KOHLS Corp
Form 10-Q
September 02, 2016

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

For the quarterly period ended July 30, 2016

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

For the Transition period from ________ to _________

Commission file number 1-11084

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

Indicate by a check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: August 27, 2016 Common Stock, Par Value $0.01 per Share, 179,593,056 shares outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

Assets	July 30, 2016 (Unaudited)	January 30, 2016 (Audited)	August 1, 2015 (Unaudited)
Current assets:			
Cash and cash equivalents	$ 700	$ 707	$ 934
Merchandise inventories	3,928	4,038	4,252
Other	327	331	310
Total current assets	4,955	5,076	5,496
Property and equipment, net	8,192	8,308	8,528
Other assets	213	222	232
Total assets	$ 13,360	$ 13,606	$ 14,256
Liabilities and Shareholders' Equity			
Current liabilities:			
Accounts payable	$ 1,375	$ 1,251	$ 1,566
Accrued liabilities	1,146	1,206	1,125
Income taxes payable	155	130	53
Current portion of long-term debt	—	—	317
Current portion of capital lease and financing obligations	127	127	117
Total current liabilities	2,803	2,714	3,178
Long-term debt	2,793	2,792	2,791
Capital lease and financing obligations	1,709	1,789	1,821
Deferred income taxes	184	257	235
Other long-term liabilities	656	563	554
Shareholders' equity:			
Common stock	4	4	4
Paid-in capital	2,973	2,944	2,914
Treasury stock, at cost	(10,047)	(9,769)	(9,308)
Accumulated other comprehensive loss	(16)	(17)	(18)
Retained earnings	12,301	12,329	12,085
Total shareholders' equity	5,215	5,491	5,677
Total liabilities and shareholders' equity	$ 13,360	$ 13,606	$ 14,256

See accompanying Notes to Consolidated Financial Statements

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

	Three Months Ended		Six Months Ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
Net sales	$4,182	$ 4,267	$8,154	$ 8,390
Cost of merchandise sold	2,532	2,605	5,092	5,206
Gross margin	1,650	1,662	3,062	3,184
Operating expenses:				
Selling, general and administrative	986	1,005	1,994	2,021
Depreciation and amortization	234	233	468	459
Impairments, store closing and other costs	128	—	192	—
Operating income	302	424	408	704
Interest expense, net	78	84	157	168
Loss on extinguishment of debt	—	131	—	131
Income before income taxes	224	209	251	405
Provision for income taxes	84	79	94	148
Net income	$140	$ 130	$157	$ 257
Net income per share:				
Basic	$0.77	$ 0.66	$0.86	$ 1.30
Diluted	$0.77	$ 0.66	$0.86	$ 1.29
Dividends declared and paid per share	$0.50	$ 0.45	$1.00	$ 0.90

See accompanying Notes to Consolidated Financial Statements

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

	Common Stock		Paid-In Capital	Treasury Stock		Accumulated Other Comprehensive Loss	Retained Earnings	Total
	Shares	Amount		Shares	Amount			
Balance at January 30, 2016	370	$ 4	$ 2,944	(184)	$ (9,769)	$ (17)	$ 12,329	$ 5,491
Comprehensive income	—	—	—	—	—	1	157	158
Stock options and awards, net of tax	1	—	29	—	(14)	—	—	15
Dividends paid ($1.00 per common share)	—	—	—	—	3	—	(185)	(182)
Treasury stock purchases	—	—	—	(7)	(267)	—	—	(267)
Balance at July 30, 2016	371	$ 4	$ 2,973	(191)	$ (10,047)	$ (16)	$ 12,301	$ 5,215

See accompanying Notes to Consolidated Financial Statements

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

	Six Months Ended July 30, 2016	August 1, 2015
Operating activities		
Net income	$ 157	$ 257
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	468	459
Share-based compensation	22	24
Excess tax benefits from share-based compensation	—	(10)
Deferred income taxes	(74)	(65)
Loss on extinguishment of debt	—	131
Impairments, store closing and other costs	57	—
Other non-cash revenues and expenses	14	17
Changes in operating assets and liabilities:		
Merchandise inventories	114	(433)
Other current and long-term assets	8	60
Accounts payable	124	55
Accrued and other long-term liabilities	(69)	(121)
Income taxes	25	(21)
Net cash provided by operating activities	846	353
Investing activities		
Acquisition of property and equipment	(340)	(377)
Other	3	3
Net cash used in investing activities	(337)	(374)
Financing activities		
Treasury stock purchases	(267)	(543)
Shares withheld for taxes on vested restricted shares	(14)	(23)

Dividends paid	(182		)	(178		)
Proceeds from issuance of debt	—			1,089		
Reduction of long-term borrowings	—			(767		)
Premium paid on redemption of debt	—			(126		)
Capital lease and financing obligation payments	(63		)	(54		)
Proceeds from stock option exercises	6			140		
Excess tax benefits from share-based compensation	—			10		
Proceeds from financing obligations	4			—		
Net cash used in financing activities	(516		)	(452		)
Net decrease in cash and cash equivalents	(7		)	(473		)
Cash and cash equivalents at beginning of period	707			1,407		
Cash and cash equivalents at end of period	$	700		$	934	
Supplemental information						
Interest paid, net of capitalized interest	$	102		$	167	
Income taxes paid	153			242		
Non-cash investing and financing activities						
Property and equipment acquired through additional liabilities	$	24		$	21	

See accompanying Notes to Consolidated Financial Statements

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KOHL’S CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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

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

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

In 2015, we adopted ASU No. 2015-17, "Balance Sheet Classification of Deferred Taxes (Topic 740)" which requires us to present deferred tax liabilities and assets as non-current in our balance sheet and corrected the presentation of certain other tax assets and liabilities. The following table summarizes changes to our August 1, 2015 balance sheet:

(Dollars in Millions)	Prior Classification	Current Classification	
Deferred taxes	Current deferred tax asset	Long-term deferred tax liability	$130

Deferred taxes	Long-term deferred tax liability	Other long-term assets	31
Deferred taxes	Other long-term liabilities	Long-term deferred tax liability	16

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KOHL’S CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

Maturity	July 30, 2016 Effective Rate	Coupon Rate	Outstanding	Outstanding January 30, 2016	August 1, 2015
			(Dollars in Millions)		
2021	4.81%	4.00%	$650	$650	$650
2023	3.25%	3.25%	350	350	350
2023	4.78%	4.75%	300	300	300
2025	4.25%	4.25%	650	650	650
2029	7.36%	7.25%	99	99	99
2033	6.05%	6.00%	166	166	166
2037	6.89%	6.88%	150	150	150
2045	5.57%	5.55%	450	450	450
2017	—	—	—	—	318
	4.88%		2,815	2,815	3,133
Unamortized debt discount			(5)	(5)	(5)
Deferred financing costs			(17)	(18)	(19)
Current potion of long-term debt			—	—	(318)
Long-term debt			$2,793	$2,792	$2,791

ASC No. 820, "Fair Value Measurements and Disclosures", requires fair value measurements be classified in various pricing categories. Our long-term debt is classified as Level 1, financial instruments with unadjusted, quoted prices listed on active market exchanges. The estimated fair value of our long-term debt was $3.0 billion at July 30, 2016, $2.8 billion at January 30, 2016, and $3.2 billion at August 1, 2015.

3. Stock-Based Compensation
The following table summarizes our stock-based compensation activity for the six months ended July 30, 2016:

	Stock Options		Nonvested Stock Awards		Performance Share Units	
(Shares and Units in Thousands)	Shares	Weighted Average Exercise Price	Shares	Weighted Average Grant Date Fair Value	Units	Weighted Average Grant Date Fair Value
Balance at beginning of period	3,076	$ 52.65	2,211	$ 57.37	347	$ 67.53
Granted	—	—	1,280	46.20	8	67.48
Exercised/vested	(146)	41.82	(782)	56.37	—	—
Forfeited/expired	(209)	56.03	(167)	55.73	(32)	67.98
Balance at end of period	2,721	$ 52.97	2,542	$ 52.16	323	$ 67.49

4. Contingencies

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

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

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

(Dollar and Shares in Millions)	Three Months Ended		Six Months Ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
Numerator—Net income	$140	$ 130	$157	$ 257
Denominator—Weighted average shares:				
Basic	180	196	182	198
Impact of dilutive stock-based awards	1	1	—	1
Diluted	181	197	182	199
Antidilutive shares	5	1	4	—

6. Impairments, Store Closing and Other Costs

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

The second quarter charge includes $119 million in future store lease obligations, the write-off of $23 million in software licenses which did not align with the strategic vision of our restructured IT leadership team, and $7 million in severance and other costs, which were partially offset by the write-off of $21 million in net lease obligations that were previously recorded on our books.

The $119 million lease obligation charge represents the discounted value of rents and other lease liabilities under non-cancelable lease terms and will be paid over the next 13 years. All of the severance will be paid out within two years. The remaining charge is primarily non-cash write-offs of assets and liabilities that were previously recorded on our books.

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

(Dollars in Millions)	Three Months Ended	Six Months Ended
	July 30, 2016	
Store leases:		
Record future obligations	$119	$ 119
Write-off net obligations	(21)	(21)
Impairments:		
Software licenses	23	23
Buildings and other store assets	—	53
Severance and other	7	18
Total	$128	$ 192

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

For purposes of the following discussion, all references to "the quarter" and "the second quarter" are for the three fiscal months (13 weeks) ended July 30, 2016 and August 1, 2015 and all references to "year to date" and "first half" are for the six fiscal months (26 weeks) ended July 30, 2016 and August 1, 2015.
The following discussion should be read in conjunction with our Consolidated Financial Statements and the related notes included elsewhere in this report, as well as the financial and other information included in our 2015 Annual Report on Form 10-K (our "2015 Form 10-K"). The following discussion may contain forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could materially differ from those discussed in these forward-looking statements. Factors that could cause or contribute to those differences include, but are not limited to, those discussed elsewhere in this report and in our 2015 Form 10-K (particularly in "Risk Factors").

Executive Summary

As of July 30, 2016, we operated 1,150 Kohl's department stores, a website (www.Kohls.com), 12 FILA outlets, and 3 Off-Aisle clearance centers. Our Kohl's stores sell moderately-priced private label, exclusive and national brand apparel, footwear, accessories, beauty and home products. Our Kohl's stores generally carry a consistent merchandise assortment with some differences attributable to local preferences. Our website includes merchandise which is available in our stores, as well as merchandise which is available only on-line.
In the first half of 2016, we opened three Kohl's stores, two Off-Aisle clearance centers, and twelve FILA outlets. Additionally, we closed 17 underperforming Kohl's stores in June. We plan to close one additional underperforming store and open six additional smaller format Kohl's stores in the Fall.

Sales were $4.2 billion for the quarter, 2.0% lower than the second quarter of last year. On a comparable store basis, sales were 1.8% lower. The decreases were primarily driven by fewer transactions in our stores.

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

- Inventory per store decreased 6%, which was consistent with our expectations.
- Gross margin as a percentage of sales increased 53 basis points to 39.5%. The increase was primarily due to fewer promotional markdowns and permanent clearance markdowns.
- Selling, general and administrative expenses (“SG&A”) decreased $19 million, or 2%, as almost every area of our business was able to reduce its planned expenses in response to the decrease in sales.

During the quarter, we recorded $128 million in expenses associated with our corporate restructuring and store closures.

Net income for the quarter was $140 million, or $0.77 per diluted share. Excluding the charges related to the store closures and corporate restructuring that we announced in February, net income was $221 million, or $1.22 per diluted share, approximately 14% higher than the second quarter of last year.

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

Net sales.

Net sales decreased $85 million, or 2.0%, to $4.2 billion for the second quarter of 2016. Year to date, net sales decreased $236 million, or 2.8%, to $8.2 billion. Comparable sales decreased 1.8% for the second quarter and 2.8% year to date. Comparable sales include sales for stores (including relocated or remodeled stores) which were open during both the current and prior year periods. We also include e-commerce sales in our comparable sales. Orders that have been shipped, but not yet been received by the customer, are excluded from net sales, but are included in our comparable sales.

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

Change in Comparable Sales	Quarter	Year to Date
Selling price per unit	(0.1)%	(0.5)%
Units per transaction	3.1	2.5
Average transaction value	3.0	2.0
Number of transactions	(4.8)	(4.8)
Comparable sales	(1.8)%	(2.8)%

Selling price per unit decreased 10 basis points for the quarter and 50 basis points year to date as higher regular priced sales were more than offset by clearance sales. The changes in units per transaction reflect customer reaction to the price changes. Generally, customers purchase more items as prices decrease and fewer items as prices increase. Transactions reflect fewer store transactions, partially offset by an increase in on-line transactions.

From a regional perspective, including on-line originated sales, all regions reported lower sales for the quarter and year to date. The Southeast and Midwest were the strongest regions for both the quarter and year to date. The South Central and Mid-Atlantic regions were challenging in both periods. The West also underperformed the Company year to date.

By line of business, Men's was the strongest category for both the quarter and year to date. Accessories and Home were the most challenging in both periods.

Gross margin.

	Quarter				Year to Date			
	2016	2015	Increase/(Decrease)		2016	2015	Increase/ (Decrease)	
(Dollars in Millions)			$	%			$	%
Gross margin	$1,650	$1,662	$ (12)	(1)%	$3,062	$3,184	$(122)	(4)%
As a percent of net sales	39.5%	38.9%		0.53 %	37.6%	38.0%		(0.40)%

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

Gross margin as a percentage of sales increased 53 basis points for the quarter primarily due to fewer promotional markdowns and permanent clearance markdowns.

Selling, general and administrative expenses.

	Quarter				Year to Date			
	2016	2015	Increase/(Decrease)		2016	2015	Increase/(Decrease)	
(Dollars in Millions)			$	%			$	%
Selling, general and administrative expenses	$986	$1,005	$ (19)	(2)%	$1,994	$2,021	$ (27)	(1)%
As a percent of net sales								