FOOT LOCKER INC
Form 10-Q
December 05, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended: October 27, 2012

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

For the transition period from __________ to __________

Commission File Number: 1-10299

FOOT LOCKER, INC.

(Exact Name of Registrant as Specified in its Charter)

New York	**13-3513936**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

112 West 34th Street, New York, New York, 10120

(Address of Principal Executive Offices, Zip Code)

(212-720-3700)

(Registrant's Telephone Number, Including Area Code)

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

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 þ No o

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 þ Accelerated filer o Non-accelerated filer o Smaller reporting company o

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

Number of shares of Common Stock outstanding at November 23, 2012: 150,724,967

FOOT LOCKER, INC.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

FOOT LOCKER, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in millions, except shares)

	October 27, 2012 (Unaudited)	October 29, 2011 (Unaudited)	January 28, 2012 *
ASSETS			
Current assets			
Cash and cash equivalents	$ 804	$ 698	$ 851
Short-term investments	49	—	—
Merchandise inventories	1,240	1,204	1,069
Other current assets	202	157	159
	2,295	2,059	2,079
Property and equipment, net	462	421	427
Deferred taxes	285	295	284
Goodwill	144	145	144
Other intangibles and other assets	113	125	116
	$ 3,299	$ 3,045	$ 3,050
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Accounts payable	$ 327	$ 284	$ 240
Accrued expenses and other current liabilities	298	284	308
	625	568	548
Long-term debt	133	136	135
Other liabilities	252	248	257
	1,010	952	940
Shareholders' equity			
Common stock and paid-in capital: 166,510,340, 163,765,923 and 164,460,073 shares, respectively	842	761	779
Retained earnings	1,999	1,732	1,788
Accumulated other comprehensive loss	(203)	(154)	(204)
	(349)	(246)	(253)

Less: Treasury stock at cost: 15,800,222, 12,546,560 and 12,840,961 shares, respectively			
Total shareholders' equity	2,289	2,093	2,110
	$ 3,299	$ 3,045	$3,050

See Accompanying Notes to Condensed Consolidated Financial Statements.
* The balance sheet at January 28, 2012 has been derived from the previously reported audited financial statements at that date, but does not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended January 28, 2012.

FOOT LOCKER, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(in millions, except per share amounts)

	Thirteen weeks ended		Thirty-nine weeks ended	
	October 27, 2012	October 29, 2011	October 27, 2012	October 29, 2011
Sales	$1,524	$1,394	$4,469	$4,121
Cost of sales	1,019	941	2,999	2,805
Selling, general and administrative expenses	319	320	931	919
Depreciation and amortization	30	27	88	82
Interest expense, net	1	1	3	4
Other income	—	—	(1)	(1)
	1,369	1,289	4,020	3,809
Income before income taxes	155	105	449	312
Income tax expense	49	39	156	115
Net income	$106	$66	$293	$197
Basic earnings per share:				
Net income	$0.70	$0.43	$1.93	$1.28
Weighted-average common shares outstanding	151.0	152.3	151.4	153.4
Diluted earnings per share:				
Net income	$0.69	$0.43	$1.90	$1.27
Weighted-average common shares assuming dilution	153.9	153.6	154.0	154.8

See Accompanying Notes to Condensed Consolidated Financial Statements.

FOOT LOCKER, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(in millions)

	Thirteen weeks ended		Thirty-nine weeks ended	
	October 27, 2012	October 29, 2011	October 27, 2012	October 29, 2011
Net income	$106	$ 66	$293	$ 197
Other comprehensive income (loss):				
Foreign currency translation adjustment:				
Translation adjustment arising during the period, net of tax	35	(31)	(7)	12
Cash flow hedges:				
Change in fair value of derivatives, net of tax	2	(1)	1	(1)
Available for sale securities:				
Unrealized gain/(loss)	—	(1)	1	(1)
Pension and postretirement adjustments:				
Amortization of net actuarial gain/loss and prior services included in net periodic benefit costs, net of income tax expense of $1, $—, $3, and $2 million, respectively	2	2	6	4
Comprehensive income	$145	$ 35	$294	$ 211

See Accompanying Notes to Condensed Consolidated Financial Statements.

FOOT LOCKER, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(in millions)

	Thirty-nine weeks ended October 27, 2012			October 29, 2011		
From Operating Activities:						
Net income	$	293		$	197	
Adjustments to reconcile net income to net cash provided by operating activities:						
Depreciation and amortization		88			82	
Share-based compensation expense		15			13	
Qualified pension plan contributions		—			(1	)
Excess tax benefits on share-based compensation		(8	)		(3	)
Change in assets and liabilities:						
Merchandise inventories		(172	)		(142	)
Accounts payable		87			60	
Other accruals		(18	)		11	
Other, net		(26	)		48	
Net cash provided by operating activities		259			265	
From Investing Activities:						
Sales of short-term investments		7			—	
		(57	)		—	

Purchases of short-term investments				
Capital expenditures		(120)		(111)
Net cash used in investing activities		(170)		(111)
From Financing Activities:				
Reduction in long-term debt		(2)		—
Purchase of treasury shares		(94)		(97)
Dividends paid		(82)		(76)
Issuance of common stock		35		9
Treasury stock issued under employee stock plan		5		4
Excess tax benefits on share-based compensation		9		3
Net cash used in financing activities		(129)		(157)
Effect of exchange rate fluctuations on Cash and Cash Equivalents		(7)		5
Net change in Cash and Cash Equivalents		(47)		2
Cash and Cash Equivalents at beginning of year		851		696
Cash and Cash Equivalents at end of interim period	$	804	$	698
Cash paid during the period:				
Interest	$	6	$	6
Income taxes	$	182	$	113

See Accompanying Notes to Condensed Consolidated Financial Statements.

FOOT LOCKER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying condensed consolidated financial statements contained in this report are unaudited. In the opinion of management, the condensed consolidated financial statements include all adjustments, which are of a normal recurring nature, necessary for a fair presentation of the results for the interim periods of the fiscal year ending February 2, 2013 and of the fiscal year ended January 28, 2012. Certain items included in these statements are based on management's estimates. Actual results may differ from those estimates. The results of operations for any interim period are not necessarily indicative of the results expected for the year. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the Notes to Consolidated Financial Statements contained in the Company's Form 10-K for the year ended January 28, 2012, as filed with the Securities and Exchange Commission on March 26, 2012.

Recent Accounting Pronouncements

During the first quarter of 2012, the Company adopted ASU No. 2011-08, *Testing Goodwill for Impairment*. The revised standard is intended to reduce the cost and complexity of the annual goodwill impairment test by providing entities an option to perform a qualitative assessment to determine whether further impairment testing is necessary. The adoption of this ASU did not have a significant effect on our results of operations or financial position.

During the first quarter of 2012, the Company also adopted ASU No. 2011-05, *Presentation of Comprehensive Income,* which requires presentation of total comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The implementation of the amended reporting guidance had no effect on our disclosures.

During the second quarter of 2012, the FASB issued ASU 2012-02, *Testing Indefinite-Lived Intangible Assets for Impairment*, which allows an entity to first assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset, other than goodwill, is impaired. If an entity concludes, based on an evaluation of all relevant qualitative factors, that it is not more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying amount, it will not be required to perform a quantitative impairment test for that asset. Entities are required to test indefinite-lived assets for impairment at least annually, and more frequently if indicators of impairment exist. This ASU will be effective for the Company on February 3, 2013, with early adoption permitted. The adoption of this ASU is not expected to have a significant effect on our results of operations or financial position.

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

FOOT LOCKER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

2. Segment Information

The Company has determined that its reportable segments are those that are based on its method of internal reporting. As of October 27, 2012, the Company has two reportable segments, Athletic Stores and Direct-to-Customers. Sales and division results for the Company's reportable segments for the thirteen weeks and thirty-nine weeks ended October 27, 2012 and October 29, 2011 are presented below. Division profit reflects income before income taxes, corporate expense, net interest expense, and net non-operating income.

Sales	Thirteen weeks ended		Thirty-nine weeks ended	
(in millions)	October 27, 2012	October 29, 2011	October 27, 2012	October 29, 2011
Athletic Stores	$1,375	$1,268	$4,060	$3,773
Direct-to-Customers	149	126	409	348
Total sales	$1,524	$1,394	$4,469	$4,121

Operating Results	Thirteen weeks ended		Thirty-nine weeks ended	
(in millions)	**October 27, 2012**	October 29, 2011	October 27, 2012	October 29, 2011
Athletic Stores	$166	$ 119	$480	$ 360
Direct-to-Customers	18	12	47	32
Restructuring charge [1]	—	—	—	(1)
Division profit	184	131	527	391
Less: Corporate expense, net	28	25	76	76
Operating profit	156	106	451	315
Other income [2]	—	—	1	1
Interest expense, net	1	1	3	4
Income before income taxes	$155	$ 105	$449	$ 312

[1] During the first quarter of 2011, the Company increased its 1993 Repositioning and 1991 Restructuring reserve by $1 million for repairs necessary to one of the locations comprising this reserve. This amount is included in selling,

general and administrative expenses in the Condensed Consolidated Statement of Operations.

(2) Other income includes non-operating items, such as: gains from insurance recoveries; discounts/premiums paid on the repurchase and retirement of bonds; royalty income; and the changes in fair value, premiums paid, and realized gains associated with foreign currency option contracts. Other income for the thirty-nine weeks ended October 27, 2012 primarily represents royalty income, partially offset by a premium paid on the repurchase and retirement of bonds. Other income for the thirty-nine weeks ended October 29, 2011 primarily represents lease termination gains related to the sale of leasehold interests and royalty income.

3. Goodwill and Other Intangible Assets

Annually during the first quarter, or more frequently if impairment indicators arise, the Company reviews goodwill and intangible assets with indefinite lives for impairment. The annual review of goodwill and assets with indefinite lives during the first quarters of 2012 and 2011 did not result in impairment charges. The fair value of each of the reporting units substantially exceeds its carrying value for both periods. The following table provides a summary of goodwill by reportable segment. The changes represent foreign exchange fluctuations.

FOOT LOCKER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

3. Goodwill and Other Intangible Assets - (continued)

(in millions)	October 27, 2012	October 29, 2011	January 28, 2012
Athletic Stores	$ 17	$ 18	$ 17
Direct-to-Customers	127	127	127
Goodwill	$ 144	$ 145	$ 144

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

	October 27, 2012			October 29, 2011			January 28, 2012		
(in millions)	Gross value	Accum. amort.	Net value	Gross Value	Accum. amort.	Net value	Gross Value	Accum. amort.	Net value
Finite life intangible assets:									
Lease acquisition costs	$163	$ (141)	$ 22	$180	$ (154)	$ 26	$171	$ (149)	$ 22
Trademark	21	(9)	12	21	(8)	13	21	(8)	13
Favorable leases	5	(5)	—	9	(9)	—	7	(7)	—
CCS customer relationships	21	(17)	4	21	(12)	9	21	(13)	8
	$210	$ (172)	$ 38	$231	$ (183)	$ 48	$220	$ (177)	$ 43
Indefinite life intangible assets:									
Republic of Ireland trademark			1			2			1
CCS tradename			10			15			10
			$ 11			$ 17			$ 11
Net identifiable intangible assets			$ 49			$ 65			$ 54

For the thirty-nine week period ended October 27, 2012, activity included amortization expense of $10 million, the effect of the weakening of the euro as compared to the U.S. dollar of $3 million, partially offset by lease acquisition additions of $8 million. The lease acquisition additions recorded during the period are being amortized over 10 years.

	Thirteen weeks ended		Thirty-nine weeks ended	
(in millions)	October 27, 2012	October 29, 2011	October 27, 2012	October 29, 2011
Amortization expense	$ 3	$ 4	$ 10	$ 13

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

3. Goodwill and Other Intangible Assets - (continued)

Future expected amortization expense for finite life intangible assets is estimated as follows:

	(in millions)
Remainder of 2012	$ 3
2013	10
2014	4
2015	3
2016	3
2017	3

4. Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss comprised the following:

(in millions)	October 27, 2012	October 29, 2011	January 28, 2012
Foreign currency translation adjustments	$ 56	$ 98	$ 63
Cash flow hedges	—	—	(1)
Unrecognized pension cost and postretirement benefit	(258)	(249)	(264)
Unrealized loss on available-for-sale security	(1)	(3)	(2)
	$ (203)	$ (154)	$ (204)

5. Financial Instruments

The Company operates internationally and utilizes certain derivative financial instruments to mitigate its foreign currency exposures, primarily related to third-party and intercompany forecasted transactions. As a result of the use of derivative instruments, the Company is exposed to the risk that counterparties will fail to meet their contractual obligations. To mitigate this counterparty credit risk, the Company has a practice of entering into contracts only with major financial institutions selected based upon their credit ratings and other financial factors. The Company monitors the creditworthiness of counterparties throughout the duration of the derivative instrument. Additional information is contained within Note 6, *Fair Value Measurements*.

Derivative Holdings Designated as Hedges

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

FOOT LOCKER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

5. Financial Instruments – (continued)

The primary currencies to which the Company is exposed are the euro, British pound, Canadian dollar, and Australian dollar. For option and forward foreign exchange contracts designated as cash flow hedges of the purchase of inventory, the effective portion of gains and losses is deferred as a component of Accumulated Other Comprehensive Loss ("AOCL") and is recognized as a component of cost of sales when the related inventory is sold. The amount reclassified to cost of sales and the ineffective portion of gains and losses related to such contracts was not significant for any of the periods presented. When using a forward contract as a hedging instrument, the Company excludes the time value of the contract from the assessment of effectiveness. At each quarter-end, the Company had not hedged forecasted transactions for more than the next twelve months, and the Company expects all derivative-related amounts reported in AOCL to be reclassified to earnings within twelve months. The notional value of the contracts outstanding at October 27, 2012 was $43 million and these contracts extend through June 2013.

Derivative Holdings Designated as Non-Hedges

The Company mitigates the effect of fluctuating foreign exchange rates on the reporting of foreign-currency denominated earnings by entering into currency option contracts. Changes in the fair value of these foreign currency option contracts, which are designated as non-hedges, are recorded in earnings immediately within other income. The realized gains, premiums paid and changes in the fair market value recorded in the Condensed Consolidated Statements of Operations were not significant for any of the periods presented. The notional value of the contracts outstanding at October 27, 2012 was $25 million and these contracts extend through January 2013.

The Company also enters into forward foreign exchange contracts to hedge foreign-currency denominated merchandise purchases and intercompany transactions that are not designated as hedges. Net changes in the fair value of foreign exchange derivative financial instruments designated as non-hedges were substantially offset by the changes in value of the underlying transactions, which were recorded in selling, general and administrative expenses. The net change in fair value was not significant for any of the periods presented. The notional value of the contracts outstanding at October 27, 2012 was $31 million and these contracts extend through January 2013.

Additionally, the Company enters into diesel fuel forward contracts to mitigate a portion of the Company's freight expense due to the variability caused by fuel surcharges imposed by our third-party freight carriers. Changes in the fair value of these contracts are recorded in earnings immediately. The effect was not significant for any of the periods presented. The notional value of the contracts outstanding at October 27, 2012 was $3 million and these contracts extend through May 2013.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

5. Financial Instruments – (continued)

Fair Value of Derivative Contracts

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

(in millions)	Balance Sheet Caption	October 27, 2012	October 29, 2011	January 28, 2012
Hedging Instruments:				
Forward foreign exchange contracts	Current asset	$ 1	$ —	$ —
Forward foreign exchange contracts	Current liability	$ 1	$ —	$ 2

Fair Value of Financial Instruments

The carrying value and estimated fair value of long-term debt were as follows:

(in millions)	October 27, 2012	October 29, 2011	January 28, 2012
Carrying value	$ 133	$ 136	$ 135
Fair value	$ 145	$ 137	$ 140

During the second quarter of 2012, the Company purchased and retired $2 million of its 8.50 percent debentures payable in 2022.

The carrying values of cash and cash equivalents, short-term investments, and other current receivables and payables approximate their fair value.

6. Fair Value Measurements

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

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

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

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

6. Fair Value Measurements – (continued)

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

(in millions)	At October 27, 2012			At October 29, 2011			At January 28, 2012		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Assets									
Short-term investments	$—	$ 49	$ —	$—	$ —	$ —	$—	$ —	$ —
Auction rate security	—	6	—	—	4	—	—	5	—
Forward foreign exchange contracts	—	1	—	—	—	—	—	—	—
Total Assets	$—	$ 56	$ —	$—	$ 4	$ —	$—	$ 5	$ —
Liabilities									
Forward foreign exchange contracts	—	1	—	—	—	—	—	2	—
Total Liabilities	$—	$ 1	$ —	$—	$ —	$ —	$—	$ 2	$ —

Available-for-sale securities are recorded at fair value with unrealized gains and losses reported, net of tax, in other comprehensive income, unless unrealized losses are determined to be other than temporary. As of October 27, 2012, the Company held $55 million of available-for-sale securities, which was comprised of $49 million in short-term investments and a $6 million auction rate security.

Short-term investments represent corporate bonds with maturity dates within one year from the purchase date. These securities are valued using quoted prices for similar instruments in active markets and therefore are classified as Level 2 instruments. Level 2 instrument valuations are obtained from readily available pricing sources for comparable instruments.

The fair value of the auction rate security is determined by review of the underlying security at each reporting period.

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

Interest income related to the short-term investments included within interest expense was not significant for both the thirteen and thirty-nine weeks ended October 27, 2012.

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

7. <u>Earnings Per Share</u>

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

FOOT LOCKER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

7. Earnings Per Share - (continued)

The Company's basic and diluted weighted-average number of common shares outstanding as of October 27, 2012 and October 29, 2011, were as follows:

	Thirteen weeks ended		Thirty-nine weeks ended	
(in millions)	October 27, 2012	October 29, 2011	October 27, 2012	October 29, 2011
Weighted-average common shares outstanding	151.0	152.3	151.4	153.4
Effect of Dilution:				
Stock options and awards	2.9	1.3		