31, 2016, there were approximately 7,439,000 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. Stock awards granted to employees generally vest evenly over a period of four years for service-based awards. Certain performance-based awards, which have variable payout conditions based on predetermined financial targets, vest three years from the date of grant. Certain stock awards and other agreements contain vesting acceleration clauses resulting from events including, but not limited to, retirement, merger or a similar corporate event. Stock awards granted to non-employee Board members generally vest in one year. Non-employee Board members automatically receive stock awards on the date of their initial election to the Board and annually thereafter on the date of the annual meeting of stockholders (so long as they continue to serve as a non-employee Board member).

Stock-Based Compensation Expense

During the thirteen and twenty-six weeks ended July 31, 2016, we recognized total stock-based compensation expense, as a component of selling, general and administrative expenses, of $11,744,000 and $27,476,000, respectively. During the thirteen and twenty-six weeks ended August 2, 2015, we recognized total stock-based compensation expense of $10,903,000 and $24,913,000, respectively.

Stock Options

The following table summarizes our stock option activity during the twenty-six weeks ended July 31, 2016:

	Shares
Balance at January 31, 2016 (100% vested)	38,500
Granted	
Exercised	(38,500)
Cancelled	
Balance at July 31, 2016	

Stock-Settled Stock Appreciation Rights

The following table summarizes our stock-settled stock appreciation right activity during the twenty-six weeks ended July 31, 2016:

	Shares
Balance at January 31, 2016 (100% vested)	634,609
Granted	
Converted into common stock	(149,065)
Cancelled	
Balance at July 31, 2016 (100% vested)	485,544

Restricted Stock Units

The following table summarizes our restricted stock unit activity during the twenty-six weeks ended July 31, 2016:

	Shares
Balance at January 31, 2016	2,288,958
Granted	1,058,718
Released	(880,388)
Cancelled	(171,444)
Balance at July 31, 2016	2,295,844
Vested plus expected to vest at July 31, 2016	1,480,484

NOTE D. EARNINGS PER SHARE

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

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

In thousands, except per share amounts	Net Earnings	Weighted Average Shares	Earnings Per Share
Thirteen weeks ended July 31, 2016			
Basic	$ 51,785	89,039	$ 0.58
Effect of dilutive stock-based awards		697	
Diluted	$ 51,785	89,736	$ 0.58
Thirteen weeks ended August 2, 2015			
Basic	$ 53,668	91,243	$ 0.59
Effect of dilutive stock-based awards		1,321	
Diluted	$ 53,668	92,564	$ 0.58
Twenty-six weeks ended July 31, 2016			
Basic	$ 91,382	89,169	$ 1.02
Effect of dilutive stock-based awards		929	
Diluted	$ 91,382	90,098	$ 1.01
Twenty-six weeks ended August 2, 2015			
Basic	$ 98,458	91,475	$ 1.08
Effect of dilutive stock-based awards		1,494	
Diluted	$ 98,458	92,969	$ 1.06

Stock-based awards of 909,000 and 627,000 were excluded from the computation of diluted earnings per share for the thirteen and twenty-six weeks ended July 31, 2016, as their inclusion would be anti-dilutive. There were no stock-based awards excluded from the computation of diluted earnings per share for the thirteen or twenty-six weeks ended August 2, 2015.

NOTE E. SEGMENT REPORTING

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

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

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

Income tax information by reportable segment has not been included as income taxes are calculated at a company-wide level and are not allocated to each reportable segment.

Table of Contents

Segment Information

In thousands	E-commerce	Retail	Unallocated	Total
Thirteen weeks ended July 31, 2016				
Net revenues[1]	$ 599,683	$ 559,346	$	$ 1,159,029
Depreciation and amortization expense	7,989	21,339	12,801	42,129
Operating income (loss)	132,733	33,217	(82,674)	83,276
Capital expenditures	4,593	25,127	20,008	49,728
Thirteen weeks ended August 2, 2015				
Net revenues[1]	$ 569,913	$ 557,115	$	$ 1,127,028
Depreciation and amortization expense	8,198	20,403	13,154	41,755
Operating income (loss)	122,461	40,503	(79,621)	83,343
Capital expenditures	4,582	23,265	18,618	46,465
Twenty-six weeks ended July 31, 2016				
Net revenues[1]	$ 1,175,917	$ 1,080,929	$	$ 2,256,846
Depreciation and amortization expense	15,603	42,088	25,678	83,369
Operating income (loss)[2]	264,278	63,342	(180,819)	146,801
Assets[3]	627,532	1,051,184	694,848	2,373,564
Capital expenditures	8,442	38,879	30,556	77,877
Twenty-six weeks ended August 2, 2015				
Net revenues[1]	$ 1,102,486	$ 1,055,218	$	$ 2,157,704
Depreciation and amortization expense	16,300	40,553	26,380	83,233
Operating income (loss)	250,035	68,629	(163,393)	155,271
Assets[3]	658,803	1,101,441	635,727	2,395,971
Capital expenditures	8,518	43,193	35,138	86,849

[1] *Includes net revenues related to our international operations (including our operations in Canada, Australia, the United Kingdom and our franchise businesses) of approximately $80.0 million and $66.9 million for the thirteen weeks ended July 31, 2016 and August 2, 2015, respectively, and $149.7 million and $121.7 million for the twenty-six weeks ended July 31, 2016 and August 2, 2015, respectively.*

[2] *Includes $13.2 million of severance-related reorganization charges due to a reduction of headcount in the first quarter of fiscal 2016, primarily in our corporate functions, which is recorded as selling, general and administrative expense within the unallocated segment.*

[3] *Includes long-term assets related to our international operations of approximately $60.7 million and $60.0 million as of July 31, 2016 and August 2, 2015, respectively.*

NOTE F. COMMITMENTS AND CONTINGENCIES

We are involved in lawsuits, claims and proceedings incident to the ordinary course of our business. These disputes, which are not currently material, are increasing in number as our business expands and our company grows larger. 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 be time consuming, result in costly litigation, require significant amounts of management time and result in the diversion of significant operational resources. The results of these lawsuits, claims and proceedings cannot be predicted with certainty. However, we believe that the ultimate resolution of these current matters will not have a material adverse effect on our consolidated financial statements taken as a whole.

NOTE G. STOCK REPURCHASE PROGRAM AND DIVIDENDS

Stock Repurchase Program

In March 2016, we announced that our Board of Directors authorized a new stock repurchase program to purchase up to $500,000,000 of our common stock that we intend to execute over the next three years. During the thirteen weeks ended July 31, 2016, we repurchased 665,517 shares of our common stock at an average cost of $53.38 per share for a total cost of approximately $35,527,000. During the twenty-six weeks ended July 31, 2016, we repurchased 1,393,146 shares of our common stock at an average cost of $54.67 per share for a total cost of approximately $76,166,000. As of July 31, 2016, we held treasury stock of $1,535,000 that represents the cost of shares available for issuance intended to satisfy future stock-based award settlements in certain foreign jurisdictions.

During the thirteen weeks ended August 2, 2015, we repurchased 899,301 shares of our common stock at an average cost of $80.55 per share for a total cost of approximately $72,438,000. During the twenty-six weeks ended August 2, 2015, we repurchased 1,563,703 shares of our common stock at an average cost of $79.94 per share for a total cost of approximately $125,000,000.

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

Dividends

We declared cash dividends of $0.37 and $0.35 per common share during the thirteen weeks ended July 31, 2016 and August 2, 2015, respectively. We declared cash dividends of $0.74 and $0.70 per common share during the twenty-six weeks ended July 31, 2016 and August 2, 2015, respectively. Our quarterly cash dividend may be limited or terminated at any time.

NOTE H. DERIVATIVE FINANCIAL INSTRUMENTS

We have retail and/or e-commerce businesses in Canada, Australia and the United Kingdom, and operations throughout Asia and Europe, which expose us to market risk associated with foreign currency exchange rate fluctuations. Substantially all of our purchases and sales are denominated in U.S. dollars, which limits our exposure to this risk. To mitigate this risk, we hedge a portion of our foreign currency exposure with foreign currency forward contracts in accordance with our risk management policies. We do not enter into such contracts for speculative purposes.

The assets or liabilities associated with the derivative instruments are measured at fair value and recorded in either other current assets or other current liabilities. As discussed below, the accounting for gains and losses resulting from changes in fair value depends on whether the derivative instrument is designated as a hedge and qualifies for hedge accounting in accordance with the FASB Accounting Standards Codification (ASC) 815, *Derivatives and Hedging*.

Cash Flow Hedges

We enter into foreign currency forward contracts designated as cash flow hedges (to sell Canadian dollars and purchase U.S. dollars) for forecasted inventory purchases in U.S. dollars by our foreign subsidiaries. These hedges generally have terms of up to 12 months. All hedging relationships are formally documented, and the forward contracts are designed to further 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

Table of Contents

assessment and measurement of hedge effectiveness and are recorded immediately in selling, general and administrative expense, net. Based on the rates in effect as of July 31, 2016, we expect to reclassify a net loss of approximately $787,000 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 purchase U.S. dollars) to reduce the exchange risk associated with our assets and liabilities denominated in a foreign currency. Any foreign exchange gains (losses) related to these contracts are recognized in selling, general and administrative expense, net.

As of July 31, 2016 and August 2, 2015, we had foreign currency forward contracts outstanding (in U.S. dollars) with notional values as follows:

In thousands	July 31, 2016	August 2, 2015
Contracts designated as cash flow hedges	$ 28,450	$ 12,500
Contracts not designated as cash flow hedges	$ 44,000	$ 35,000

Hedge effectiveness is evaluated prospectively at inception, on an ongoing basis, as well as retrospectively using regression analysis. Any measureable ineffectiveness of the hedge is recorded in selling, general and administrative expense, net. No gain or loss was recognized for cash flow hedges due to hedge ineffectiveness and all hedges were deemed effective for assessment purposes for the thirteen and twenty-six weeks ended July 31, 2016 and August 2, 2015.

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

In thousands	Thirteen Weeks Ended July 31, 2016	Thirteen Weeks Ended August 2, 2015	Twenty-six Weeks Ended July 31, 2016	Twenty-six Weeks Ended August 2, 2015
Net gain (loss) recognized in OCI	$ 1,434	$ 1,084	$ (1,499)	$ 571
Net gain reclassified from OCI into cost of goods sold	$ 50	$ 643	$ 459	$ 911
Net foreign exchange gain (loss) recognized in selling, general and administrative expense:				
Instruments designated as cash flow hedges[1]	$ (13)	$ (26)	$ 10	$ (42)
Instruments not designated or de-designated[2]	$ 309	$ 2,023	$ (3,033)	$ 2,405

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

[2] *Changes in fair value for instruments not designated as cash flow hedges as well as de-designated instruments.*

The fair values of our derivative financial instruments are presented below. All fair values were measured using Level 2 inputs as defined by the fair value hierarchy described in Note I.

In thousands	Balance sheet location	July 31, 2016	August 2, 2015
Derivatives designated as hedging instruments:			
Cash flow hedge foreign currency forward contracts	Other current assets	$ 309	$ 610
Cash flow hedge foreign currency forward contracts	Other current liabilities	(695)	
Total, net		$ (386)	$ 610
Derivatives not designated as hedging instruments:			
Foreign currency forward contracts	Other current assets	$ 9	$ 79
Foreign currency forward contracts	Other current liabilities		
Total, net		$ 9	$ 79

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.

Table of Contents

NOTE I. FAIR VALUE MEASUREMENTS

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

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

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

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

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

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

Foreign Currency Derivatives and Hedging Instruments

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

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

Property and Equipment

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

There were no transfers between Level 1, 2 or 3 categories during the thirteen and twenty-six weeks ended July 31, 2016 or August 2, 2015.

Table of Contents

NOTE J. ACCUMULATED OTHER COMPREHENSIVE INCOME

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

In thousands	Foreign Currency Translation	Cash Flow Hedges	Accumulated Other Comprehensive Income
Balance at January 31, 2016	$ (11,480)	$ 864	$ (10,616)
Foreign currency translation adjustments	5,208		5,208
Change in fair value of derivative financial instruments		(2,165)	(2,165)
Reclassification adjustment for realized gains on derivative financial instruments [1]		(302)	(302)
Other comprehensive income (loss)	5,208	(2,467)	2,741
Balance at May 1, 2016	$ (6,272)	$ (1,603)	$ (7,875)
Foreign currency translation adjustments	$ (3,005)	$	$ (3,005)
Change in fair value of derivative financial instruments		1,058	1,058
Reclassification adjustment for realized gains on derivative financial instruments [1]		(38)	(38)
Other comprehensive income (loss)	(3,005)	1,020	(1,985)
Balance at July 31, 2016	$ (9,277)	$ (583)	$ (9,860)
Balance at February 1, 2015	$ (3,522)	$ 974	$ (2,548)
Foreign currency translation adjustments	867		867
Change in fair value of derivative financial instruments		(379)	(379)
Reclassification adjustment for realized gains on derivative financial instruments [1]		(198)	(198)
Other comprehensive income (loss)	867	(577)	290
Balance at May 3, 2015	(2,655)	397	(2,257)
Foreign currency translation adjustments	(3,694)		(3,694)
Change in fair value of derivative financial instruments		800	800
Reclassification adjustment for realized gains on derivative financial instruments [1]		(474)	(474)
Other comprehensive income (loss)	(3,694)	326	(3,368)
Balance at August 2, 2015	$ (6,349)	$ 723	$ (5,625)

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

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they do not fully materialize or are proven incorrect, could cause our business and results of operations to differ materially from those expressed or implied by such forward-looking statements. Such forward-looking statements include statements related to: our merchandise strategies; our beliefs regarding the resolution of current lawsuits, claims and proceedings; our stock repurchase program; our expectations regarding our cash flow hedges and foreign currency risks; our planned use of cash; our compliance with the financial covenants contained in our credit facilities; our belief that our cash on-hand, in addition to our available credit facilities, will provide adequate liquidity for our business operations over the next 12 months; our beliefs regarding our exposure to foreign currency exchange rate fluctuations; and our beliefs regarding seasonal patterns associated with our business, as well as statements of belief and statements of assumptions underlying any of the foregoing. You can identify these and other forward-looking statements by the use of words such as may, should, expects, plans, anticipates, beli estimates, predicts, intends, potential, continue, or the negative of such terms, or other comparable terminology. risks, uncertainties and assumptions referred to above that could cause our results to differ materially from the results expressed or implied by such forward-looking statements include, but are not limited to, those discussed under the heading Risk Factors in this document and our Annual Report on Form 10-K for the year ended January 31, 2016, 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

OVERVIEW

Williams-Sonoma, Inc. is a specialty retailer of high-quality products for the home. These products, representing distinct merchandise strategies Williams-Sonoma, Pottery Barn, Pottery Barn Kids, West Elm, PBteen, Williams-Sonoma Home, Rejuvenation, and Mark and Graham are marketed through e-commerce websites, direct mail catalogs and 626 stores. We have retail and/or e-commerce businesses in the U.S., Canada, Australia and the United Kingdom, and ship our products to customers worldwide. Our catalogs reach customers throughout the U.S. and Australia. In addition, we have unaffiliated franchisees that operate stores and/or e-commerce websites in the Middle East, the Philippines and Mexico.

The following discussion and analysis of financial condition, results of operations, and liquidity and capital resources for the thirteen weeks ended July 31, 2016 (second quarter of fiscal 2016), as compared to the thirteen weeks ended August 2, 2015 (second quarter of fiscal 2015) and the twenty-six weeks ended July 31, 2016 (year-to-date 2016), as compared to the twenty-six weeks ended August 2, 2015 (year-to-date 2015), should be read in conjunction with our Condensed Consolidated Financial Statements and the notes thereto.

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

Second Quarter of Fiscal 2016 Financial Results

Net revenues in the second quarter of fiscal 2016 increased by $32,001,000, or 2.8%, compared to the second quarter of fiscal 2015, with comparable brand revenue growth of 0.6%. The increase in net revenues was driven by a 5.2% increase in our e-commerce net revenues (primarily driven by West Elm and Williams-Sonoma) and a 0.4% increase in our retail net revenues (primarily driven by West Elm and our international operations), with particular strength in furniture. Net revenue growth in the second quarter of fiscal 2016 included a 19.6% increase in our international revenues and a 2.9% increase in retail leased square footage primarily due to 14 net new stores.

In Pottery Barn, our largest brand, comparable brand revenues decreased 4.8% in the second quarter of fiscal 2016 compared to the second quarter of fiscal 2015. Pottery Barn was most impacted by a softening retail environment and declining mall traffic. Product introductions in upholstered and outdoor furniture were well received, offset by underperformance in fashion bedding and indoor pillows, as well as lack of newness in decorative accessories and tabletop. In the second quarter, Williams-Sonoma comparable brand revenues were flat year over year. We saw gains in cookware, particularly our Williams-Sonoma branded product, as well as strong growth in Williams-Sonoma Home. These strengths, however, were offset by softness in food, electrics and cooks tools. In West Elm, comparable brand revenues increased 15.8% in the second quarter of fiscal 2016 on top of 15.7% in the second quarter of fiscal 2015. All major product categories posted significant gains, particularly in our core furniture business. Results were driven by new introductions across our indoor furniture categories as well as overall strength in our outdoor furniture. In Pottery Barn Kids, comparable brand revenues increased 0.1% in the second quarter of fiscal 2016 compared to the second quarter of fiscal 2015. Strength in our furniture and back to school businesses was offset by softness in the textiles category. In PBteen, comparable brand revenues declined 5.2% in the second quarter of fiscal 2016 compared to the second quarter of fiscal 2015. Favorable results from our expanded back to school focus were more than offset by reduced sales in textiles and out of stock inventory in other areas.

Additionally, in the second quarter of fiscal 2016, diluted earnings per share was $0.58, versus $0.58 in the second quarter of fiscal 2015, and we returned $68,675,000 to our stockholders through stock repurchases and dividends.

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.

Table of Contents

The following table summarizes our net revenues for the second quarter of fiscal 2016 and fiscal 2015, and year-to-date 2016 and 2015:

	Thirteen Weeks Ended				Twenty-six Weeks Ended			
In thousands	July 31, 2016	% Total	August 2, 2015	% Total	July 31, 2016	% Total	August 2, 2015	% Total
E-commerce net revenues	$ 599,683	51.7%	$ 569,913	50.6%	$ 1,175,917	52.1%	$ 1,102,486	51.1%
Retail net revenues	559,346	48.3%	557,115	49.4%	1,080,929	47.9%	1,055,218	48.9%
Net revenues	$ 1,159,029	100.0%	$ 1,127,028	100.0%	$ 2,256,846	100.0%	$ 2,157,704	100.0%

Net revenues in the second quarter of fiscal 2016 increased by $32,001,000, or 2.8%, compared to the second quarter of fiscal 2015, with comparable brand revenue growth of 0.6%. The increase in net revenues was driven by a 5.2% increase in our e-commerce net revenues (primarily driven by West Elm and Williams-Sonoma) and a 0.4% increase in our retail net revenues (primarily driven by West Elm and our international operations), with particular strength in furniture. Net revenue growth in the second quarter of fiscal 2016 included a 19.6% increase in our international revenues and a 2.9% increase in retail leased square footage primarily due to 14 net new stores.

Net revenues for year-to-date 2016 increased by $99,142,000 or 4.6%, compared to year-to-date 2015, with comparable brand revenue growth of 2.5%. The increase in net revenues was driven by a 6.7% increase in our e-commerce net revenues (primarily driven by West Elm) and a 2.4% increase in our retail net revenues (primarily driven by West Elm and our international operations), with particular strength in furniture. Net revenue growth for year-to-date 2016 included a 23.0% increase in our international revenues and a 2.9% increase in retail leased square footage primarily due to 14 net new stores.

Comparable Brand Revenue Growth

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. Outlet comparable store net revenues are included in their respective brands. Comparable brand revenue excludes sales from certain operations until such time that we believe those sales are meaningful to evaluating the performance of the brand. Sales related to our international franchise operations have also been excluded as they are not operated by us.

Comparable stores are defined as permanent stores where gross square footage did not change by more than 20% in the previous 12 months and which have been open for at least 12 consecutive months without closure for seven or more consecutive days.

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
Comparable brand revenue growth (decline)	July 31, 2016	August 2, 2015	July 31, 2016	August 2, 2015
Pottery Barn	(4.8%)	6.4%	(2.4%)	4.4%
Williams-Sonoma	0.0%	(0.3%)	1.7%	1.1%
West Elm	15.8%	15.7%	17.4%	15.5%
Pottery Barn Kids	0.1%	3.3%	0.9%	2.1%

PBteen	(5.2%)	3.9%	(2.1%)	3.5%
Total	0.6%	6.3%	2.5%	5.5%

14

Table of Contents

RETAIL STORE DATA

		Store Count				Average Leased Square Footage Per Store	
	May 1, 2016	Openings	Closings	July 31, 2016	August 2, 2015	July 31, 2016	August 2, 2015
Williams-Sonoma	241	1	(1)	241	241	6,600	6,600
Pottery Barn	200	1		201	199	13,800	13,700
Pottery Barn Kids	90		(1)	89	89	7,500	7,500
West Elm	87	2		89	78	13,300	13,400
Rejuvenation	6			6	5	9,000	10,000
Total	624	4	(2)	626	612	10,000	9,900
Store selling square footage at period-end						3,894,000	3,771,000
Store leased square footage at period-end						6,262,000	6,088,000

COST OF GOODS SOLD

	Thirteen Weeks Ended				Twenty-six Weeks Ended			
In thousands	July 31, 2016	% Net Revenues	August 2, 2015	% Net Revenues	July 31, 2016	% Net Revenues	August 2, 2015	% Net Revenues
Cost of goods sold[1]	$ 748,490	64.6%	$ 720,403	63.9%	$ 1,453,790	64.4%	$ 1,372,238	63.6%

[1] *Includes total occupancy expenses of $164,702,000 and $155,993,000 for the second quarter of fiscal 2016 and the second quarter of fiscal 2015, respectively, and $326,721,000 and $307,444,000 for year-to-date 2016 and year-to-date 2015, 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.

Second Quarter of Fiscal 2016 vs. Second Quarter of Fiscal 2015

Cost of goods sold increased by $28,087,000, or 3.9%, in the second quarter of fiscal 2016 compared to the second quarter of fiscal 2015. Cost of goods sold as a percentage of net revenues increased to 64.6% in the second quarter of fiscal 2016 from 63.9% in the second quarter of fiscal 2015. This increase was primarily driven by an increase in occupancy costs related to investments in our supply chain, as well as higher franchise and wholesale revenues, which have a lower gross margin.

In the e-commerce channel, cost of goods sold as a percentage of net revenues decreased in the second quarter of fiscal 2016 compared to the second quarter of fiscal 2015 primarily driven by improved shipping and fulfillment related costs as a result of our focus on all of our supply chain and inventory initiatives.

In the retail channel, cost of goods sold as a percentage of net revenues increased in the second quarter of fiscal 2016 compared to the second quarter of fiscal 2015 primarily driven by lower selling margins as well as occupancy deleverage.

Table of Contents

Year-to-Date Fiscal 2016 vs. Year-to-Date Fiscal 2015

Cost of goods sold increased by $81,552,000, or 5.9%, year-to-date fiscal 2016 compared to year-to-date fiscal 2015. Cost of goods sold as a percentage of net revenues increased to 64.4% year-to-date 2016 from 63.6% year-to-date fiscal 2015. This increase was primarily driven by lower selling margins and an increase in occupancy costs related to investments in our supply chain, as well as higher franchise and wholesale revenues, which have a lower gross margin.

In the e-commerce channel, cost of goods sold as a percentage of net revenues increased year-to-date fiscal 2016 compared to year-to-date fiscal 2015 primarily driven by an increase in occupancy costs related to investments in our supply chain, partially offset by higher selling margins as a result of our focus on all of our supply chain initiatives.

In the retail channel, cost of goods sold as a percentage of net revenues increased year-to-date fiscal 2016 compared to year-to-date fiscal 2015 primarily driven by lower selling margins as well as higher franchise and wholesale revenues which, have lower gross margins.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

	Thirteen Weeks Ended				Twenty-six Weeks Ended			
In thousands	July 31, 2016	% Net Revenues	August 2, 2015	% Net Revenues	July 31, 2016	% Net Revenues	August 2, 2015	% Net Revenues
Selling, general and administrative expenses	$ 327,263	28.2%	$ 323,282	28.7%	$ 656,255	29.1%	$ 630,195	29.2%

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

Second Quarter of Fiscal 2016 vs. Second Quarter of Fiscal 2015

Selling, general and administrative expenses increased by $3,981,000, or 1.2%, in the second quarter of fiscal 2016 compared to the second quarter of fiscal 2015. Selling, general and administrative expenses as a percentage of net revenues decreased to 28.2% in the second quarter of fiscal 2016 from 28.7% in the second quarter of fiscal 2015. This decrease as a percentage of net revenues was primarily driven by the leverage of employment costs and lower general expenses.

In the e-commerce channel, selling, general and administrative expenses as a percentage of net revenues increased in the second quarter of fiscal 2016 compared to the second quarter of fiscal 2015 primarily driven by an increase in advertising expenses.

In the retail channel, selling, general and administrative expenses as a percentage of net revenues decreased in the second quarter of fiscal 2016 compared to the second quarter of fiscal 2015 primarily driven by a reduction in employment costs.

Year-to-Date Fiscal 2016 vs. Year-to-Date Fiscal 2015

Selling, general and administrative expenses increased by $26,060,000, or 4.1%, year-to-date fiscal 2016 compared to year-to-date fiscal 2015. Selling, general and administrative expenses as a percentage of net revenues decreased to 29.1% year-to-date fiscal 2016 from 29.2% year-to-date fiscal 2015. This decrease as a percentage of net revenues was primarily driven by the leverage of employment costs and general expenses, partially offset by severance-related reorganization charges of approximately $13,221,000 in the first quarter of fiscal 2016.

In the e-commerce channel, selling, general and administrative expenses as a percentage of net revenues remained flat year-to-date fiscal 2016 compared to year-to-date fiscal 2015.

Table of Contents

In the retail channel, selling, general and administrative expenses as a percentage of net revenues decreased year-to-date fiscal 2016 compared to year-to-date fiscal 2015 primarily driven by a reduction in employment costs.

INCOME TAXES

The effective tax rate was 37.7% for year-to-date 2016 and 36.5% for year-to-date 2015, reflecting favorable resolution of certain tax matters for year-to-date 2015.

LIQUIDITY AND CAPITAL RESOURCES

As of July 31, 2016, we held $111,122,000 in cash and cash equivalents, the majority of which is held in demand deposit accounts and money market funds, of which $53,748,000 was held by our foreign subsidiaries. As is consistent within our industry, our cash balances are seasonal in nature, with the fourth quarter historically representing a significantly higher level of cash than other periods.

In fiscal 2016, we plan to use our cash resources to fund our inventory and inventory related purchases, advertising and marketing initiatives, stock repurchases, dividend payments and purchases of property and equipment. In addition to our cash balances on hand, we have a $500,000,000 unsecured revolving line of credit (credit facility) that may be used to borrow revolving loans or to request the issuance of letters of credit. We may, upon notice to the administrative agent, request existing or new lenders to increase the credit facility by up to $250,000,000, at such lenders option, to provide for a total of $750,000,000 of unsecured revolving credit. For year-to-date 2016, we borrowed $125,000,000 under the credit facility, all of which was outstanding as of July 31, 2016. For year-to-date 2015, we borrowed $150,000,000 under the credit facility, all of which was outstanding as of August 2, 2015.

As of July 31, 2016, issued but undrawn standby letters of credit totaling $12,276,000 were outstanding under the credit facility. Additionally, as of July 31, 2016, we had three unsecured letter of credit reimbursement facilities for a total of $70,000,000, of which $5,621,000 was outstanding. These letter of credit facilities represent only a future commitment to fund inventory purchases to which we had not taken legal title. We are currently in compliance with all of our financial covenants under the credit facility and the three unsecured letter of credit reimbursement facilities and, based on our current projections, we expect to remain in compliance throughout the next 12 months. We believe our cash on hand, in addition to our available credit facilities, will provide adequate liquidity for our business operations over the next 12 months.

Cash Flows from Operating Activities

For year-to-date 2016, net cash provided by operating activities was $33,448,000 compared to net cash provided by operating activities of $36,805,000 for year-to-date 2015. For year-to-date 2016, net cash provided by operating activities was primarily attributable to earnings adjusted for non-cash items partially offset by a decrease in accounts payable and income taxes payable. Net cash provided by operating activities decreased compared to year-to-date 2015 primarily due to a decrease in both accounts payable and income taxes payable due to the timing of payments and a decrease in customer deposits, partially offset by a decrease in merchandise inventories.

Cash Flows from Investing Activities

For year-to-date 2016, net cash used in investing activities was $77,514,000 compared to $86,571,000 for year-to-date 2015, and was primarily attributable to purchases of property and equipment. Net cash used in investing activities compared to year-to-date 2015 decreased primarily due to a decrease in purchases of property and equipment.

Cash Flows from Financing Activities

For year-to-date 2016, net cash used in financing activities was $37,160,000 compared to $53,733,000 for year-to-date 2015. For year-to-date 2016, net cash used in financing activities was attributable to repurchases of common stock and the payment of dividends, partially offset by borrowings under our revolving line of credit. Net cash used in financing activities compared to year-to-date 2015 decreased primarily due to a decrease in repurchase of common stock partially offset by a decrease in borrowings under our revolving line of credit.

Stock Repurchase Program and Dividends

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

Critical Accounting Policies

Management s Discussion and Analysis of Financial Condition and Results of Operations is based on our Condensed Consolidated Financial Statements, which have been prepared in accordance with U.S. GAAP. The preparation of these Condensed Consolidated

Table of Contents

Financial Statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosures of contingent assets and liabilities. These estimates and assumptions are evaluated on an ongoing basis and are based on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results could differ significantly from these estimates. During the second quarter of fiscal 2016, there have been no significant changes to the critical accounting policies discussed in our Annual Report on Form 10-K for the year ended January 31, 2016.

Seasonality

Our business is subject to substantial seasonal variations in demand. Historically, a significant portion of our 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 centers, and incur significant fixed catalog production and mailing costs.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Interest Rate Risk

Our revolving line of credit has a variable interest rate which, when drawn upon, subjects us to risks associated with changes in that interest rate. As of July 31, 2016, we had borrowings of $125,000,000 outstanding under the credit facility. A hypothetical increase or decrease of one percentage point on our existing variable rate debt instrument would not materially affect our results of operations or cash flows.

In addition, we have fixed and variable income investments consisting of short-term investments classified as cash and cash equivalents, which are also affected by changes in market interest rates. As of July 31, 2016, our investments, made primarily in demand deposit accounts and money market funds, are stated at cost and approximate their fair values.

Foreign Currency Risks

We purchase a significant amount of inventory from vendors outside of the U.S. in transactions that are denominated in U.S. dollars. Approximately 1% of our international purchase transactions are in currencies other than the U.S. dollar, primarily the euro. Any foreign currency impact related to these international purchase transactions was not significant to us during the second quarter of fiscal 2016 or the second quarter of fiscal 2015. Since we pay for the majority of our international purchases in U.S. dollars, however, a decline in the U.S. dollar relative to other foreign currencies would subject us to risks associated with increased purchasing costs from our vendors in their effort to offset any lost profits associated with any currency devaluation. We cannot predict with certainty the effect these increased costs may have on our financial statements or results of operations.

In addition, our retail and/or e-commerce businesses in Canada, Australia and the United Kingdom, and our operations throughout Asia and Europe, expose us to market risk associated with foreign currency exchange rate fluctuations.

Substantially all of our purchases and sales are denominated in U.S. dollars, which limits our exposure to this risk. However, some of our foreign operations have a functional currency other than the U.S. dollar. While the impact of foreign currency exchange rate fluctuations was not material to us in the second quarter of fiscal 2016 or the second quarter of fiscal 2015, we have continued to see volatility in the exchange rates in the countries in which we do business. As we continue to expand globally, the foreign currency exchange risk related to our foreign operations may increase. To mitigate this risk, we hedge a portion of our foreign currency exposure with foreign currency forward contracts in accordance with our risk management policies (see Note H to our Condensed Consolidated Financial Statements).

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of July 31, 2016, an evaluation was performed by management, with the participation of our Chief Executive Officer (CEO) and our Chief Financial Officer (CFO), of the effectiveness of our disclosure controls and procedures. Based on that evaluation, our management, including our CEO and CFO, concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow for timely discussions regarding required disclosures, and that such information is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission.

Table of Contents

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.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

See Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended January 31, 2016 for a description of the risks and uncertainties associated with our business. There were no material changes to such risk factors in the current quarterly reporting period.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table provides information as of July 31, 2016 with respect to shares of common stock we repurchased during the second quarter of fiscal 2016. For additional information, please see Note G to our Condensed Consolidated Financial Statements within Part I of this Form 10-Q.

Fiscal period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of a Publicly Announced Program	Maximum Dollar Value of Shares That May Yet Be Purchased Under the Program
May 2, 2016 May 29, 2016	230,267	$ 53.68	230,267	$ 508,850,000
May 30, 2016 June 26, 2016	170,286	$ 52.85	170,286	$ 499,850,000
June 27, 2016 July 31, 2016	264,964	$ 53.47	264,964	$ 485,684,000
Total	665,517	$ 53.38	665,517	$ 485,684,000

In March 2016, we announced that our Board of Directors had authorized a new stock repurchase program to purchase up to an additional $500,000,000 of our common stock that we intend to execute over the next three years. Stock repurchases under this program may be made through open market and privately negotiated transactions at times and in such amounts as management deems appropriate. The timing and actual number of shares repurchased will depend on a variety of factors including price, corporate and regulatory requirements, capital availability and other market conditions. The stock repurchase program does not have an expiration date and may be limited or terminated at any time without prior notice.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

Table of Contents

ITEM 6. EXHIBITS

(a) Exhibits

Exhibit Number	Exhibit Description
10.1+	Williams-Sonoma, Inc. 2001 Incentive Bonus Plan, as amended and restated effective June 2, 2016 (incorporated by reference to Exhibit A to the Company s Definitive Proxy Statement on Schedule 14A as filed with the Securities and Exchange Commission on April 15, 2016, File No. 001-14077)
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
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

+ Indicates a management contract or compensatory plan or arrangement.

* Filed herewith.

Table of Contents

SIGNATURE

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

WILLIAMS-SONOMA, INC.

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

Date: September 8, 2016